SCHEDULE 6

ACCOUNTING PRINCIPLES AND RULES

PART VI

RULES FOR DETERMINING PROVISIONS

Preliminary

33. Provisions which are to be shown in a society's accounts must be determined in accordance with paragraphs 34 to 40 below.

Technical provisions

34. The amount of technical provisions must at all times be sufficient to cover any liabilities arising out of insurance contracts as far as can reasonably be foreseen.

Provision for unearned premiums

35.—(1) The provision for unearned premiums must in principle be computed separately for each insurance contract, save that statistical methods (and in particular proportional and flat rate methods) may be used where they may be expected to give approximately the same results as individual calculations.

(2) Where the pattern of risk varies over the life of a contract, this must be taken into account in the calculation methods.

Provision for unexpired risks

36. The provision for unexpired risks (as defined in paragraph 10 of Schedule 9 below) must be computed on the basis of claims and administrative expenses likely to arise after the end of the financial year from contracts concluded before that date, in so far as their estimated value exceeds the provision for unearned premiums and any premiums receivable under those contracts.

Long term business provision

37.—(1) The long term business provision must in principle be computed separately for each long term contract, save that statistical or mathematical methods may be used where they may be expected to give approximately the same results as individual calculations.

(2) A summary of the principal assumptions in making the provision under subparagraph (1) must be given in the notes to the accounts.

(3) The computation must be made annually by a Fellow of the Institute or Faculty of Actuaries on the basis of recognised actuarial methods, with due regard to the actuarial principles laid down in the Friendly Societies (Authorisation) Regulations 1994(**1**).

Provisions for claims outstanding

(**1**) S.I. 1994 No. 1982.

General business

38.—(1) A provision must in principle be computed separately for each claim on the basis of the costs still expected to arise, save that statistical methods may be used if they result in an adequate provision having regard to the nature of the risks.

(2) This provision must also allow for claims incurred but not reported by the balance sheet date, the amount of the allowance being determined having regard to past experience as to the number and magnitude of claims reported after previous balance sheet dates.

(3) All claims settlement costs (whether direct or indirect) must be included in the calculation of the provision.

(4) Recoverable amounts arising out of subrogation or salvage must be estimated on a prudent basis and either deducted from the provision for claims outstanding (in which case if the amounts are material they must be shown in the notes to the accounts) or shown as assets.

(5) In sub-paragraph (4) above, "subrogation" means the acquisition of the rights of members or policy holders with respect to third parties, and "salvage" means the acquisition of the legal ownership of insured property.

(6) Where benefits resulting from a claim must be paid in the form of annuity, the amounts to be set aside for that purpose must be calculated by recognised actuarial methods, and paragraph 40 below must not apply to such calculations.

(7) Implicit discounting or deductions, whether resulting from the placing of a current value on a provision for an outstanding claim which is expected to be settled later at a higher figure or otherwise effected, is prohibited.

39.—(1) Explicit discounting or deductions to take account of investment income is permitted, subject to the following conditions:

(a) the expected average interval between the date for the settlement of claims being discounted and the accounting date must be at least four years;

(b) the discounting or deductions must be effected on a recognised prudential basis;

(c) when calculating the total cost of settling claims, the society must take account of all factors that could cause increases in that cost;

(d) the society must have adequate data at its disposal to construct a reliable model of the rate of claims settlements; and

(e) the rate of interest used for the calculation of present values must not exceed a rate prudently estimated to be earned by assets of the society which are appropriate in magnitude and nature to cover the provisions for claims being discounted during the period necessary for the payment of such claims, and must not exceed either:

(i) a rate justified by the performance of such assets over the preceding five years; or

(ii) a rate justified by the performance of such assets during the year preceding the balance sheet date.

(2) When discounting or effecting deductions, the society must, in the notes to the accounts, disclose:

(a) the total amount of provisions before discounting or deductions,

(b) the categories of claims which are discounted or from which deductions have been made; and

(c) for each category of claims, the methods used, in particular the rates used for the estimates referred to in sub-paragraphs (1)(d) and (e), and the criteria adopted for estimating the period that will elapse before the claims are settled.

Long term business

40. The amount of the provision for claims must be equal to the sums due to beneficiaries, plus the costs of settling claims.