



**Financial Services  
Commission**

# **Insurance Guidance Note No. 9**

## **Insurance Companies Ordinance 1987**

### **Guidance Notes On Reporting The Use Of Derivatives**

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## Introduction

1. The Insurance Companies (Accounts and Statements) Regulations 1996 (“the 1996 Regulations”) introduced the format in which insurance companies were required to submit their annual returns to the Commissioner of Insurance. These Regulations were recently replaced by the Insurance Companies (Accounts and Statements) Regulations 1998 (“the Regulations”). Separate revised guidance on the Preparation of Annual Returns for General Business and Long Term Business have now been issued as Insurance Guidance Notes 2A and 2B respectively. Those Guidance Notes did not deal with derivatives. This Note, therefore, deals exclusively with the reporting of derivatives as required by Form INS 9 and regulation 23. Special attention has been given to this issue because of the well publicised risks inherent in holding these instruments. This guidance is intended to be informative and does not have the force of law. Companies are advised to discuss other accounting aspects of derivatives with their auditors. Other guidance on the treatment of derivatives is given in Guidance Note No. 4, “Valuation of Assets”; Guidance Note No. 5, “Systems of control over investments (and counterparty exposure) including the use of derivatives” and Guidance Note No 11, “The Use of Derivatives Contracts in Insurance Funds”.

## Analysis of Derivative Contracts (Form INS 9)

### Purpose

2. Form INS 9 comprises a schedule of derivative contracts which requires a breakdown of calculated asset and liability values for rights/obligations under all approved derivative contracts, with the exception of those used for the purposes of matching index linked or property linked liabilities, where disclosure is covered by Forms INS 55 or INS 56.

However, to the extent that the company holds derivative contracts in connection with linked contracts but additional to the amounts necessary to match linked liabilities, these should be recorded on Form INS 9. For example, if a company has transacted a tranche of derivatives to match linked liabilities in the expectation of selling a particular volume of linked business but where the actual volume fell short of expectations, the excess would be recorded on Form INS 9. Similarly, if a company retains excess derivatives no longer necessary for matching purposes (for example, as a result of policy surrenders), these would also be recorded on Form INS 9.

### Completion of the Form

3. Form INS 9 should be completed for total other than long term business; total long term business (if any) and each fund or group of funds for which separate assets are appropriate.
4. If Form INS 9 is required, but the entries are blank for both this year and the previous year, the form can be omitted provided a note is submitted giving the reason. The note should be coded 0900.

### Preparation

5. This Note addresses the following points at issue:-
  - which derivatives need to be entered on the forms
  - what needs to be recorded in respect of the amounts of margin paid or received
  - the reconciliation to other Forms



- the approach to take for instruments which are required, under the Insurance Companies (Valuation of Assets and Liabilities) Regulations 1996 (“the Asset Valuation Regulations”) to be treated as derivatives even though they may have some other legal form (i.e. quasi-derivatives or “contracts or assets having the effect of a derivative contract”).
6. Quasi-derivatives are not recorded on the face of Form INS 9 but are required to be shown as a supplementary note [Code 0902] – see paragraphs 21 and 22.
  7. Where a provision for adverse changes is required in accordance with regulation 19 of the Asset Valuation Regulations, no adjustment is to be made on Form INS 9 to the value of the derivative which gave rise to the provision. The provision itself is to be shown on Form INS 6 or INS 7, as appropriate.
  8. Assets and liabilities under derivative contracts are required to be shown on Form INS 9 analysed between:
    - (a) futures contracts;
    - (b) options; and
    - (c) contracts for differences.

Within these categories, the valuations are further broken down, in lines 11 to 35, to show amounts relating to:

    - (i) fixed interest securities;
    - (ii) equity shares;
    - (iii) land;
    - (iv) currencies; and
    - (v) other;

For example, exchange rate derivatives will fall under the “currencies” category; interest rate derivatives would appear to be classified as “other”.
  9. Assets and liabilities are to be shown gross unless netting is allowed under accepted accounting practice, which would require that there is a legal right of set-off. However, where derivatives with the same counterparty do have a legal right of set-off but are not symmetrical, (i.e. they do not cancel out, or part cancel out, a given position), then they may not be shown net. Derivatives which do have a legal right of set-off but which are required to be disclosed on separate Forms INS 9 must not be net and should be shown gross on each form.
  10. Amounts disclosed on lines 11 to 35 are determined in accordance with the Asset Valuation Regulations and should exclude any variation margins received or paid.

