
STATUTORY INSTRUMENTS

1996 No. 3008

FRIENDLY SOCIETIES

The Friendly Societies (Insurance Business) (Amendment) Regulations 1996

Made - - - - *6th December 1996*
Laid before Parliament *9th December 1996*
Coming into force - - *30th December 1996*

The Friendly Societies Commission, being a Department designated for the purposes of section 2(2) of the European Communities Act 1972(1) in relation to the authorisation of the carrying on by friendly societies of insurance business and the regulation of such business and its conduct and in relation to anything supplemental or incidental to such matters(2), in exercise of the powers conferred by that section and, with the consent of the Treasury, in exercise of the powers conferred upon it by sections 45(1) and (2), 56(1) and (2) and 121(3) of the Friendly Societies Act 1992(3), hereby makes the following Regulations:

Citation, commencement and general

1.—(1) These Regulations may be cited as the Friendly Societies (Insurance Business) (Amendment) Regulations 1996 and shall come into force on 30th December 1996.

(2) The Friendly Societies (Insurance Business) Regulations 1994(4) (“the 1994 Regulations”) shall be amended as follows.

Localisation

2. In paragraph (1) of regulation 17 of the 1994 Regulations (localisation) for the words “the European Community”, in each place where they occur, substitute “any EEA State”.

(1) 1972 c. 68.
(2) The European Communities (Designation) (No. 5) Order 1992 (S.I. 1992/3197).
(3) 1992 c. 40. The Act was amended by the Friendly Societies (Amendment) Regulations 1993 (S.I. 1993/2519), the Friendly Societies Act 1992 (Amendment) Regulations 1994 (S.I. 1994/1984), the Deregulation (Friendly Societies Act 1992) Order 1996 (S.I. 1996/1188) and by the Financial Institutions (Prudential Supervision) Regulations 1996 (S.I. 1996/1669).
(4) S.I. 1994/1981.

Exclusions from regulations 13 to 17

3. In regulation 18(1) of the 1994 Regulations (exclusions from regulations 13 to 17) for the words “European Community” substitute “EEA States”.

Interpretation: Part IV

4.—(1) Paragraph (1) of regulation 19 of the 1994 Regulations (interpretation: Part IV) shall be amended as follows.

(2) Before the definition of “approved counterparty” insert—

““amortised value” means the amortised value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to societies;”.

(3) In the definition of “approved counterparty”, at the end of sub-paragraph (b) omit “or” and at the end of sub-paragraph (c) add

“or

(d) in respect of a transaction involving a new issue of securities which are to be listed, the issuer or an approved investment firm acting on behalf of the issuer;”.

(4) After the definition of “building society” insert—

““collective investment scheme” has the meaning assigned to it in section 75 of the Financial Services Act 1986(5);”.

(5) After the definition of “contract for differences” insert—

““counterparty” has the meaning assigned to it in paragraph 2 of Schedule 5 to these Regulations;”.

(6) Omit the definition of “debenture” and after the definition of “debt” insert—

““debt security” includes bonds, notes, debentures and debenture stock;

“deferred acquisition costs” means those items referred to at G II under the heading “Assets” in Part I of Schedule 2 to the Friendly Societies (Accounts and Related Provisions) Regulations 1994(6);”.

(7) At the end of the definition of “derivative contract” add “and includes a contract under which the amount payable by either party is calculated by reference to the amortised value of any property;”.

(8) After the definition of “enactment” insert—

““equivalent securities” means securities issued by the same issuer being of an identical type and having the same nominal value, description and amount;

“exposure” in relation to assets means an amount determined in accordance with regulation 32 of, and paragraph 5 of Schedule 5 to, these Regulations;

“exposure” in relation to a counterparty means an amount determined in accordance with regulation 32 of, and paragraphs 14 to 16 of Schedule 5 to, these Regulations;”.

(9) Omit the definitions of “equity share” and “equity share capital”.

(10) In the definition of “general business amount” for the words “regulation 32(9) below” substitute “paragraph 2 of Schedule 5 to these Regulations”.

(11) After the definition of “industrial and provident society”, insert—

(5) 1986 c. 60; section 75 was amended by article 6 of the Financial Services Act 1986 (Restriction of Scope of Act and Meaning of Collective Investment Scheme) Order 1990 (S.I. 1990/349) and paragraph 22 of Schedule 7 to the Investment Services Regulations 1995 (S.I. 1995/3275).

(6) S.I. 1994/1983.

- ““initial margin” in respect of a derivative contract or a contract or asset having the effect of a derivative contract means assets which, before or at the time the contract is entered into, are transferred by the society subject to a condition that such assets (or, where the assets transferred are securities, equivalent securities) will be returned to the society on completion of that contract;”.
- (12) Omit the definition of “insurance liabilities”.
- (13) After the definition of “intermediary”, insert—
- ““issuer” in respect of a collective investment scheme means the manager or operator of the scheme and in respect of an interest in a limited partnership means the partnership;”.
- (14) In the definition of “listed”, for paragraphs (a) and (b), substitute—
- “(a) that there has been granted and not withdrawn a listing in respect of that investment on any stock exchange in an EEA State which is a stock exchange under the law of that State; or
- (b) that facilities have been granted for dealing in that investment on a regulated market;”.
- (15) In the definition of “long term business amount” for the words “regulation 32(9) below” substitute “paragraph 2 of Schedule 5 to these Regulations”.
- (16) Omit the definition of “middle market quotation” and insert—
- ““market value” means the market value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to societies;”.
- (17) After the definition of “option” insert—
- ““permitted asset exposure limit” has the meaning assigned to it in paragraph 3 of Schedule 5 to these Regulations;
- “permitted counterparty exposure limit” has the meaning assigned to it in paragraph 4 of Schedule 5 to these Regulations;”.
- (18) Omit the definition of “price earnings ratio”.
- (19) In the definition of “regulated institution”, at the beginning of sub-paragraph (a), insert “an insurance company which is either”.
- (20) In the definition of “regulated market”, in sub-paragraph (c), for “European Community” substitute “EEA States”.
- (21) In the definition of “securities” for the word “debentures” substitute the words “debt securities”.
- (22) Omit the definition of “stock lending transaction”.
- (23) After the definition of “Treasury Bills” insert—
- ““variation margin” means—
- (a) in respect of a derivative contract, or a contract having the effect of a derivative contract, assets (other than assets transferred by way of initial margin) which, at the relevant date, have been transferred by, to, or for the benefit of, the society in pursuance of a condition in that contract or a related contract; and
- (b) in respect of an asset having the effect of a derivative contract, assets which, at the relevant date, have been transferred by, to, or for the benefit of, the society in pursuance of a contractual right conferred, or obligation imposed, by the holding of the asset having the effect of a derivative contract;”
- (24) After the definition of “warrant” insert—

““working day” means any day other than Saturday, Sunday, Good Friday, Christmas Day and any day which is a bank holiday in any part of the United Kingdom under section 1 of the Banking and Financial Dealings Act 1971(7).”.

