



**Financial Services  
Commission**

**Insurance Guidance Note No. 13**  
**Insurance Companies Ordinance 1987**  
**Guidance Note On The Insurance Groups**  
**Directive Parent Undertaking Solvency Margin**  
**Calculation**

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## Introduction

1. This guidance relates to the parent undertaking solvency calculation required by the Insurance Groups Directive and implemented by the Insurance Companies (Parent Undertaking Solvency Margin Calculation) Regulations 2004 ("the Regulations"). The calculation is formulated on a basis analogous to the basis on which shares in group undertakings are valued for the required solvency margin (Appendix C to Guidance Note No. 4), but in contrast the parent undertaking solvency calculation is applied to an insurer's ultimate insurance parent undertaking and its ultimate EEA insurance parent undertaking, if different. Valuation of shares in group undertakings at the solo level focus "downwards" on the insurer's holding in group undertakings, whereas the parent undertaking solvency calculation focuses "upwards" towards the ultimate parent of the insurance group of which it is a member. The Regulations apply to accounting periods ending after 31 December 2003.

## Application and scope

2. Under regulation 3(1) the parent undertaking solvency calculation applies only to an insurer whose head office is in Gibraltar (other than a pure reinsurer) which is a subsidiary undertaking of an insurance undertaking (whether engaged in direct insurance business or a pure reinsurer) or an insurance holding company (either of these would be an insurance parent undertaking). If an insurer has no such parent it is not required to do the parent undertaking solvency calculation although it is required to report material connected-party transactions.
3. The information and calculations to be provided under the Regulations are in respect of the insurer and each member of its insurance group. The insurance group consists of the insurer's ultimate insurance parent undertaking and its related undertakings which are insurance undertakings or insurance holding companies.
4. An insurance holding company is an undertaking whose main business is to acquire holdings in subsidiary undertakings that are wholly or mainly insurance undertakings. In interpreting 'main business' and 'mainly insurance undertakings' the factors which should be taken into account include:
  - whether the main activity of the undertaking is to acquire or hold shares and securities of insurance undertakings or insurance holding companies;
  - the proportion of the gross assets of the undertaking represented by its participations in insurance undertakings;
  - the proportion of the net assets of the undertaking represented by its participations in insurance undertakings;
  - the proportion of income (being gross written premiums, turnover or other similar items) of the group from insurance business; and
  - the risk to capital within the group from the insurance business carried on within the group.

An insurance holding company under the Insurance Groups Directive cannot normally also be a financial holding company under the Banking Co-ordination Directive and Capital Adequacy Directive (93/6/EEC).

5. Where an insurer to which the Regulations apply has several insurance parent undertakings, the parent undertaking solvency calculation applies only to the ultimate (worldwide) insurance parent undertaking and ultimate EEA insurance

parent undertaking, if different. Thus parent calculations do not have to be performed for intermediate parents. Where it is unclear who the ultimate insurance parent undertaking is (e.g. in the case of a joint venture), the insurer should discuss the issue with the Head of Insurance Supervision well in advance of the time when the calculation is to be provided.

6. Article 3 of the Insurance Groups Directive allows group undertakings to be excluded from supplementary supervision in certain circumstances including where the undertaking is of negligible interest with respect to the objectives of supplementary supervision or where inclusion would be inappropriate or misleading. Circumstances under which the Commissioner will consider applications for a waiver under section 113 of the Ordinance to exclude undertakings under this provision include group undertakings which are in turn-off or liquidation. For instance if the ultimate insurance parent undertaking or the ultimate EEA insurance parent undertaking is in liquidation and the insurer is ring-fenced from any claims in respect of that parent, the Commissioner may consider an application to waive the requirements of the Regulations in respect of that parent; a condition of waiver may be that another company is treated as the ultimate insurance parent undertaking or the ultimate EEA insurance parent undertaking.

## Timing

7. The parent undertaking solvency calculation must be provided within six months of the end of the financial year to which it relates. Under regulation 3(2), the calculation will generally be made by reference to the last financial year (the financial year in question) of the insurer and will thus be provided at the time of deposit of the insurer's return.
8. Although the information and calculations required under the Regulations do not form part of the annual return, the Commissioner will adopt a similar enforcement approach to non-compliance with all aspects of the Regulations, including the timing of submissions, as it does for the annual return.