## Instructions to the Form

11. Form INS 9 comes with instructions for its completion which, as part of the Regulations, have the force of law. It is, therefore, necessary to consider these first.
 

Instruction 1: A Form INS 9 should be completed separately for the “other than long term assets” and the “long term assets”. Each long term business fund accounted for by a separate Form INS 5 should also have a Form INS 9 completed. A sub fund whose accounting details are only given as part of Schedule 4 should be covered by a commentary in that Schedule.

Instruction 2: Analysis is by the principal underlying asset. When there is a mixture of asset types, the derivative should be split if it is sensible to do so. If not, then it should be categorised under the most significant asset type.

Instruction 3: Derivatives are to be assigned to the “assets” and “liabilities” columns according to whether the gross position is an asset or a liability and irrespective of the net position after margin.

Instruction 4: The asset values to be shown are gross of any variation margins received (or, unusually, paid), i.e. assuming such margins have been reversed. The asset values are to be determined under the Asset Valuation Regulations, i.e. before the further determination of liability under regulation 19 (which, of course, can apply to an uncovered asset). Form INS 9 does not therefore deal with economic exposure to various assets classes. This issue is dealt with in the supplementary information provided in accordance with regulation 23.

Instruction 5: Netting of derivative positions may be permissible for the purpose of completing Form INS 9, provided it would be permissible under generally accepted accounting practice. However, there are additional pre-conditions to netting. Within a Form INS 9, derivatives which partly or wholly offset one another (for example, a bought future and a sold future on the same index) cannot be netted to one net asset or liability figure unless there is a legal right of set-off with the counterparty concerned, or between the counterparties concerned. Where the derivatives are with the same counterparty and legal set-off applies, but the derivatives are not symmetrical, i.e. they do not cancel out, or part cancel out, a given position, then gross figures should be shown. Where a legal right of set-off applies but the derivatives have to be reported on separate Forms INS 9, they should be shown gross in each form.

Instruction 6: The aggregate amount of variation margin to be offset against the amounts shown in lines 11 to 35 is to be shown at line 41.

Instruction 7: The assets shown at line 49, column 1, should be included at line 44 in Form INS 5. Where line 49, column 1, also includes deductions for applicable margins, this should be included either in Forms INS 6 or INS 7 as liabilities, or in Form INS 5 as deductions from assets according to the same accounting treatment as is adopted in the statutory accounts. Other general buffer or good faith margins paid out (initial margins) are expected to appear on Form INS 5, probably on line 78.

Instruction 8: Similarly, the liabilities shown at line 49, column 2 should be in Form INS 6 (if long term) or Form INS 7 (if other than long term) at lines 38 and 49 respectively. Also similarly, deductions for applicable margins which are included at line 49, column 2 should be included in Form INS 5, or INS 6 / INS 7 according to the same accounting treatment as adopted in the statutory accounts.

Instruction 9: No entry is to be made on Form INS 9 in respect of initial margin paid or received.

## Further points on margins

12. The variation margin received for assets acts as an offset to the value of the derivative that flows through to Form INS 5, and such margin then needs to be categorised itself in Form INS 5, probably under deposits if the margin payment is deposited with the insurer's bankers. Initial margins should, however, appear in Form INS 5, normally line 78, i.e. unsecured amounts due to the insurer, unless the insurer has more unusually received initial margin and so the amount is a creditor. The Asset Valuation Regulations now define both variation and initial margin. It should be noted that the definition of variation margin may be wider than a market understanding as it includes all collateral



arrangements. It is this wider definition which should be followed in completion of Form INS 9.