5. For paragraphs (3) and (4) of regulation 19 substitute—

“(3) For the purposes of these Regulations, a debt owed to (or an obligation to be fulfilled for the benefit of) a society shall be regarded as being secured only to the extent that it is—

(a) secured by—

- (i) a letter of credit established with an approved credit institution; or
- (ii) a guarantee provided by an approved credit institution,

and the sum of the aggregate amount available under all letters of credit established for the benefit of the society with the same counterparty, the aggregate amount of all guarantees issued for the benefit of the society by that counterparty and the amount of any exposure of the society to that counterparty does not exceed the permitted counterparty exposure limit for that counterparty; or

(b) secured by assets for the valuation of which provision is made in this Part of these Regulations and—

- (i) the value of such assets (after deducting reasonable expenses of sale and the amount of any other debt or obligation secured thereon having priority to or ranking equally with the debt or obligation) is sufficient to enable the debt or obligation to be discharged in full; and
- (ii) the value of the assets when aggregated with the society’s exposure to assets of the same description does not exceed the permitted exposure limit for assets of that description (as defined in regulation 32 of, and paragraph 3 of Schedule 5 to, these Regulations); and
- (iii) where the assets give rise to exposure to a counterparty, the exposure of the society to that counterparty, when added to the sum of the aggregate amount available under all letters of credit established for the benefit of the society with that counterparty, and the aggregate amount of all guarantees issued for the benefit of the society by that counterparty, does not exceed the permitted counterparty exposure limit for that counterparty.

(4) For the purposes of paragraph (3) above—

- (a) the aggregate amount available under letters of credit established with a counterparty shall be taken not to exceed the sum of the aggregate amount of all debts and the aggregate value of all obligations in respect of which those letters of credit were established;
- (b) the aggregate amount of guarantees issued by a counterparty shall be taken not to exceed the sum of the aggregate amount of all debts and the aggregate value of all obligations so guaranteed; and
- (c) assets which are securing any other debt owed to (or obligation to be fulfilled for the benefit of) the society shall be treated as if they were assets of the society.”.

Application: Part IV

6.—(1) Regulation 20 of the 1994 Regulations (application: Part IV) shall be amended as follows.

(2) For paragraph (4) substitute—

“(4) Where in all the circumstances of the case it appears that any asset is of a lesser value than the amount calculated in accordance with this Part of these Regulations, such lesser value shall be the value of the asset.”

(3) In paragraph (5) for the words “shall be of a lesser value than a specified amount” substitute “is of a lesser value than the amount calculated in accordance with this Part of these Regulations”.

(4) After paragraph (7) insert—

“(8) Where a society has entered into a contract for the conversion of currency which satisfies the conditions set out in paragraph (9) below, then for any of the purposes for which this Part of these Regulations applies, the society shall treat the conversion as having been made on the relevant date.

(9) The conditions referred to in paragraph (8) above are that—

(a) either—

- (i) the contract provides for the conversion into another currency of an amount representing the sale of an asset which has, on the relevant date, been sold but not delivered, or
- (ii) the contract provides for the purchase of currency for the purpose of settling the purchase of an asset which has, on the relevant date, been purchased but not delivered;

(b) the conversion is to take place during a period which is—

- (i) where the contract is in connection with the delivery of a listed security, a period commencing on the date of the contract and extending for the usual period of settlement as laid down by the rules of the relevant stock exchange or regulated market; or
- (ii) where the contract is in connection with the delivery of any other asset, a period commencing on the date of the contract and extending for twenty working days thereafter; and

(c) the contract is listed or has been entered into with an approved counterparty.”

Valuation of assets and liabilities of dependants for the purposes of regulation 21

7.—(1) Regulation 22(5) of the 1994 Regulations shall be amended as follows.

(2) In the definition of “assets of a relevant description” for “Part I” substitute “Part II”.

(3) In the definition of “permitted limit”, after “paragraph 1”, insert “in Part II” and for “paragraphs 2 to 17” substitute “the remaining paragraphs in Part II”.

Assets sold to or purchased from an approved credit institution or an approved investment firm subject to an agreement for resale or repurchase

8. After regulation 22 of the 1994 Regulations insert—

“Assets sold to or purchased from an approved credit institution or an approved investment firm subject to an agreement for resale or repurchase

22A.—(1) Where a society has sold securities to or purchased securities from an approved credit institution or an approved investment firm and such sale or purchase was made subject to an agreement that the approved credit institution or approved investment firm would, either on demand by the society or within six months of such sale or purchase, subsequently sell to or purchase from the society equivalent securities, then if at the relevant

date such subsequent sale or purchase has not taken place and the conditions specified in paragraphs (2) and either (3) or (4) below (as appropriate) are satisfied, the society—

- (a) shall value—
 - (i) securities sold by it under such agreement as if such securities had been retained by it; and
 - (ii) assets provided by it as consideration for the purchase of securities under such agreement as if such consideration had not been provided by it; and
- (b) shall not ascribe a value to—
 - (i) any consideration received for the sale of securities under such agreement (or any assets purchased by it with such consideration) up to the limit of the value of the securities sold; or
 - (ii) any securities purchased by it under such agreement (or any assets purchased with the proceeds of the sale of any such securities) up to the limit of the consideration (valued in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to societies) provided by it.

