Appendix 6

Prudential – Insurance Business Rulebook (PIN)

*In this attachment underlining indicates new text and striking through indicates deleted text.

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2.3 Management of particular risks

2.3.1 An Insurer must develop, implement and maintain a risk management system to identify, assess, monitor, mitigate and control balance sheet risk, including but not limited to:

(a) reserving risk;

(b) investment risk (including risks associated with the use of derivatives);

(c) underwriting risk;

(d) claims management risk;

(e) product design and pricing risk; ~~and~~

(f) liquidity management risk~~.~~;

(g) insolvency risk; and

(h) Climate-Related Financial Risk.

Guidance

GEN 3.6 contains additional requirements that apply to Authorised Persons in relation to the management of Climate-Related Financial Risks.

2.3.2 An Insurer must develop, implement and maintain a risk management system to identify, assess, monitor, mitigate and control credit quality risk.

2.3.3 An Insurer must develop, implement and maintain a risk management system to identify the non-financial and operational risks faced by the Insurer, including but not limited to:

(a) technology risk (including processing risks);

(b) reputational risk;

(c) fraud and other fiduciary risks;

(d) compliance risk;

(e) outsourcing risk;

(f) business continuity planning risk;

(g) legal risk;

(h) key person risk; and

(i) Cyber Risk.

Guidance

GEN 3.5 contains additional requirements that apply to Authorised Persons in relation to Cyber Risk.

2.3.4 An Insurer must develop, implement and maintain a risk management system to identify, assess, monitor, mitigate and control reinsurance risk. Reinsurance risk refers to risks associated with the Insurer's use of reinsurance arrangements as cedant. Such risks include those in Rule 2.3.3.

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2.3.6 An Insurer must develop, implement and maintain a risk management system which includes an explicit asset liability management ("ALM") policy, which must clearly specify the nature, role and extent of ALM activities and their relationship with any other relevant function or activity of the insurer including, but not limited to, product development, pricing functions and investment management.

Guidance

1. An Insurer's ALM policy should be appropriate taking into account the nature, scale and complexity of its ALM risks.

2. The ALM policy should include details as to how:

   (a) the investment and liability strategies adopted by the Insurer allow for the interaction between assets and liabilities;

   (b) any correlations between assets and liabilities are taken into account;

   (c) the liability cash flows will be met by cash inflows; and

   (d) the valuations of assets and liabilities will change under an appropriate range of different scenarios.

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4.2.2 An Insurer must always have capital resources that are, in the opinion of its directors formed on reasonable assumptions, adequate for the conduct of its business, taking into consideration the size of the Insurer and the nature, mix and complexity of the risks it underwrites in its business.

Guidance

1. Where an Insurer effects Direct Long-Term Insurance contracts, Rule 4.2.2 implies that the Insurer must also be able to fund and service the claims and obligations arising out of its Long-Term Insurance Business in a manner which is sustainable over the long term.

2. To be able to demonstrate to the Regulator that the Insurer complies with Rule 4.2.2 on an ~~on-going~~ ongoing basis, the Regulator expects the Insurer to develop internal capital models to support the self- assessment of capital adequacy. Those internal capital models should include mechanisms to estimate in a realistic manner the impact on the Insurer's capital position of possible scenarios relevant to the Insurer's business. The results of scenario

testing should be communicated to the appropriate levels of management within the Insurer. Insurers should be able to demonstrate to the Regulator that the Insurer has adequate capital resources to withstand external and internal shocks to which they may plausibly be exposed.

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5.1.2 Subject to Rules 5.1.3, 5.1.4~~, 5.1.5~~ and 5.1.6, an Insurer must recognise and measure its assets and liabilities in accordance with ~~so many of~~ Rules 5.3, 5.4, 5.5 and 5.6 as ~~may~~ they apply to the Insurer.