13. In the unusual situation of a variation margin payment to the broker on an asset, then such an amount should appear on Form INS 9 as a positive entry at line 41, and thus an appropriate increase to the asset.
14. Liabilities follow the normal accounting rules of regulation 18. Again the inclusion of all variation margins is necessary, even if this gives rise to a negative entry in either Form INS 6 or INS 7. The offset of margins paid against the amount of the liability means no further entries are needed, as the net entry at line 47 of Forms INS 6 or INS 7 encapsulates the offset of the derivative liability and the sums put up in surety for such liability. In the unusual case of amounts received from the broker on a liability, such amount should appear in Form INS 9 as a positive entry at line 41, thus an appropriate increase to the liability.
15. Asset and liability margin payments must be accounted for separately. Margin is cash or securities actually received from a broker, or paid to a broker. Amounts due to be paid by either party, or amounts held in an account at the broker, where the company has no legal rights over such account, are not transferred margin and should not be presented as such. Form INS 9 must demonstrate the margins actually received into possession of the insurer or released by the insurer. Thus, at any reporting date, even daily margined contracts may be a day behind as the margin process is not instantaneous.
16. Margin received or paid to different counterparties cannot be offset in any circumstances, even where the counterparties are connected companies of one another. Similarly, margin paid to and received from a single counterparty cannot be offset, where no legal right of offset applies. Thus, one over-margined asset cannot have its deduction for margin on Form INS 9 reduced to allow the reduction of a Form INS 9 margin on an over-margined liability unless legal rights of offset apply.
17. Margin means the amounts transferred back and forth under part of the terms of the derivative. Only amounts closely connected to the derivative under a formal agreement that has legal rights of offset between the margin payment and the settlement of the derivative should be included, and not other deposits from or with the counterparty.
18. Where margin payment is by pledges of assets, such as short gilts, the same approach should be followed. Unconditional granting of title to a broker will mean the asset can no longer be recorded as that of the insurer, and has been replaced by a debt due from the broker.

## Supplementary notes

19. Two supplementary notes are specified in paragraphs 15 and 16 of Schedule 1 to the Regulations covering treatment of variation margin [Code 0901] and use of quasi-derivatives [Code 0902]. Also refer to paragraph 4 of these Notes with regards to the situation where the entries are blank.

### Note 1

20. This note (see paragraph 15 of Schedule 1) needs 3 separate items, as follows:
  - the aggregate amount of an “excess” variation margin which has been received by the company, the excess being due to market movements which have subsequently been partly or wholly reversed.
  - how variation margin received is distributed amongst the different lines of Form INS 5.

- the extent to which the amount recorded in any line of Form INS 5 has been reduced to reflect the liability to repay any excess referred to above.

## Note 2

21. A further supplementary note is prescribed covering quasi-derivatives – see paragraph 16 of Schedule 1. These are exempt from special disclosure provided that, in aggregate, they are below the “materiality threshold” set out in paragraph 16. Separate thresholds apply for assets and liabilities and are to be calculated prior to any adjustment for variation margin.
22. For quasi-derivatives which are assets, the test at paragraph 16 of Schedule 1 is whether the aggregate value of all such quasi-derivatives exceeds 2½% of the total Form INS 5 asset value (i.e. for the long term business fund, or a long term business sub fund, the non-linked property linked and index linked assets totalled at line 89 of the particular Form INS 5). No attempt should be made to value the “derivative component” of a quasi-derivative separately and apply the materiality test to that component; the test should be applied to the value of the instrument as a single entity.
23. For quasi derivatives that are liabilities the test of disclosure is in some ways more demanding, being whether the aggregate liability of all such quasi-derivatives would exceed 2.5% of the non insurance liabilities of Forms INS 7 or the relevant Form INS 6, as appropriate. Any provision under regulation 19 of the Asset Valuation Regulations would count towards this aggregate liability, even where it arises from a quasi-derivative that is currently an asset.
24. If the holdings are sufficiently significant to trigger disclosure, then the (non-zero) amounts contributed by quasi-derivatives to each line in Forms INS 5, INS 6 and INS 7 are to be stated. In addition, the information specified under Note 1 is also required in respect of such contracts.
25. Leaving aside quasi-derivatives used for the purpose of matching linked liabilities, it would be a little unusual for quasi-derivatives to be subject to margining arrangements. In any event, the rules for the valuation of assets and determination of liabilities in the Asset Valuation Regulations make no provision for valuation of quasi-derivatives net of value of margin (or collateral) and the appropriate values for the purpose of this disclosure are therefore the gross asset or liability values. Any margins paid or received should appear in Forms INS 5, INS 6 or INS 7 as debtor or creditor items.
26. An example of the disclosure required when the materiality test is passed is as follows:
 