## Calculation and reporting responsibilities

9. Where several insurers to which the Regulations apply have the same ultimate insurance parent undertaking or ultimate EEA insurance parent undertaking or both, the parent undertaking solvency calculation requirement applies to all of them. In these circumstances, under regulation 3(5)(b), one insurer may submit the information required in the Regulations on behalf of the other insurers in the insurance group. This should consist of one package of the relevant information with confirmation that the insurer submitting the information has made it available to the Boards of directors of the other insurers in the insurance group. The purpose of this requirement is to ensure that all the insurers in the group are aware of the relevance of the group information to themselves.
10. Where the parent undertaking solvency calculation and deficit details required under regulation 3(2)(d) and (e) have been prepared according to the requirements of another EEA State, an audit statement by a local auditing firm to that effect should fulfil the requirement in regulation 3(5)(c) in respect of that calculation. Where such an audit statement is supplied and has been included in a declaration under the Regulations submitted by an insurer, the Gibraltar auditor should exclude the information from the scope of its review.
11. Where an insurance group consists of an ultimate insurance parent undertaking which is itself an insurer whose head office is in Gibraltar and which has a Gibraltar insurance subsidiary or subsidiaries which is or are themselves insurers,

the parent undertaking solvency calculation will cover the same group undertakings as the parent's own adjusted solvency requirement. The results may differ because admissibility limits will not apply to the parent undertaking solvency calculation (and hence that calculation will often produce a higher result). The subsidiary insurer need not in these circumstances deposit the parent undertaking solvency calculation. However, this does not affect the requirement to provide information under regulation 3(2).

12. As with the solo firm rules, accounts drawn up according to local accounting standards and requirements may be used for designated states or territories, adjusted if necessary to meet the regulatory requirement in the Regulations. Insurers may apply for an order under section 113 of the Ordinance modifying the legislation to allow them to use other relevant local requirements. In that event it will generally be necessary to establish that they are at least equivalent to Gibraltar standards.
13. Where the group of which the insurer is a member holds interests in insurance undertakings through a corporate structure which does not constitute an insurance group as defined, the Commissioner may need full information about the group of which the insurer is a member in order to exercise effective supervision over the insurer. In these circumstances the Commissioner may, under his powers in Part X of the Ordinance, require information about that group to be supplied in broadly equivalent terms to that provided for under the Regulations. Similarly where an insurance group is part of a wider group, the Commissioner may require information about that wider group.

## Basic requirements

14. Regulation 3(2)(a) to (c) requires information about each member of an insurance group and the relationship between them. This may be provided in the form of the example at the end of this Guidance Note or by means of an annotated structure chart together with a list of cross-holdings of shares by class and voting rights in each insurer and insurance holding company in the insurance group.
15. Regulation 3(2)(d) & (e) require details of the ultimate, and ultimate EEA, insurance parent undertaking's share of any solvency deficits in certain members of the insurance group. These requirements apply to deficits in insurance group members which are participating undertakings in the insurer and related undertakings of the insurer, to individual deficits of more than 5% of the positive relevant parent undertaking solvency calculation and to sufficient deficits as may be necessary to ensure that deficits not reported do not exceed 10% of the relevant positive parent undertaking solvency calculation. Where information on deficits is provided by one member of the insurance group on behalf of other members, it must cover the participating undertakings in and related undertakings of all those other members. The insurer will need to perform sufficient analysis on insurance group members outside the direct ownership chain for whom it is not reporting deficits to ascertain that these limits are not breached. Where the relevant parent undertaking solvency calculation is negative, all deficits must be reported. The Commissioner considers this minimum level of information on deficits in members of an insurance group to be essential for identification of potential risks to an insurer arising from its membership of an insurance group.
16. The valuation of members of an insurance group for the purposes of the parent undertaking solvency calculation in regulation 3(3) is the same as for valuation of group undertakings for solvency purposes in regulation 12 of the Insurance Companies (Valuation of Assets and Liabilities) Regulations 1996 except that the admissibility limits in regulation 15(1)(a) to (c) are not applied. Thus the

ultimate insurance parent undertaking's surplus assets and the ultimate EEA insurance parent undertaking's surplus assets include their proportional share of surplus assets of each member of the insurance group (insurance holding companies being treated as if they were insurers with a nil required minimum margin), but with excluded excess assets added back in. Once surplus assets have been identified at the level of the ultimate insurance parent undertaking and the ultimate EEA insurance parent undertaking, they must be restated according to our valuation rules.