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5.1.5 ~~An Insurer may use approximate methods to measure an asset or a liability, where the result obtained by the use of that approximate method would not be materially different from the result obtained by applying a measurement method prescribed in this Chapter.~~

[Deleted]

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5.3.1 Except where this Chapter provides otherwise, the assets and liabilities of an Insurer must be recognised and measured in accordance with a basis of accounting set out in Rule 5.3.2.

Guidance

The exceptions provided in this Chapter relate to the following:

a. specific Rules in respect of certain assets and liabilities, intended to achieve a regulatory objective not achieved by application of ~~either or both of~~ the ~~bases~~ basis of accounting set out in Rule 5.3.2;

b. assets and liabilities that are not dealt with in ~~either or both of~~ the ~~bases~~ basis of accounting set out in Rule 5.3.2; and

c. the overriding power of the Regulator, set out in Rule 5.1.6, to require an Insurer to adopt a particular measurement for a specific asset or liability.

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5.3.2 The basis of accounting adopted by an Insurer for the purposes of Rule 5.3.1 must be~~:~~

~~(a) in the case of a Takaful Insurer, the standards of the Accounting and Auditing Organisation for Islamic Financial Institutions; or~~

~~(b) in any other case,~~ the International Financial Reporting Standards (IFRS).

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5.4.2 Premiums in respect of a group of ~~direct~~ insurance contracts or~~, facultative~~ reinsurance contracts ~~and non-proportional treaty reinsurance contracts~~ entered into by an Insurer acting as insurer must, in accordance with IFRS 17, be treated as receivable from the ~~date of entering into the Contract of Insurance.~~ earliest of:

(a) the beginning of the coverage period applicable to the group of contracts;

(b) when the first payment from a policyholder in the group of contracts becomes due; or

(c) when the group of contracts becomes onerous.

5.4.3 ~~Premiums in respect of proportional treaty reinsurance contracts entered into by an Insurer as insurer must be treated as receivable in accordance with the pattern of the cedant entering into the underlying Contract of Insurance.~~

(1) A group of reinsurance contracts held by an Insurer must be recognised as an asset or liability, as applicable, from the earlier of:

(a) the beginning of the coverage period of the group of reinsurance contracts that are held; or

(b) when the group of underlying insurance contracts becomes onerous.

(2) Notwithstanding (1)(a), an Insurer must delay the recognition of a group of reinsurance contracts held by it that provide proportionate coverage until the date

that any underlying insurance contract is initially recognised, if that date is later than the beginning of the coverage period of the group of reinsurance contracts.

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5.4.10 Where an Insurer is required to recognise a liability associated with the value of expected future payments, that liability must be ~~measured as the net present value of those expected future payments.~~ calculated in accordance with the appropriate measurement model determined under IFRS 17.

5.4.11 Where an Insurer is required to recognise an asset arising from expected future receipts, that asset must be ~~measured as the net present value of those expected future receipts.~~ calculated in accordance with the appropriate measurement model determined under IFRS 17.

...

5.5 Discount rates

5.5.1 ~~The Regulator may specify actuarial principles to be used by an Insurer in measuring assets and liabilities.~~

An Insurer is required to use discount rates in accordance with IFRS 17.

5.5.2 ~~For the purposes of determining the net present value of expected future payments in accordance with Rule 5.4.10, an Insurer must use as a discount rate the gross redemption yield, as at the Solvency Reference Date, of a portfolio of AAA-Rated sovereign risk securities with a similar expected payment profile to the liability being measured.~~

An Insurer must disclose in the audited financial statements the discount rates employed by it, as well as the methodology used to derive the discount rates.