(2) The condition specified in this paragraph is that, where at any time after the sale or purchase of securities by the society under an agreement described in paragraph (1) above either—

- (a) the amount of the consideration received by the society for the sale of the securities fell below the value of the securities sold by it; or
- (b) the value of the securities purchased by the society fell below the value of the consideration provided by it

by more than 2.5 per cent. of the value of the securities sold or purchased (as the case may be), the society demanded additional consideration whose amount was equal to the shortfall and such demand was complied with before the end of the working day next following the day on which such shortfall occurred.

(3) The conditions specified in this paragraph are that, if the society purchases securities from an approved credit institution or an approved investment firm and the consideration provided by the society is other than by way of sale of securities,—

- (a) the securities purchased are—
 - (i) approved securities;
 - (ii) listed securities; or
 - (iii) securities issued by an approved credit institution; and
- (b) the securities purchased do not include—
 - (i) securities (other than approved securities) issued by the same counterparty whose aggregate value amounts to more than 15 per cent. of the value of the securities purchased; or
 - (ii) if the condition in sub-paragraph (b)(i) above is not satisfied, securities whose value when aggregated with the society's existing exposure to assets of the same description or to the same counterparty would exceed the appropriate permitted asset exposure limit or permitted counterparty exposure limit as determined in accordance with regulation 32 of, and Schedule 5 to, these Regulations.

(4) The conditions specified in this paragraph are that, if the society sells securities to an approved credit institution or an approved investment firm,—

- (a) the consideration provided by the approved credit institution or approved investment firm is—
 - (i) cash;
 - (ii) approved securities;
 - (iii) listed securities;
 - (iv) securities issued by an approved credit institution;
 - (v) a Talisman short term certificate;
 - (vi) a charge over assets set out in sub-paragraphs (i) to (iv) above;
 - (vii) a letter of credit established with an approved credit institution; or
 - (viii) a guarantee provided by an approved credit institution; and
 - (b) the consideration does not include—
 - (i) except to the extent that the condition in sub-paragraph (b)(ii) below is satisfied, consideration whose amount when aggregated with the society's existing exposure to assets of the appropriate description or to the relevant counterparty would exceed the appropriate permitted asset exposure limit or permitted counterparty exposure limit as determined in accordance with regulation 32 of, and Schedule 5 to, these Regulations; or
 - (ii) consideration more than 15 per cent. of the aggregate amount of which takes the form of securities (other than approved securities) issued by, letters of credit established with, guarantees provided by, cash deposited with, a charge over cash deposited with or a charge over securities issued by, the same counterparty; and
 - (c) the consideration to be provided by the society for the subsequent purchase of equivalent securities is—
 - (i) where the consideration for the original purchase by the approved credit institution or approved investment firm was (wholly or in part) cash, cash denominated in the same currency, and
 - (ii) where the consideration was (wholly or in part) securities, securities equivalent to the securities provided by way of consideration.
- (5) For the purposes of this regulation, where the society has received consideration in respect of a sale of the kind described in paragraph (1) above, in addition to any other exposure to assets or to a counterparty—
- (a) if such consideration takes the form of a letter of credit established with, or a guarantee provided by, an approved credit institution, it shall be considered to give rise to exposure to that institution by the amount of the consideration;
 - (b) if such consideration takes the form of a charge over securities, it shall be considered to give rise to exposure to securities of the same description and to the issuer of those securities by the amount of the consideration; and
 - (c) if such consideration takes the form of cash deposited with another party for the benefit of the society, or a charge over cash deposited with another party, it shall be considered to give rise to exposure to that party by the amount of the consideration.
- (6) For the purposes of this regulation, the amount of any consideration shall be—
- (a) where the consideration is a letter of credit established with an approved credit institution, the lower of the amount made available under the letter of credit and the value of the assets sold;

- (b) where the consideration is a guarantee provided by an approved credit institution, the lower of the amount of the guarantee and the value of the assets sold;
 - (c) where the consideration takes the form of assets of any of the types mentioned in paragraph (4)(a)(i) to (iv) above, or a charge over such assets, the value of the assets as determined in accordance with this Part of these Regulations; and
 - (d) where the consideration takes the form of a Talisman short term certificate, the value of the securities represented by that certificate.
- (7) Where a society has entered into a number of agreements described in paragraph (1) above, for the purposes of paragraphs (3) and (4) of this regulation—
- (a) any or all agreements under which the subsequent sale or purchase has not taken place at the relevant date may be treated as one agreement; and
 - (b) in such case, the 15 per cent. limits referred to in paragraphs (3)(b)(i) above and (4)(b)(ii) above shall be calculated by reference to the aggregate of the value of the securities purchased under paragraph (3) above and the amount of any consideration under paragraph (4) above.”.

Debts and other rights

9. For regulation 23 of the 1994 Regulations (debts and other rights) substitute—

“Debts and other rights

23.—(1) The value of any debt due, or to become due, to a society, other than a debt to which regulation 21(3) above or regulation 26 below applies or to which paragraphs (2) to (6) of this regulation apply, shall be—

- (a) in the case of a debt which is due, or will become due, within twelve months of the relevant date (including any debt which would become due within that period if the society were to exercise any right to which it is entitled to require payment of the same), the amount which can reasonably be expected to be recovered in respect of that debt; and
- (b) in the case of any other debt, the amount which would reasonably be paid by way of consideration for an immediate assignment of the debt;

in either case due account being taken of the terms and conditions for payment of the debt and, where the debt is secured, the nature and quality of the security.

(2) Any debt due, or to become due, to a society under a letter of credit shall be left out of account for the purposes of this Part of these Regulations.

(3) In the case of long term business carried on by a society, the value of any debt due, or to become due, to the society which is secured on a policy of insurance issued by the society and which (together with any other debt secured on that policy) does not exceed the amount payable on a surrender of that policy at the relevant date shall be the amount of that debt.

(4) Subject to paragraph (5) below, the value of any rights of the society under a contract of reinsurance to which it is a party shall be the amount which can reasonably be expected to be recovered in respect of those rights.

(5) Paragraph (4) above shall not apply to—

- (a) rights under a contract of reinsurance in respect of long term business except to the extent that debts are due under such contracts; or
- (b) debts to which regulation 21(3) applies which are due or are to become due.