17. Regulation 3(3) requires a statement of the group surplus assets position and an explanation of any deficit, including information on any remedial action taken or planned. The parent undertaking solvency calculation is only a requirement to provide information rather than a formal test. If there is a negative result, the explanation should include sufficient information for the Commissioner to determine whether there is a threat to the financial position of the insurance group and the insurers within it. This may not necessarily be the case. Equally a positive result may not necessarily indicate the absence of such a threat. The objective is that the Commissioner should have sufficient information to determine whether he should investigate further or take other action. Insurers should therefore be ready to provide the Commissioner with background documentation on the calculation if required.
18. Notwithstanding 17, a positive result from the calculation is the standard that an insurance group is in normal circumstances expected to achieve. The Commissioner will consider each case according to its particular facts and will consider using his own-initiative or other powers under the Ordinance where he considers a threat to the financial position of an insurer exists. A potential threat may be indicated, inter alia, by a deficit in the parent undertaking solvency calculation, a deficit in the solvency position of individual members of the insurance group and by certain intra-group exposures.
19. Further considerations will need to be given to the parent undertaking solvency calculation in the context of the implementation of the proposed Financial Groups Directive which will introduce supplementary supervision for financial conglomerates and amend certain aspects of the European directives governing supplementary supervision of insurance groups and financial groups.
20. The Asset Valuation Regulations permit shares in non-insurance group undertakings to be valued at market value as determined under regulation 6. This allows goodwill in non-insurance group undertakings to count towards an insurer's required solvency margin where appropriate. 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. Market value must not exceed the value that could effectively be made available or realised to meet losses (if any) arising in the insurer.

## Hybrid capital

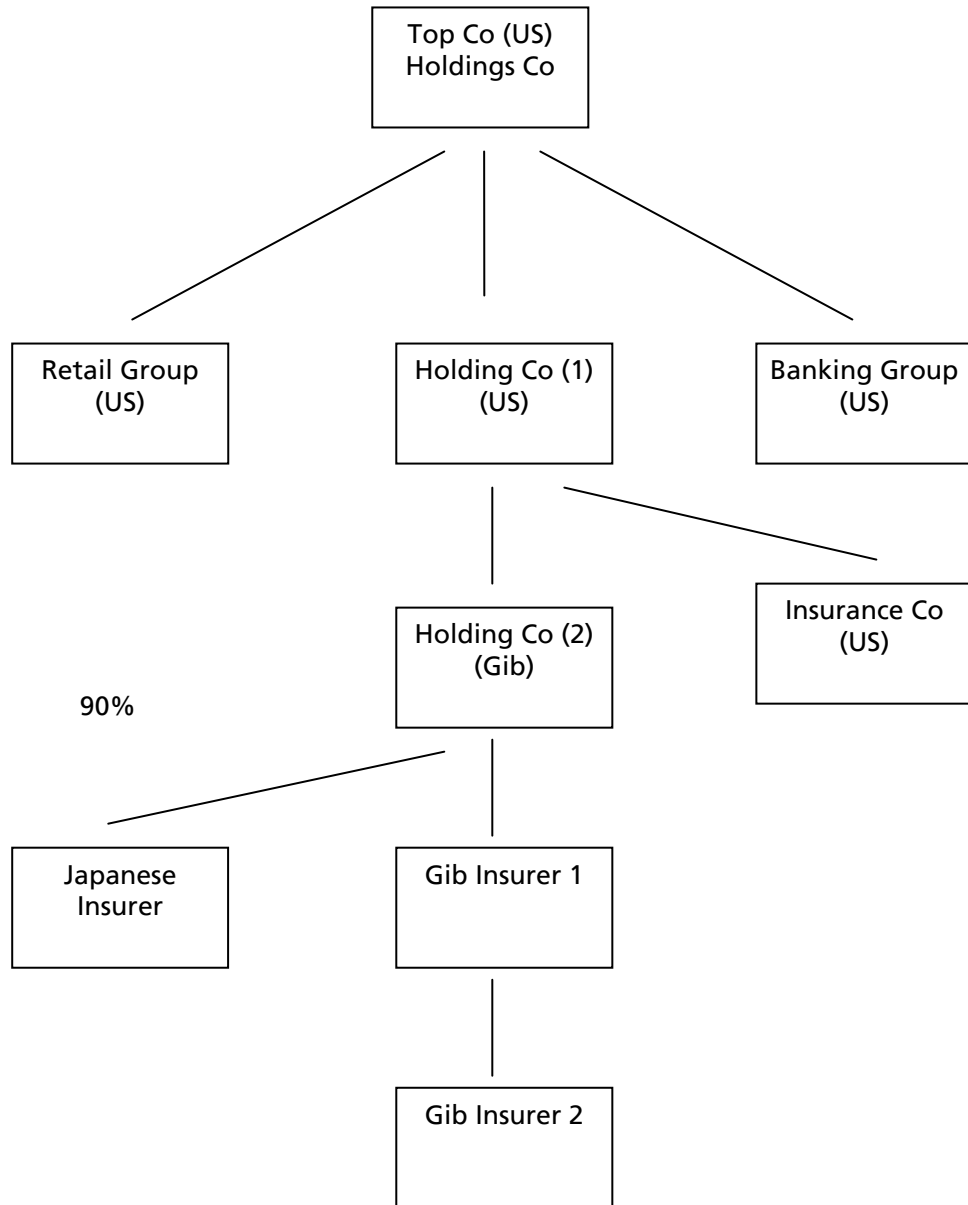
21. The Commissioner may, in appropriate cases, by an order under section 113 of the Ordinance, allow an insurer to count the value of certain types of hybrid capital instruments which are issued by a member of the insurance group that is not an insurer towards a proportion of their group's notional group solvency margin, thus enhancing the result of the parent undertaking solvency calculation. The type of instruments that will normally be eligible for such treatment and the terms which such instruments should meet in order to qualify are in general the same as those which would apply had the instrument been issued by the insurer.