“A FTSE-linked bond with embedded option to achieve a guaranteed maturity value of £10m was included in line 48 of Form INS 5. The current value of the bond is £11m. The bond is not margined and was held for the full year.”

## Examples of completion of Forms INS 5, INS 6, INS 7 and INS 9 in respect of derivative holdings

27. A number of illustrative examples of completion of Form INS 9 are given in the Appendix. The examples introduced illustrate the inter-relationship between Forms INS 5, INS 6 (or INS 7) and INS 9.

## Regulation 23 Statement: Derivatives

### Scope of the statement

28. Every insurer is required to make a Regulation 23 statement, whether or not it used derivatives in the year in question. For this purpose, "derivatives" is defined by the regulation to include not only contracts which have the legal form of a derivative contract but also the quasi-derivatives defined in regulation 14A of the Asset Valuation Regulations. The latter category includes a number of instruments which are in common use and which have certain characteristics of a derivative, such as partly-paid shares and convertible bonds.
29. For those insurers whose policy and practice is to use neither derivatives nor quasi-derivatives, a short statement to this effect is all that is necessary.
30. It is worth noting that the statement has been expanded beyond its original limits set down in the 1996 Regulations.

### Contents of the statement

31. Regulation 23 calls for a "brief description" of the insurer's use of derivatives. This means a description which is adequate to give the reader a reasonable flavour of the use of derivatives, including certain key points, e.g., use of derivatives to effect significant switches in the balance of portfolio or use of unusual derivatives. The detailed requirements of the statement are set out below, referenced by the paragraphs of regulation 23(1).
32. (a) any investment guidelines ... for the use of derivative contracts  
 The insurer's policy needs to be explained, even if that policy is not to use derivatives. (In this context it is worth remembering that forward currency derivatives are not derivatives for the purposes of the Regulations if they satisfy the requirements of regulation 3(9) of the Asset Valuation Regulations). A statement that derivatives are only used to match policy liabilities is however, too brief and a fuller description of the criteria used must be given.
33. (b) ...guidelines ... for the use of contracts ... not ... reasonably likely to be exercised  
 The insurer must state whether such contracts are allowable under its guidelines. Thus the restriction of the use of derivatives to those bought and sold to deal at prices close to the market price of the underlying asset at outset would allow a negative reply to this question. Conversely, if, for example, the guidelines allow the practice of selling options out of the money, or purchasing barrier options, neither of which were expected to be called, this would need detailing together with its purpose. Where such contracts have been entered into in the year, or subsisted over the year, then a brief description is required by paragraph (c) of the size (in economic exposure) of the contracts and the approximate market movement that would trigger them.
34. (d) ...amounts recorded in Form INS 5  
 Insurers may find a LIFFE style report the most suitable to present the changes to Form INS 5, i.e. a presentation of the current Form INS 5 by broad asset class amended by the impact of futures on economic exposure. The prudence required in the context of options is not the same as that when considering the admissibility limits of regulation 15 of the Asset Valuation Regulations where the maximum exposure to an asset is in question. For paragraph (d), merely options that are currently expected to be exercised should be assumed to be exercised. This would normally follow the value of the option at the accounting date; if of high value, then exercise is likely but if close to valueless

then exercise is unlikely. Further information is required under paragraph (f) only if the impact of derivatives in amending economic exposure has been materially different at other times of the year, not merely if the overall economic exposure of the insurer has been different.