(6) Any debt due, or to become due, to a society—

- (a) from an intermediary in respect of money advanced on account of commission to which that intermediary is not absolutely entitled at the relevant date; or
 - (b) which is a debt owed in respect of premiums (due account being taken of rebates, refunds and commissions payable) which is recorded in the society's accounting records as due and payable and has been outstanding for more than three months,
- shall be left out of account for the purposes for which this Part of these Regulations applies.

(7) The value of any right to recover assets transferred by way of initial margin in respect of a derivative contract or a contract or asset having the effect of a derivative contract shall be determined—

- (a) where the initial margin was a payment in cash, as if there were a debt owed to the society for that amount, and
- (b) where the initial margin took the form of a transfer of securities, as if there were a debt owed to the society of an amount equal to the value of such securities as determined in accordance with this Part of these Regulations.

(8) The value of any rights arising under a derivative contract to which regulation 30 below does not apply, or under a contract or asset having the effect of such a contract, shall be the value of any right to recover assets transferred by way of initial margin together with the value of any other unconditional right to receive a specified amount.

(9) This regulation shall not apply to any rights (other than debts due) in respect of—

- (a) investments in dependants;
- (b) securities or beneficial interests in a limited partnership;
- (c) units or other beneficial interests in a collective investment scheme;
- (d) a derivative contract, except as provided under paragraphs (7) or (8) above; or
- (e) a contract or asset which has the effect of a derivative contract except as provided under paragraphs (7) or (8) above or under regulation 31(4) or (5) below.”.

Securities and beneficial interests in limited partnerships (substitution for regulation concerning unlisted securities)

10. For regulation 26 of the 1994 Regulations (unlisted securities) substitute—

“Securities and beneficial interests in limited partnerships

26.—(1) Subject to paragraph (2) below, this regulation applies to the valuation of investments comprising securities and beneficial interests in limited partnerships and, for the purposes of paragraph (6) below, investments includes loans.

(2) This regulation shall not apply to the valuation of securities which are—

- (a) derivative contracts;
- (b) investments in dependants;
- (c) units or other beneficial interests in collective investment schemes, except as provided in regulation 27(2) below; or
- (d) contracts or assets having the effect of derivative contracts, except as provided in regulation 31(4) below.

(3) Subject to paragraph (6) below, the value of an investment to which this regulation applies shall be—

- (a) where the investment is transferable and paragraph (4) below does not apply, the market value;

- (b) where the investment is transferable and paragraph (4) below applies, the lower of—
 - (i) the market value, and
 - (ii) the amount which would reasonably be expected to be received by way of consideration for an assignment or transfer of the investment at a date not later than twelve months after the relevant date, it being assumed that negotiations for the assignment or transfer commenced on the relevant date and the assignment or transfer was made other than to the issuer or to an associate or an associated company of the issuer or of the society; or
- (c) where the investment is not transferable—
 - (i) the amount payable on redemption on the relevant date or the most recent date before the relevant date on which the issuer of the investment could have been required to redeem the investment; or
 - (ii) where the investment cannot be redeemed, the amount which would reasonably be paid by way of compensation for the surrender of the interest in the investment.

(4) Subject to paragraph (5) below, this paragraph applies where it is not reasonable to assume that, had negotiations for the assignment or transfer of the investment commenced not more than seven working days before the relevant date, the investment could have been assigned or transferred on the relevant date for an amount not less than 97.5 per cent. of the market value other than to the issuer or to an associate or an associated company of the issuer or of the society.

- (5) Paragraph (4) above shall be taken not to apply if it applies by reason only that—
 - (a) the listing of the investment has been temporarily suspended following receipt of price sensitive information by the stock exchange on which the investment is listed or the regulated market on which facilities for dealing have been granted; or
 - (b) the extent of the holding would prevent an orderly disposal of the investment for an amount equal to or greater than 97.5 per cent. of the market value.

(6) Where a society has made more than one unlisted investment (other than a number of investments exclusively comprising loans) and the value of such investments when taken together is greater than the aggregate of the values of each investment valued separately, then such higher value may be ascribed to the investments if it is reasonable to assume that none of the investments would be assigned or transferred separately.”.

Beneficial interests in collective investment schemes (substitution for regulation concerning unit trusts)

11. For regulation 27 of the 1994 Regulations (unit trusts) substitute—

“Beneficial interests in collective investment schemes

27.—(1) Subject to paragraph (3) below, this regulation applies to holdings of units, or other beneficial interests in—

- (a) a scheme falling within Council Directive [85/611/EEC](#) of 20th December 1985⁽⁸⁾ on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities;

⁽⁸⁾ O.J. No. L375, 31.12.85, p.3. The Directive was amended by Directive [88/220/EEC](#) (O.J. No. L100, 19.4.88, p.31) and Directive [95/26/EC](#) (O.J. No. L168, 18.7.95, p.7).

- (b) an authorised unit trust scheme or a recognised scheme within the meaning of the Financial Services Act 1986 (not falling within sub-paragraph (a) above); or
 - (c) any other collective investment scheme where—
 - (i) the scheme does not employ derivative contracts unless they are contracts to which regulation 30 below applies;
 - (ii) the scheme does not employ contracts or assets having the effect of derivative contracts unless they have the effect of derivative contracts to which regulation 30 below applies; and
 - (iii) the property of the scheme does not include assets other than those for the valuation of which provision is made in this Part of these Regulations.
- (2) The value of units or other beneficial interests in a collective investment scheme to which this regulation applies shall be—
- (a) where the issuer can be required to purchase the units or other beneficial interests from the holder upon the holder giving notice of one month or less, the price at which the issuer would have purchased the units or other beneficial interests on the relevant date or the most recent date before the relevant date on which it could have been required to make such a purchase; or
 - (b) where the issuer cannot be required to purchase the units or other beneficial interests as set out in sub-paragraph (a) above, a value determined in accordance with regulation 26 above.
- (3) Other than as provided in regulation 31(4) below, this regulation shall not apply to units or other beneficial interests in a collective investment scheme which has the effect of a derivative contract.”.

Deferred acquisition costs (substitution for regulation concerning listed investments)

12. For regulation 28 of the 1994 Regulations (listed investments) substitute—

“Deferred acquisition costs

28. In the case of general business, the value of deferred acquisition costs shall be the value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to societies.”.