~~**5.5.3** For the purposes of determining the net present value of expected future receipts in accordance with Rule 5.4.11, an Insurer must use as a discount rate the gross~~

~~redemption yield, as at the Solvency Reference Date, of a portfolio of AAA-Rated sovereign risk securities with a similar expected payment profile to the asset being measured.~~

~~Guidance~~

~~1. Where an Insurer's Insurance Business includes more than one Class of Business, the Insurer will normally be expected to establish payment profiles separately for each material Class of Business.~~

~~2. Where the expected payment profile of assets or liabilities cannot be matched – for example, because the duration is too long – the Insurer should assume a discount rate regarded as consistent with the intention of this section.~~

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5.6.2 Premiums in respect of a group of reinsurance contracts entered into by an Insurer acting as insurer must be treated as receivable from the ~~date on which they are due and receivable.~~ earlier of:

(a) the beginning of the coverage period of the group of reinsurance contracts; or

(b) when the Insurer recognises the group of underlying contracts as onerous.

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5.6.5 An Insurer must ~~treat as a liability the amount of Policy Benefits that are due for payment on or before the Solvency Reference Date~~ calculate insurance contract liabilities in accordance with the appropriate measurement model determined under IFRS 17.

~~**5.6.6** An Insurer must treat as a liability the net present value of future Policy Benefits under policies that are in force as at the Solvency Reference Date, taking into account all prospective liabilities as determined by the policy conditions for each existing contract, and taking credit for premiums payable after the Solvency Reference Date.~~

~~**5.6.7** In measuring the liability referred to in Rule 5.6.6, the Insurer must:~~

~~(a) use actuarial principles;~~

~~(b) make proper provision for all liabilities on prudent assumptions that include appropriate margins for adverse deviation of the relevant factors; and~~

~~(c) assign a liability value greater than or equal to zero to each contract or to each homogeneous group of contracts;~~

~~(d) not make allowance for any future lapse, surrender, making paid-up or revival of a contract where such an allowance would result in a decrease in the liability in respect of that contract;~~

~~(e) take specifically into account:~~

~~(i) all guaranteed Policy Benefits, including guaranteed surrender values;~~

~~(ii) vested, declared or allotted bonuses or other forms of participation to which policy holders are already either collectively or individually contractually entitled;~~

~~(iii) reasonable expectations of policyholders in respect of bonuses or other forms of participation, other than as set out in (ii);~~

~~(iv) all options available to the policy holder under the terms of the contract;~~

~~(v) discretionary charges and deductions from Policy Benefits, in so far as they do not exceed the reasonable expectations of policy holders;~~

~~(vi) expenses, including commissions; and~~

~~(vii) any rights under contracts of reinsurance in respect of Long-Term Insurance Business; and~~

~~(f) apply a discount rate determined with reference to the expected risk-adjusted yield on the assets allocated to cover the liability and investment of net receipts attributable to the policies. In arriving at the discount rate, prudent allowance must be made for the risk of adverse deviation in those expected yields.~~

~~**Guidance**~~

1. ~~Because of Rule 5.6.7(c), no policy may be treated as an asset in the valuation and policies must be valued individually, unless they form part of a homogeneous group of contracts. This means an Insurer may treat groups of homogeneous contracts together and not breach the requirements in that Rule provided that the valuation in respect of that group of homogeneous contracts does not collectively represent an asset. The onus is on the Insurer to demonstrate that the contracts represent a homogeneous group. In deciding whether to treat a group of contracts as homogeneous, an Insurer should consider whether the group would remain homogeneous under realistic scenarios to which the Insurer could be exposed.~~

2. ~~Rule 5.6.7(d) prevents an Insurer from reducing the valuation by taking into account future lapses and surrenders, or future action by the policyholder to make the policy paid-up or to 'revive' a paid-up policy where the product features permit such action. Since persistency may be volatile, it is considered imprudent for an Insurer to rely upon 'lapse support' in its valuation. However, voluntary discontinuance of policies may increase a valuation as well as reduce it (for example, a guaranteed surrender value may exceed the actuarially-calculated liability for part of the life of the contract). In performing the valuation, the insurer should therefore make prudent allowance for the effect of lapses, surrenders, and related policyholder actions where these increase the valuation. The impact may vary over the life of a particular contract; for example, lapse at one stage in the contract life may represent a cost to the Insurer, whereas at another, it may represent a benefit.~~