35. (e) ...to the maximum extent

Paragraph (d) requires the expected changes to exposure to be stated. Paragraph (e) requires the same information as (d) but assuming that derivatives are exercised against the insurer so as to create the largest changes in the economic exposures of the insurer in its major asset classes. While derivative positions that net out, or can be used to net out exposures, will not contribute to this presentation, any other optional derivative positions are to be assumed to be exercised so as to create the most extreme exposures potentially possible.

36. (f) how different ... other time of the financial year ... maximum extent

This requires the analysis of (d) and (e) above to be tested for other points of the year. Where a more significant position occurred other than at the financial year end the position then needs to be described. As noted above for the test under (d), the insurer must look for items when the use of derivatives to amend economic exposure has been significantly different at other times of the year, not when the direct exposure of the insurer has been different. For the test under (e), the purpose is to gauge whether, during the year, the insurer's use of more exotic or obscure derivatives has been greater than at the financial year end. The description may thus need to refer to several different times during the year where there was significant activity that was different in nature.

37. (g) maximum loss:

The requirement for the maximum exposure to a counterparty failure at the year end requires this to be tested as well "in the event of other foreseeable market conditions". This means a test of individual counterparty exposure (not just the counterparty giving the maximum exposure at the accounting date) under typical market movements and the current margining arrangements. If this gives a higher figure (perhaps due to infrequent margining), then this higher figure should be stated.

38. (h) ...does not fall within regulation 14A(2) .. or ... paragraph 14

Structured products that fail the test in regulation 14A(4), and are thus valued purely as unconditional debt under the terms of regulation 14A(5), should be described under this section. (To save correspondence, the value assigned to such assets in the relevant Form INS 5 should be stated). Other derivatives that are not permitted (or admissible) derivatives held in the internal property linked funds, the rest of the long term business fund, or the other than long term business fund must also be described here.

39. (i) ...fixed consideration:

A note is required of what fixed sums have been earned by the insurer (for example, premiums received by the insurer for selling options), and a summary of the contracts involved over the period of the Annual Returns (not merely those in force at the year end).

## Appendix - Examples of completion of Forms INS 5, INS 6, INS 7 and INS 9 in respect of derivative holdings

### Introduction To The Examples

1. The examples introduced below illustrate the inter-relationship between Forms INS 5, INS 6 (or INS 7) and INS 9.
2. The examples can be summarised as follows:
  - Example 1 – Derivatives used to rebalance portfolio (see paragraph 24 of Guidance Note No 11 but reversed to illustrate treatment of assets). Initial margin not accounted for on Form INS 9.
  - Example 2 – Treatment of simple derivative (option) which is a liability. Illustration that, in accordance with Instruction 3 to Form INS 9, “negative assets or liabilities” can arise as a result of margining.
  - Example 3 – Two equity futures and a currency forward (see paragraph 75 of Guidance Note No 11).
  - Example 4 – Direct asset, derivative and both inadmissible asset and regulation 19 of the Asset Valuation Regulations items (see paragraph 136 of Guidance Note No 11, amended slightly to allow inadmissibility offset.) Provision for adverse changes also required.
  - Example 5 – Range of direct assets and derivative with counterparty inadmissibility. The asset inadmissibility has been ignored to avoid making the example overly complex.
  - Example 6 – Sterling to DM interest rate swap. Illustrates provision for adverse changes on uncovered swap.

### Derivatives Used In The Examples

3. These are defined here so that the examples can refer to the instruments involved in a more abbreviated form (the bold part of each description). The example defines whether the derivative is bought or sold.

#### **Futures**

4. A traded Long Gilt future from 7/12/95 for settlement March 1996 at a price then of 101 15/32. This was valued at 31/12/95 at 100 23/32 (after 100 15/32 on 30/12/95) giving a liability per bought contract of £50,000 times 24/32ths or £375.  
The initial margin was £1,000 per contract and variation margin of £500 per contract had been paid to date.
5. A Currency Forward for US dollars for settlement in March 1996. This was valued at 31/12/95 at a 3 month rate of exchange of 0.6393 when the cash market was 0.6391, i.e. a liability of £(0.6393-0.6391) per \$1,000,000 purchase or £200.