Derivative contracts

13. For regulation 30 of the 1994 Regulations (derivative contracts) substitute—

“Derivative contracts

30.—(1) The value of rights (other than rights to recover assets transferred by way of initial margin) under a derivative contract to which this regulation applies shall be—

- (a) in the case of a listed derivative contract, the market value; and
- (b) in the case of an unlisted derivative contract, the amount which would reasonably be paid by way of consideration for closing out that contract,

in either case taking into account the market value of any assets which, at the relevant date, have been transferred by way of variation margin.

- (2) This regulation applies to an approved derivative contract which is covered and—

- (a) which is held in connection with a contract or asset of the type described in paragraph (3) below for the purposes of reduction of investment risks or efficient portfolio management; or
 - (b) which has effect as if so held for such purposes.
- (3) The contract or asset described in this paragraph shall be either—
- (a) an approved derivative contract or a contract or asset having the effect of an approved derivative contract which, when taken together with the approved derivative contract the rights under which are being valued in accordance with this regulation, would have the effect that the society either holds an asset for the valuation of which provision is made in this Part of these Regulations or holds an approved derivative contract in connection with such an asset; or
 - (b) an asset for the valuation of which provision is made in this Part of these Regulations, being neither a derivative contract nor a contract or asset having the effect of a derivative contract.
- (4) For the purposes of this regulation an approved derivative contract is covered if it does not require a significant provision to be made in respect of it pursuant to regulation 36 below.
- (5) For the purposes of determining in accordance with paragraph (4) above whether a required provision is significant, regard shall be had to the obligations of the society under the contract and the volatility of the assets identified by the society as being suitable to cover such obligations, and the required provision in respect of any one derivative contract shall be deemed to be significant if—
- (a) the aggregate provision required in respect of all contracts having a similar effect is significant; or
 - (b) the aggregate provision required in respect of all contracts with which it is connected is significant.
- (6) In this regulation “approved derivative contract” means a derivative contract entered into by a society to which section 37(2) or (3) of the 1992 Act applies and which—
- (a) either is listed or has been entered into with an approved counterparty; and
 - (b) the society reasonably believes may be readily closed out; and
 - (c) is either a contract for differences to which paragraph (7) below applies or a futures contract or an option to either of which paragraph (8) below applies.
- (7) This paragraph applies to—
- (a) a contract for differences under which the amount payable by either party is calculated solely by reference to fluctuations in any of the following—
 - (i) the value of an asset for the valuation of which provision is made in this Part of these Regulations; or
 - (ii) the amount of income from such an asset over a defined period; or
 - (iii) an index of such assets, being an index in respect of which a derivative contract is listed; or
 - (iv) a national index of retail prices published by or under the authority of a government of a State belonging to Zone A as defined in Council Directive [89/647/EEC](#) of 18th December 1989⁽⁹⁾ on a solvency ratio for credit institutions;
- or an arithmetic average thereof, and

(9) O.J. No. L386, 30.12.89, p.14.

- (b) a contract under which the amount payable by either party is calculated by reference to the difference between the market value and the amortised value of any asset for the valuation of which provision is made in this Part of these Regulations.

(8) This paragraph applies to a futures contract or an option which in either case provides for the acquisition or disposal of assets for the valuation of all of which provision is made in this Part of these Regulations at a price which is determined by one or more of the following methods—

- (a) for each date on which the contract may be completed or the option exercised, the price is a fixed amount under the terms of the contract or option;
- (b) it is determined by reference to the market value or the amortised value of an asset for the valuation of which provision is made in this Part of these Regulations or the amount of income over a defined period from such an asset;
- (c) it is determined by reference to an index of the kind mentioned in paragraph (7) (a)(iii) or (iv) above.”.

Contracts and assets having the effect of derivative contracts (substitution for regulation concerning other assets)

14. For regulation 31 of the 1994 Regulations (other assets) substitute—

“Contracts and assets having the effect of derivative contracts

31.—(1) Subject to paragraph (3) below, for the purposes of this Part of these Regulations, a contract has the effect of a derivative contract if it is a contract (other than a derivative contract) which provides whether upon the exercise of a right by the society or otherwise—

- (a) for payment (at any time) of amounts which are determined by fluctuations in—
 - (i) the value of property of any description;
 - (ii) an index of the value of property of any description;
 - (iii) income from property of any description; or
 - (iv) an index of income from property of any description;
- (b) for delivery of an asset other than an asset for the valuation of which provision is made in regulation 25 of these Regulations to or by the society; or
- (c) for the conversion of an asset held by the society or another party to—
 - (i) an asset of a different type; or
 - (ii) a different asset of the same type.

(2) Subject to paragraph (3) below, for the purposes of this Part of these Regulations an asset has the effect of a derivative contract if the asset is an asset (other than an approved security or an asset falling within regulation 27(1)(a) above) and the holding of the asset confers contractual rights or imposes contractual obligations to make or accept payment, delivery or conversion as set out in sub-paragraphs (a) to (c) of paragraph (1) above.

(3) A contract or asset does not have the effect of a derivative contract by reason only that—

- (a) it provides for the unconditional delivery of assets, or for the payment for unconditional delivery of assets, such delivery or payment to be made within a period commencing at the date of the contract and extending—

- (i) in the case of a listed security, for the usual period for delivery or payment as determined by the rules of the stock exchange or regulated market on which the securities are listed or facilities for dealing have been granted;
 - (ii) in any other case, for twenty working days;
 - (b) it is a contract of the type described in regulation 20(8) above in respect of which the conditions set out in regulation 20(9) above have been satisfied; or
 - (c) it is a transaction to which regulation 22A(1) above applies.
- (4) Rights in respect of a contract or asset whose effect is that of a derivative contract to which regulation 30 above applies shall—
- (a) where the asset is a security, be valued in accordance with regulation 26 above;
 - (b) where the asset comprises units or other beneficial interests in a collective investment scheme, be valued in accordance with regulation 27 above; and
 - (c) where the asset is a debt or other right, be valued in accordance with regulation 23 above.
- (5) Rights in respect of a contract or asset whose effect is that of a derivative contract to which regulation 30 above does not apply shall have a value determined in accordance with regulation 23(8) above.
- (6) For the purposes of determining whether a contract or asset has the effect of a derivative contract to which regulation 30 applies, it shall be deemed to have the effect of a derivative contract which is listed or transacted with an approved counterparty if it is itself listed or so transacted.”.