3. ~~Rule 5.6.7(e)(iii) requires an Insurer to take into account bonuses not yet allocated in determining the liability for capital adequacy purposes. In essence, this Rule prevents an Insurer from counting as capital any surplus on participating contracts that is expected, under the terms of the contracts concerned, to accrue to the policyholders in the future. Therefore, although attribution of surplus on participating contracts is discretionary, the Insurer must make a reasonable estimate, taking into account the perceived and reasonable expectations of policyholders. Assumptions made in reaching this estimate (for example, on future investment income) should be consistent with those made for other purposes of the valuation. However, the~~

~~recognition of future bonuses or other forms of participation in this liability does not affect the determination of surplus for other purposes, such as allocation of bonuses of surplus prior to allocation of those bonuses.~~

~~4. For the purposes of Rule 5.6.7(f), an Insurer should ensure that yields used to determine the discount rate are adjusted to take account of the risk that yields will decrease. High yields that represent compensation for risks such as credit or currency risk should be adjusted down to account for those elements of the yield.~~

~~**5.6.8** The Regulator may specify actuarial principles to be followed by Insurers in measuring the liability referred to in Rule 5.6.6.~~

~~**5.6.9** Rule 5.6.6 does not require an Insurer to obtain a valuation by an Actuary of the liability referred to in that Rule, at a Solvency Reference Date other than the Insurer's annual reporting date.~~

~~**Guidance**~~

~~An Insurer is also required to provide a periodic report on its Long-Term Insurance Liabilities, prepared by an Actuary, including an actuarial investigation of the financial condition of its Long-Term Insurance Business. The relevant provisions are set out in Rule 7.3.~~

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10.1.4 An Authorised ISPV must develop, implement and maintain a risk management system to address all material risks to which it is subject<u>, in accordance with Rule 2.2</u>. In particular, it must have regard to the Guidance on managing investment risk set out in Rule A2.6.<u> At a minimum, the risk management and internal controls of an Authorised ISPV must ensure that:</u>

<u>(a)</u> <u>investment restrictions are not breached;</u>

<u>(b)</u> <u>interest payments, dividends, expenses and taxes are properly accounted for;</u>

<u>(c)</u> <u>movements above established thresholds in assets and collateral accounts are reported;</u>

(d) assets are legally existent and technically identifiable; and

(e) liabilities can be determined on a timely and accurate basis and obligations satisfied in accordance with the underlying contracts.

10.1.5 An Authorised ISPV must include in each of its contracts of reinsurance terms which ensure that its aggregate maximum liability at any time under those contracts of reinsurance does not exceed the amount of its assets at that time.

10.1.6 An Authorised ISPV must ensure that under the terms of any debt issuance or other financing arrangements used to fund its reinsurance liabilities the rights of the providers of that debt or other financing are fully subordinated to the claims of creditors under its contracts of reinsurance. Investors in an Authorised ISPV may not have recourse to a ceding Insurer in the event of an economic loss.

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A2.14 Reinsurance risk

Guidance

1. Management of reinsurance risk relates to the selection, monitoring, review and control of reinsurance arrangements, for both treaty and facultative reinsurance – that is, where some part of an Insurer's individual or aggregate insurance risks is ceded to other Insurers, whether by a direct Insurer to a reinsurer or by a reinsurer to other reinsurers. Ceding insurers and reinsurers should finalise the formal reinsurance contract prior to the inception date of the reinsurance cover contract.

2. An Insurer should inform the Regulator immediately if there is a likelihood of a problem arising with its reinsurance arrangements that is likely to materially detract from its current or future capacity to meet its obligations, or which may affect the transfer of risk or orderly operation of its reinsurance contracts, and discuss with the Regulator its plans to redress this situation. Problems that might trigger such a situation could include the insolvency of a reinsurer with a significant share in the Insurer's programme, discovery of exposures without

current reinsurance coverage, or exhaustion of reinsurance covers through multiple losses.