22. The basis on which an order under section 113 of the Ordinance may permit hybrid capital to count as pure capital is different in the case of an issue by an insurance parent undertaking from the basis on which hybrid capital is dealt with at the level of insurers within the insurance group. In the case of parents, the hybrid capital position is viewed on a group-wide basis. The 50% and 25% limits which, in the case of insurers, apply by reference to the required margin of solvency, apply, in the case of the parent, by reference to the insurance group's notional group solvency margin. This is calculated as the sum of the group's proportional shares of the notional required minimum margins of the insurance undertakings in the group. The limits are reduced by the amount of any hybrid capital issued by members of the insurance group (whether in that case those members are insurance undertakings or not) and left out of account in determining the liabilities of those members (the insurance parent undertaking may itself have a notional required minimum margin if it is an insurance undertaking in its own right).
23. If an insurer guarantees, directly or indirectly, the issue of hybrid capital instruments by its ultimate insurance parent undertaking or ultimate EEA insurance parent undertaking, such a guarantee will be taken into account by the Commissioner when determining whether to allow insurers in the group to count any part of the hybrid capital issued by the relevant insurance parent undertaking towards the notional group solvency margin (such guarantees should be disclosed in the annual return in supplementary note 0602 or 0702). If the guarantee counteracts the effect of any subordination in that hybrid capital, then it is unlikely that the Commissioner would allow the hybrid capital to count towards the notional group solvency margin.
24. The Commissioner will expect to be consulted at an early stage on plans by insurance groups to raise hybrid capital.



A. Example: Calculation of Parent Undertaking Solvency Margin





Note: All companies are 100% owned unless otherwise indicated.

Gib Insurers 1 and 2 will be required to submit parent undertaking solvency calculations in respect of:

- ❖ Holding Co (1) – which is the ultimate insurance parent undertaking, and
- ❖ Holding Co (2) – which is the ultimate EEA insurance parent undertaking.
- ❖ No parent undertaking solvency calculation is required in respect of Top Co as this is a “mixed activity” holding company, i.e. a parent undertaking which is not itself an insurer or an insurance holding company (an undertaking whose main activity is the holding of participations in insurance undertakings). If, however, the insurance activities of the Top Co group significantly outweighed the retail and banking activities, the ultimate insurance parent undertaking calculation would be carried out at the Top Co level.

## Proforma Solvency Margin Calculation

Example balance sheets:

Company	Assets (excluding book value of investments in other insurance group members)	Liabilities	RMM/Notional RMM
	£m	£m	£m
Holding Co (1)	100	90	Nil
Insurance Co (US)	200	120	40
Holding Co (2)	10	60	Nil
Japanese Insurer	50	40	20
Gib Insurer 1	150	80	50
Gib Insurer 2	100	60	20

The parent solvency position needs to be calculated from the bottom of the group upwards.