Assets to be taken into account only to a specified extent

15. For regulation 32 of the 1994 Regulations (assets to be taken into account only to a specified extent) substitute—

“Assets to be taken into account only to a specified extent

32.—(1) Subject to paragraphs (5) to (7) below, the aggregate value of the assets of a society as determined in accordance with this Part of these Regulations shall, for any of the purposes for which this Part of these Regulations apply, be reduced by an amount representing the aggregate of—

- (a) the amount by which the society is exposed to assets of any description in excess of the permitted asset exposure limit for assets of that description;
- (b) the amount by which the society is exposed to a counterparty in excess of the permitted counterparty exposure limit for such counterparty;
- (c) the amount by which the society has an excess concentration with a number of counterparties;
- (d) the value of any assets transferred to or for the benefit of the society in pursuance of a condition in a derivative contract to which regulation 30 above does not apply or a related contract; and
- (e) the value of any assets transferred to or for the benefit of the society in pursuance of a contract whose effect is that of a derivative contract to which regulation 30 above does not apply or a related contract,

as determined in accordance with Schedule 5 to these Regulations.

(2) Where a society is exposed to assets of any description in excess of the permitted asset exposure limit for such assets, the reduction required to be made by paragraph (1)(a) above shall be made—

- (a) by deducting (as far as possible) the amount of the excess from the assets of that description held by the society; and
- (b) where the society does not hold sufficient assets of that description to eliminate the excess (or does not hold any assets of that description) by making an appropriate deduction from the aggregate value of the assets which the society would otherwise be permitted to take into account for any of the purposes for which this Part of these Regulations applies.

(3) Where a society is required to make a reduction in accordance with paragraph (1)(b), (c), (d) or (e) above, the reduction shall be made by making a deduction from the aggregate value of the assets which the society would otherwise be permitted to take into account for any of the purposes for which this Part of these Regulations applies.

(4) Where a society carrying on long term business has attributed assets partly to a long term business fund and partly to its other assets, any reduction required to be made by this regulation shall be made in the same proportion as the attribution.

(5) Assets of a society comprising—

- (a) approved securities or any interest accrued thereon;
- (b) debts to which regulation 23(3) applies;
- (c) rights to which regulation 23(4) applies;
- (d) debts in respect of premiums;
- (e) moneys due from, or guaranteed by, the government of any State which belongs to Zone A as defined in Council Directive [89/647/EEC](#) of 18th December 1989 on a solvency ratio for credit institutions;
- (f) shares in or debts due or to become due from a dependant falling within regulation 21 above;
- (g) holdings in a scheme falling within Council Directive [85/611/EEC](#) of 20th December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities; or
- (h) deferred acquisition costs

shall not be taken into account in any of the calculations described in paragraph (1) above.

(6) Where a society has entered into any contracts providing for the payment of index linked benefits, the provisions of paragraph (1)(a) above shall not apply to assets of that society to the extent that they are held to match liabilities in respect of such benefits.

(7) This regulation shall not apply to a registered friendly society to which neither section 37(2) nor (3) of the 1992 Act applies.”.

Interpretation: Part V

16.—(1) Regulation 33 of the 1994 Regulations (interpretation: Part V) shall be amended as follows.

(2) For the definition of “general business liabilities” substitute—

““general business liabilities” has the same meaning as in Part IV of these Regulations;”.

(3) After the definition of “general business liabilities” insert—

““insurance liabilities” means amounts calculated in accordance with this Part of these Regulations in respect of those items shown at C and D under the heading “Liabilities” in Part I of Schedule 2 to the Friendly Societies (Accounts and Related Provisions) Regulations 1994.”

Provision for adverse changes

17. For regulation 36 of the 1994 Regulations (provision for adverse changes) substitute—

“**36.**—(1) A society which has or may have (following the exercise of any right by the society or any other party) an obligation to which this regulation applies to deliver assets or make a payment shall—

- (a) at all times identify the assets held by it which it considers to be the most suitable to cover such obligation; and
- (b) make prudent provision for the effect on the amount of its excess assets of adverse variations between the value of the assets identified and the value of the assets which it is or may be obliged to deliver or the amount of the payment which it is or may be obliged to make.

(2) For the purposes of paragraph (1) above the society shall take into account all reasonably foreseeable adverse variations and shall have particular regard to past volatility in the value of the assets concerned (or assets of a similar nature) and the possibility of adverse changes in such volatility in the future.

(3) For the purposes of this regulation—

“linked assets” has the meaning given in regulation 19(1) above;

“property linked liabilities” has the meaning given in paragraph 2 of Schedule 5 to these Regulations; and

“the amount of its excess assets” means the difference between the aggregate value of its assets (other than linked assets to the extent that they are held to match property linked liabilities) determined in accordance with Part IV of these Regulations and the amount of its liabilities (other than property linked liabilities or liabilities for which provision is made in accordance with this regulation).

(4) Subject to paragraph (5) below, this regulation applies to an obligation—

- (a) under a contract relating to investments of the kinds mentioned in item B under the heading “Assets” in Part I of Schedule 2 to the Friendly Societies (Accounts and Related Provisions) Regulations 1994 (whether such contract constitutes an asset or liability of the society);
- (b) undertaken for the purposes of, or in connection with the making of, investments of the kind mentioned in sub-paragraph (a) above; or
- (c) under a contract providing for the purchase, sale or exchange of currency.

(5) This regulation shall not apply to a contract to the extent that it relates to, or is for the purposes of the making of an investment in, or is in connection with the making of an investment in, a building which is to be occupied by the society and used by the society for the conduct of its business.”

General business liabilities

18. For regulation 37 of the 1994 Regulations (general business liabilities) substitute—

“General business liabilities

37. The amount of insurance liabilities which are general business liabilities shall be determined in accordance with the rules set out in Part VI of Schedule 6 to the Friendly Societies (Accounts and Related Provisions) Regulations 1994.”.

Long term liabilities

19. In regulation 38(3) of the 1994 Regulations (long term business), after sub-paragraph (d), add the following sub-paragraph—

“(e) any rights under contracts of reinsurance in respect of long term business.”.