#### **Options**

6. A traded BP call option at 420p from 7/12/95 for expiry by April 1996.  
This was valued at 25p at 31/12/95 (after 26p at 30/12/95) and thus 25p x 1000 or £250 per contract. Initial margin as writer £1,000 and variation margin of £50 paid to date.
7. A traded BP put option at 420p from 7/12/95 for expiry by April 1996.



This was valued at 14p at 31/12/95 (after 13p at 30/12/95) and thus 14p x 1000 or £140 per contract. Initial margin as writer £1,000 and no variation margin to date.

8. A traded FTSE 100 call option at 3100 from 7/12/95 for expiry by June 1996.

This was valued at 143 at 31/12/95 (after 145 at 30/12/95) and thus 143 x £10 or £1,430 per contract. Initial margin as writer £1,000 and variation to date of £1,450.

#### **Contracts For Differences**

9. A traded FTSE 100 future from 7/12/95 for settlement March 1996 at a price then of 3036.

This was valued at 31/12/95 at 3092 (cash market 3065.5) after 3077 on 30/12/95 and thus  $(3092-3036) \times £25$  or £1,400 per contract.

The initial margin was £2,000 per contract and variation margin of £1,025 per contract had been paid to date.

10. A traded S&P 500 Future from 7/12/95 for settlement March 1996 at a price then of 457.0.

This was valued at 31/12/95 at 461.35 (cash market 459.27) after 464.6 on 30/12/95 and thus  $(461.35-457.0) \times \$500$  or \$2,175 per contract.

The maintenance margin was \$1,500 per contract and had been topped up by \$4,000 per contract to date.

11. A Swap of sterling to DM short interest rates on £30m of sterling, expiring May 1996.

This was valued at a liability of £500,000 at 31/12/95.

## EXAMPLE 1 - Simple Bought And Sold Asset Derivatives

100 bought Traded FTSE 100 future contracts, total asset £140,000

150 sold Traded Long Gilt future contracts, total asset £56,250

Total margin £97,500 on FTSE 100 future with broker, £200,000 paid to broker as initial and £102,500 received from broker as variation margin.

Total margin £75,000 on Long Gilt with broker, £150,000 paid to broker as initial and £75,000 received from broker as variation margin.

Initial margin taken to line 56 of Form INS 5, receipt of variation margin assumed on deposit, thus line 54 of Form INS 5.

<b>FORM INS 6 (part)</b>		
Long Term business liabilities and margins		As at the end of the financial year
Other Creditors	38	
Provision for adverse changes	41	
<b>Total</b>	<b>59</b>	
<b>FORM INS 5 (part)</b> Admissible assets		As at the end of the financial year
Equity shares	41	
Rights under derivative contracts	44	19
Deposits less than 1 month	54	177
Deposits more than 1 month	55	
Other financial investments - other	56	350
<b>TOTAL</b>	<b>99</b>	<b>546</b>

<b>FORM INS 9</b>				
Derivative Contracts			As at the end of the financial year	
			Assets	Liabilities
Futures  Contracts	Fixed interest	11	56	
	Equity shares	12		
	Land	13		
	Currencies	14		
	Other	15		
Options	Fixed interest	21		
	Equity shares	22		
	Land	23		
	Currencies	24		
	Other	25		
Contracts for Differences	Fixed interest	31		
	Equity shares	32	140	
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41	(177)	
<b>TOTAL (11 to 41)</b>		<b>51</b>	<b>19</b>	

## EXAMPLE 2 - Simple Liability Option Derivatives

100 sold Traded FTSE 100 call options contracts of liability £143,000

Total margin £245,000 on FTSE 100 option with broker, £100,000 paid to broker as initial and £145,000 paid to broker as variation margin.