### Step 1 – Calculate the values of subsidiaries of Holding Co (2)

	Gib Insurer 2	Gib Insurer 1 excluding Gib Insurer 2	Gib Insurer 1 including Gib Insurer 2	Japanese Insurer
	£m	£m	£m	£m
Assets	100	150	170*	50
Less: liabilities	(60)	(80)	(80)	(40)
Net assets	40	70	90	10
RMM	(20)	(50)	(50)	(20)
Surplus (deficit)**	20	20	40	(10)



- \* Assets of Gib Insurer 1 of £150m plus surplus in Gib Insurer 2 of £20m.
- \*\* Asset and counterparty limits are dis-applied in the parent calculation. When excess assets have been excluded in the surpluses of Insurer 1 and 2 they should be added back in.

## Step 2 – Calculate the solvency position of Holding Co (2)

	£m	£m
Assets of Holding Co (2) (excluding book value of investments in other insurance group members)		10
Less: liabilities of Holding Co (2)		<u>(60)</u>
Net assets of Holding Co (2) excluding participations		(50)
Add: surplus assets of Gib Insurer 1 (incl. Insurer 2)	40	
Less: Full deficit for Japanese Insurer*	<u>(10)</u>	30
Solvency surplus/ (deficit) for Holding Co (2)		<u>(20)</u>

\* Where an insurance subsidiary undertaking has a solvency deficit, the full value of that solvency deficit must be brought in as a notional liability, even where the subsidiary is less than 100% owned.

## Step 3 – Calculate the values of the immediate subsidiaries of Holding Co (1)

	Holding Co (2) (see above)	US Insurer
	£m	£m
Assets	50*	200
Less: liabilities	(70)**	(120)
Net assets	(20)	80
RMM	nil	(40)
Surplus / (deficit)	(20)	40

\* Assets of Holding Co 2 of £10m plus value of participations of £40m.

\*\* Liabilities of Holding Co 2: £60m plus deficits in participations of £10m.

## Step 4 – Calculate the solvency position of Holding Co (1)

	£m	£m
Assets of Holding Co (1) (excluding book value of investments in other insurance group members)		100
Less: liabilities of Holding Co (1)		<u>(90)</u>
Net assets of Holding Co (1) excluding participations		10
Add: surplus value of US Insurer	40	
Less: deficit for Holding Co (2)	<u>(20)</u>	
Solvency surplus / (deficit) Holding Co (1)		<u><b>30</b></u>

## B: Example: Parent Undertaking Reporting Format

### Declaration under the Insurance Companies (Parent Undertaking Solvency Margin Calculation) Regulations 2004

Company's name:

Date:

#### Regulation 3(2)

A	B	C	D	E	F	G
Company Name	Location of Head Office	Principal Activity	Relationship with other members of Insurance Group		Ultimate insurance parent's share of solvency deficit in company (if any)	Ultimate EEA insurance parent's share of solvency deficit in company (if any)
(2)(a)	(2)(a)	(2)(a)	(2)(b) & (2)(c)		(2)(d)***	(2)(e)***
			Amount/description of shareholding **	Amount/description of shareholding directly held **		

\* The information in columns A to E may alternatively be provided in the form of an annotated group structure chart.

\*\* including classes of shares and voting rights.

\*\*\* where deficits have or may have been excluded as a result of the exemptions in (d) or (e), this should be disclosed (it is not necessary to disclose the number or amounts of such deficits).

**Regulation 3(3)**

	Sub-regulation	Ultimate Insurance Parent Undertaking	Ultimate EEA Insurance Parent Undertaking
Surplus assets	(3)(a)	£ <b>A</b>	£ <b>A</b>
<b>Less</b>			
Any provision for related undertaking	(3)(a)(i)	<b>B</b>	<b>B</b>
Any deficit in assets available to cover:			
- any liabilities not already provided for	(3)(a)(ii)(a)	<b>C</b>	<b>C</b>
- the notional minimum margin (if any) of the ultimate (ultimate EEA) insurance parent	(3)(a)(ii)(b)	<b>D</b>	<b>D</b>
<b>Surplus/deficit (E=A-B-C-D)</b>		<b>E</b>	<b>E</b>