Rates of interest

20. In paragraph (3) of regulation 43 of the 1994 Regulations (rates of interest) for sub-paragraph (b) substitute—

“(b) the future income from the asset required to be taken into account (whether interest, dividends or repayment of capital) shall be reduced by a proportion corresponding to such part of any excess exposure to assets of that description, calculated in accordance with paragraph 13 of Schedule 5 to these Regulations, as may reasonably be attributed to such assets.”.

Expenses

21. In paragraph (1) of regulation 45 of the 1994 Regulations (expenses) omit the word “existing”.

Linked long term contracts

22.—(1) Regulation 51 of the 1994 Regulations (linked long term contracts) shall be amended as follows.

(2) In paragraph (1) for “paragraph 16” substitute “paragraph 17”.

(3) In paragraph (4) omit sub-paragraph (a).

Interpretation: Part VII

23. In regulation 53 (interpretation: Part VII), after paragraph (a), insert the following paragraph—

“(aa) “gross claims” means the amount paid in respect of claims, including reinsured amounts;”.

Insurance statistics: member States

24. In regulation 56(2) (statistics in respect of general business) for the words “gross premiums receivable” substitute “gross premiums receivable, commissions attributable to those premiums and gross claims”.

Schedule 2

25.—(1) Paragraph 1 of Schedule 2 to the 1994 Regulations (general business solvency margin: first method of calculation (premium basis)) shall be amended as follows.

(2) After the definition of “gross premiums” insert—

““incepted” refers to the time when the liability to risk of a society under a contract of insurance commenced and, for this purpose, a contract providing continuous cover shall be deemed to commence on each anniversary date of the contract;”.

(3) For the definition of “receivable” substitute—

““receivable” in relation to a society, a financial year and a premium means due to the society in respect of contracts of insurance incepted during that financial year, whether or not the premium is received during that financial year.”.

Schedule 5

26. For Schedule 5 to the 1994 Regulations (assets to be taken into account only to a specified extent) substitute Schedule 5 as set out in Schedule 1 to these Regulations.

Schedule 6

27. For Schedule 6 to the 1994 Regulations (permitted links), substitute Schedule 6 as set out in Schedule 2 to these Regulations.

Transitional provision

28. Notwithstanding regulation 22 above, regulation 51 of the 1994 Regulations shall continue to apply to contracts entered into before the commencement of these Regulations as if regulation 22 above had not been made.

In witness whereof the common seal of the Friendly Societies Commission is hereunto fixed, and is authenticated by me, a person authorised under paragraph 13 of Schedule 1 to the Friendly Societies Act 1992 on 2nd December 1996.

L.S.

Michael Cook
Secretary to the Commission

We consent to regulations 1, 4–22 and 25–28.

Bowen Wells
Roger Knapman
Two of the Lords Commissioners of Her
Majesty’s Treasury

6 December 1996

SCHEDULE 1

Regulation 26

[SCHEDULE 5 TO THE 1994 REGULATIONS] ASSETS TO BE TAKEN INTO ACCOUNT ONLY TO A SPECIFIED EXTENT

PART I

EXCESS EXPOSURE: METHOD OF CALCULATION

1. Unless the context requires otherwise, words and expressions used in this Schedule bear the same meanings as in Parts IV and V of these Regulations.

2. For the purposes of this Schedule—

“business amount” means—

- (a) for a society carrying on only general business, the general business amount;
- (b) for a society carrying on only long term business, the long term business amount;
- (c) for a society carrying on both general business and long term business, in the case of its general business assets, the general business amount and in the case of its long term business assets, the long term business amount;

“connected company” of any company means—

- (a) that company’s holding company;
- (b) a subsidiary of that company;
- (c) a subsidiary of the holding company of that company;

and references to “subsidiary” and “holding company” shall have the same meanings as they have in section 96 of the 1982 Act⁽¹⁰⁾;

“counterparty” in relation to a society means—

- (a) any one individual;
- (b) any one unincorporated body of persons;
- (c) any one company not being a member of a group;
- (d) any group of companies excluding any companies within the group which are dependants of the society; or
- (e) any government of a State together with all the public bodies, local authorities or nationalised industries of that State,

in which the society has made investments or against whom it has rights whether in pursuance of a contract entered into by the society or otherwise; and references to dealings with or by a counterparty includes dealings with or by any person or body of persons included within the definition of counterparty;

“counterparty exposure” means the aggregated value determined in accordance with paragraph 14 below;

“debts due or to become due” includes any debts which would become due if the society were to exercise any right to which it is entitled to require payment or repayment of the same;

“diversified contract for differences” means a contract for differences whose value does not depend to a significant extent on fluctuations in the value of, or the income from, assets of

⁽¹⁰⁾ These definitions were amended by section 30 of, and Schedule 2 to, the Companies Consolidation (Consequential Provisions) Act 1985 (1985 c. 9) and article 23 of, and Part II of Schedule 1 to, the Companies Consolidation (Consequential Provisions) (Northern Ireland) Order 1986 (S.I. 1986/1035).

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any of the descriptions in paragraphs 19 to 28, 30 or 32 to 38 of Part II of this Schedule and “undiversified contract for differences” shall be construed accordingly;

“excess concentration with a number of counterparties” has the meaning given in paragraph 18 below;

“general business amount” means the aggregate of the society’s insurance liabilities (net of reinsurance) in respect of general business and an amount equal to whichever is the greater of 225,000 ECU or 20 per cent. of the general premium income;

“group” has the meaning given in section 262(1) of the Companies Act 1985⁽¹¹⁾;

“index linked liabilities” means insurance liabilities in respect of index linked benefits;

“insurance liabilities” means amounts calculated in accordance with Part V of these Regulations in respect of those items shown at C and D under the heading “Liabilities” in Part I of Schedule 2 to the Friendly Societies (Accounts and Related Provisions) Regulations 1994;

“long term business amount” means the amount of the society’s insurance liabilities in respect of long term business (net of reinsurance ceded and excluding property linked liabilities), together with—

- (a) the amount of the required margin of solvency (or the amount of the minimum guarantee fund if greater) determined in accordance with regulations 4 to 6 and Schedule 1 above less the amount of any implicit item valued in accordance with regulations 9 to 11 of these Regulations; and
- (b) the amount of any deposit-back in connection with a contract of reinsurance in respect of long term business;

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

“permitted asset exposure limit” has the meaning given in paragraph 3 of this Schedule;

“permitted counterparty exposure limit” has the meaning given in paragraph 4 of this Schedule;

“property linked liabilities” means insurance liabilities in respect of property linked benefits;

“readily realisable” in relation to a listed investment means a listed investment in respect of which regulation 26(4) does not apply or, by virtue of regulation 26(5), is to be taken not to apply;

“short term deposit” means a sum of money which may be withdrawn at the discretion of the lender without penalty or loss of accrued interest by giving notice of withdrawal of one month or less.