3. Each Insurer is required (by Rule 2.3.5) to maintain a written reinsurance management strategy appropriate to the size and complexity of the operations of the Insurer and which defines and documents the Insurer's objectives and strategy for reinsurance management.

4. An Insurer's reinsurance management strategy should, at a minimum, include the following elements:

   a. systems for the selection of reinsurance brokers and other reinsurance advisers;

   b. systems for selecting and monitoring reinsurance programmes, including the reporting of claims thereunder;

   c. processes to clearly document the principal economic and coverage terms and conditions of reinsurance contracts;

   ~~c~~d. clearly defined managerial responsibilities and controls;

   ~~d~~e. clear methodologies for determining all aspects of a reinsurance programme, including:

      i. identification and management of aggregations of risk exposure;

      ii. selection of maximum probable loss factors;

      iii. selection of realistic disaster scenarios, return periods and geographical aggregation areas; and

      iv. identification and management of vertical and horizontal coverage of the reinsurance programme;

   ~~e~~f. selection of participants ~~on~~ in reinsurance contracts, including the consideration of diversification and ~~credit worthiness~~ creditworthiness; and

~~f~~g. systems for identifying credit exposures ~~(~~, actual and potential~~)~~, to individual reinsurers or Groups of connected reinsurers ~~on~~ in programmes that are already in place.

5. Senior management should review an Insurer's reinsurance management systems on a regular basis. The review should cover:

a. the identification and recording of policies underwritten to which reinsurance is attached;

b. the identification of the dates when an obligation to pay reinsurance premiums arises;

c. an assessment of the systems for the reporting and ongoing monitoring and management of claims made under reinsurance contracts;

~~c~~d. the identification of losses triggering recoveries under reinsurance contracts;

~~d~~e. management of the timing of payments to, and collections from, reinsurance counterparties;

~~e~~f. the credit standing and capacity of reinsurance counterparties to meet obligations to which they are subject as a result of claims incurred or to which they would become subject in the event of the occurrence of losses;

~~f~~g. any concentration of reinsurance arrangements with reinsurance counterparties which would create large exposures or detract from diversification benefits in the event of occurrence of losses;

~~g~~h. the extent of reliance on reinsurance with related parties, and the accessibility of intra group funding under a range of realistic conditions; and

~~h~~i. the impact of any adverse trends in estimated Insurance Liabilities on the adequacy of the Insurer's reinsurance arrangements, and any implications for the capacity of the Insurer to meet its future policyholder obligations.

6. Procedures for assessing the credit standing of reinsurance counterparties may include the following:

    a. establishment of a security committee with a specific brief to undertake the procedures;

    b. obtaining appropriate advice from reinsurance brokers;

    c. review of the ratings published by ratings agencies;

    d. monitoring of key performance indicators in reinsurers' published reports; and

    e. consideration of general conditions in the relevant reinsurance market.

7. The ceding Insurer should have in place procedures for identifying reinsurers that provide security that it finds acceptable and should keep these procedures periodically under review. If a ceding Insurer develops a pre-approved list of reinsurers, there should also be processes for dealing with situations where there is a need to assess reinsurers outside any pre-approved list. Ceding Insurers may have their own credit committees to make their own assessment of the risk.

8. Any approved security criteria should be derived from a high-level statement of what reinsurance security will be acceptable to the ceding Insurer, which may be based on:

    a. external opinions;

    b. the ceding Insurer's own view of the reinsurer;

    c. minimum levels of capital;

    d. duration and quality of relationship;

    e. expertise of the reinsurer;

    f. levels of retrocession;

g. reinsurance brokers’ security criteria; or

h. a mixture of these and other factors.

9. For facultative reinsurance, the ceding Insurer should have a specific process in place to approve, monitor and confirm the placement of each facultative risk. If facultative reinsurance is necessary to ensure that acceptance of a risk would not exceed maximum net capacity and/or risk limits, such facultative reinsurance should be secured before the ceding Insurer accepts the risk.

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