FORM INS 6 (part)			FORM INS 9			
Long Term business liabilities and margins		As at the end of the financial year	Derivative Contracts		As at the end of the financial year	
					Assets	Liabilities
Other Creditors	38	(2)	Futures Contracts	Fixed interest	11	
Provision of adverse changes	41			Equity shares	12	
Total	59	(2)		Land	13	
<b>FORM INS 5 (part)</b> Admissible assets		As at the end of the financial year		Currencies	14	
Equity shares	41			Other	15	
Rights under derivative contracts	44		Options	Fixed Interest	21	
Deposits less than 1 month	54			Equity shares	22	143
Deposits more than 1 month	55			Land	23	
Other financial investments - other	56	100		Currencies	24	
<b>TOTAL</b>		<b>99</b>	<b>100</b>	Other	25	
			Contracts for Differences	Fixed interest	31	
				Equity shares	32	
				Land	33	
				Currencies	34	
				Other	35	
			Adjustment for margins	41		(145)
			<b>TOTAL (11 to 41)</b>	<b>51</b>		<b>(2)</b>

### EXAMPLE 3 - Two Equity Futures And A Currency Forward

100 sold Traded FTSE 100 Future contracts of total liability £140,000

Bought Currency Forward for US Dollar for £7,750,000 of total liability £2,425

60 bought Traded S&P 500 Future contracts valued at \$130,500 or £83,403

All contracts due to complete in 3 months time.

Total margin £302,500 on FTSE 100 future with broker, £200,000 paid to broker as initial, and £102,500 paid to broker as variation margin.

No margin on currency forward.

Total margin \$90,000 on S&P 500 future with broker, \$90,000 paid to broker as initial only.

Value at 31/12/95 £57,519.

<b>FORM INS 6 (part)</b>		
Long Term business liabilities and margins		As at the end of the financial year
Other Creditors	38	40
Provision of adverse changes	41	
Total	59	40
<b>FORM INS 5 (part)</b> Admissible assets		As at the end of the financial year
Equity shares	41	
Rights under derivative contracts	44	83
Deposits less than 1 month	54	
Deposits more than 1 month	55	
Other financial investments - other	76	200 +58
<b>TOTAL</b>	<b>99</b>	<b>341</b>

<b>FORM INS 9</b>			As at the end of the financial year	
Derivative Contracts			Assets	Liabilities
Futures Contracts	Fixed interest	11		
	Equity shares	12		
	Land	13		
	Currencies	14		2
	Other	15		
Options	Fixed Interest	21		
	Equity shares	22		
	Land	23		
	Currencies	24		
	Other	25		
Contracts for Differences	Fixed interest	31		
	Equity shares	32	83	140
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41		(102)
<b>TOTAL (11 to 41)</b>		<b>51</b>	<b>83</b>	<b>40</b>

## EXAMPLE 4 - Direct Asset, Derivative And Both Inadmissible Asset And Regulation 19 Items

400,000 holding of BP shares at 425.5p per share, total asset £1,702,000

3,000 written traded BP put option at 420p, valued at £420,000 liability.

Total margin £3,000,000 on traded option, all initial.

General Business Amount (GBA) £400m. 2.5% of GBA equals £10m and total exposure is to 3.4m shares worth £14,467,000. Inadmissible asset is thus £4,467,000, with first offset to direct equity holding and balance to line 87 of Form INS 5.

Regulation 19 liability taken as say 50% fall in price i.e.  $(4.255 \times 50\% - 4.20) \times 1000 \times 3000$  thus £6,217,500, less any regulation 18 liability (i.e. £420,000), less any relief from inadmissibility that such a fall would cause (3,616,000 - see below) therefore £2,181,500 provision.

<b>FORM INS 7 (part)</b>			<b>FORM INS 9</b>				
Liabilities (other than long term business)		As at the end of the financial year	Derivative Contracts		As at the end of the financial year		
					Assets	Liabilities	
Other Creditors	49	420	Futures	Fixed interest	11		
Provision of adverse changes	61	2182	Contracts	Equity shares	12		
Total	69	2602		Land	13		
<b>FORM INS 5 (part)</b>				Currencies	14		
Admissible assets		As at the end of the financial year		Other	15		
Equity shares	41	1702-1702		Options	Fixed Interest	21	
Rights under derivative contracts	44		Equity shares	22		420	
Deposits less than 1 month	54		Land	23			
Deposits more than 1 month	55		Currencies	24			
Other financial investments - other	56	3000	Other	25			
			Contracts for Differences	Fixed interest	31		
			Equity shares	32			
			Land	33			
			Currencies	34			
			Other	35			
Deduction for inadmissible assets	87	(2765)	Adjustment for margins	41			
TOTAL	99	235					
			TOTAL (11 to 41)		51	420	



The inadmissibility offset and provision for adverse changes are calculated as follows

£000s	Year end	50% fall	
Margin deposit	3000	3000	
Direct shares	1702	851	
Put Option	(420)	(6218)	
Inadmissibility deduction	(4467)	-	3.4m shares worth under 2.5%
Total	(185)	(2367)	<b>Difference i.e. £2181.5k is Minimum Reg 19 amount</b>

## EXAMPLE 5 - Range Of Direct Assets And Derivatives With Counterparty Inadmissibility

£450,000 debt due from XYZ stockbrokers.

£1,200,000 deposit with XYZ Bank (an approved credit institution) on a 15 month fixed term.

£250,000 worth of shares in XYZ Holdings.

2,000 BP traded call options at 420p with XYZ Market makers (an approved counterparty) worth £500,000 but offset by £100,000 received from broker as variation margin and put on deposit with a non XYZ bank.

General Business Amount is £20,000,000.

Total inadmissible by counterparty limits is £300,000. (None of above exposures are via short-term deposits, therefore 10% counterparty exposure limit applies). Inadmissibility of exposure to BP shares (via call options) ignored for simplicity.

<b>FORM INS 7 (part)</b>		
Liabilities (other than long term business)		As at the end of the financial year
Other Creditors	49	
Provision for adverse changes	61	
Total	69	
<b>FORM INS 5 (part)</b>		As at the end of the financial year
Admissible assets		
Equity shares	41	250
Rights under derivative contracts	44	400
Deposits less than 1 month	54	100
Deposits more than 1 month	55	1200
Other financial Investments - other	56	450
Deduction for inadmissible assets	87	(300)
<b>TOTAL</b>	<b>99</b>	<b>2100</b>

<b>FORM INS 9</b>				
Derivative Contracts			As at the end of the financial year	
			Assets	Liabilities
Futures Contracts	Fixed interest	11		
	Equity shares	12		
	Land	13		
	Currencies	14		
	Other	15		
Options	Fixed interest	21		
	Equity shares	22	500	
	Land	23		
	Currencies	24		
	Other	25		
Contracts For Differences	Fixed Interest	31		
	Equity shares	32		
	Land	33		
	Currencies	34		
	Other	35		
Adjustment for margins		41	(100)	
<b>TOTAL (11 to 41)</b>		<b>51</b>	<b>400</b>	

## EXAMPLE 6 - Sterling To DM Interest Rate Swap

£30m Swap of sterling to DM short interest rates, total liability £500,000

Provision for Regulation 19 taken as if interest rate margin between sterling and DM widens by 2%, as contract uncovered. Provision £250,000.

<b>FORM INS 6 (part)</b>			<b>FORM INS 9</b>			
Long Term business liabilities and margins		As at the end of the financial year	Derivative Contracts		As at the end of the financial year	
					Assets	Liabilities
Other Creditors	38	500	Futures	Fixed interest	11	
Provision of adverse changes	41	250	Contracts	Equity shares	12	
Total	59	750		Land	13	
<b>FORM INS 5 (part)</b>		As at the end of the financial year		Currencies	14	
Admissible assets				Other	15	
Equity shares	21			Options	Fixed Interest	21
Rights under derivative contracts	44			Equity shares	22	
Deposits less than 1 month	54			Land	23	
Deposits more than 1 month	55			Currencies	24	
Other financial investments - other	56			Other	25	
TOTAL	99		Contracts for Differences	Fixed interest	31	
				Equity shares	32	
				Land	33	
				Currencies	34	500
				Other	35	
			Adjustment for margins		41	
			TOTAL (11 to 41)		51	500