3. The permitted asset exposure limit for assets of any of the descriptions in any paragraph of Part II of this Schedule is the percentage of the business amount set out opposite that paragraph. In the case of an asset which is not covered by any of the descriptions in Part II of this Schedule (other than a derivative contract) the permitted asset exposure limit is nil.

4. The permitted counterparty exposure limit is—

- (a) where the counterparty is an individual or an unincorporated body of persons, 5 per cent. of the business amount;
- (b) where the counterparty is a counterparty of the type mentioned in sub-paragraph (e) in the definition of counterparty, 5 per cent. of the business amount;
- (c) where the counterparty is a body corporate or group, each of—
 - (i) 20 per cent. of the business amount;

(11) 1985 c. 6; section 262 was inserted by section 22 of the Companies Act 1989 (c. 40).

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- (ii) 10 per cent. of the business amount where the exposure arises otherwise than by reason that debts are due, or are to become due, as a result of short term deposits made with an approved credit institution; and
- (iii) 5 per cent. of the business amount where the exposure is other than to bodies which are approved counterparties.

Calculation of exposure to assets

5. A value shall be ascribed to assets of each description which shall be an amount determined in accordance with the provisions of Part IV of these Regulations or, where the assets are of a description for the valuation of which no provision is made in Part IV of these Regulations, an amount which would reasonably be paid by way of consideration for an immediate assignment or transfer of such assets. The amount by which the society is exposed to assets of each description shall be determined by adjusting the value of the assets in accordance with paragraphs 6 to 12 below.

Adjustments in respect of futures contracts

6. The value ascribed under paragraph 5 above in respect of assets of each description shall be increased or decreased by the value of assets of that description which the society is deemed to have acquired or disposed of pursuant to a futures contract.

7. For the purposes of paragraph 6 above, the society shall be deemed to have acquired or disposed of assets pursuant to a futures contract if, at the relevant date, it has entered into (and not closed out) a futures contract which—

- (a) provides for the acquisition of assets by the society; or
- (b) is listed and provides for the disposal of assets by the society; or
- (c) is not listed but provides for the disposal of assets by the society to an approved counterparty and it is prudent to assume that such disposal will take place within one year of the relevant date.

Adjustments in respect of options

8. The figure arrived at under paragraphs 5 to 7 above in respect of assets of each description shall be increased or decreased by the value of assets of that description which the society is deemed to have acquired or disposed of pursuant to an option.

9. For the purposes of paragraph 8 above, the society shall be deemed to have acquired or disposed of assets pursuant to an option if, at the relevant date, it is a party to an option and it is prudent to assume that the option will be exercised and the option is one which—

- (a) provides for the acquisition of assets by the society; or
- (b) is listed and provides for the disposal of assets by the society; or
- (c) is not listed but provides for the disposal of assets by the society to an approved counterparty and it is prudent to assume that such disposal will take place within one year of the relevant date.

Adjustments in respect of initial margins

10. The figure arrived at under paragraphs 5 to 9 above in respect of assets of each description shall be increased by an amount representing the value of any assets of that description which have been transferred by the society by way of initial margin.

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Adjustments in respect of an undiversified contract for differences or a contract or asset having the effect of a derivative contract

11. The amount arrived at in accordance with paragraphs 5 to 10 above shall be increased or decreased by an amount representing the value of assets which the society is deemed to have acquired or disposed of under—

- (a) an undiversified contract for differences; or
- (b) a contract or asset other than a diversified contract for differences which has the effect of a derivative contract.

12. For the purposes of paragraph 11 above, the society shall be deemed to have achieved the effect of such contract by entering into appropriate futures contracts or options. The assets deemed to be acquired or disposed of shall be dealt with in accordance with the provisions in paragraphs 6 and 8 respectively.

Excess asset exposure

13. The amount by which the society is exposed to assets of a particular description in excess of the permitted asset exposure limit shall be calculated by subtracting the permitted asset exposure limit for assets of that description from the corresponding amount of the exposure, calculated in accordance with paragraphs 5 to 12 above. For this purpose, exposure to assets shall be excluded to the extent that such exposure has caused the recognition of excess exposure to assets of a different description. If the figure arrived at is negative, it shall be taken to be zero.

Calculation of exposure to a counterparty

14. Subject to paragraphs 15 and 16 below, the value of all investments (determined in accordance with regulation 26 above) issued by any one counterparty and the value of all rights (determined in accordance with regulations 23, 30 and 31 above) against that counterparty, in each case up to the amount of the appropriate permitted asset exposure limit, shall be aggregated. Where the counterparty is an issuer of a collective investment scheme falling within regulation 27(1)(c) above, the value of units or other beneficial interest in the collective investment scheme shall be included.

15. Where a society has rights in respect of an obligation to be fulfilled by a counterparty and—

- (a) the obligation is a secured obligation which—
 - (i) is secured by cash deposited with, or a letter of credit established with, or securities issued by, or a guarantee provided by, an approved credit institution or an approved financial institution; and
 - (ii) is due to be fulfilled within 12 months of the relevant date; or
- (b) the obligation is a secured obligation which is secured by listed securities which are readily realisable or by approved securities which in either case—
 - (i) have been deposited with an approved credit institution, an approved financial institution or an approved investment firm; and
 - (ii) are beneficially owned by the counterparty but will not be available for the benefit of creditors generally in the event of the winding-up of the counterparty,

the aggregation required by paragraph 14 above need not include the value of such rights.

16. If the society has liabilities to the counterparty which may be offset against the above-mentioned assets in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for societies, then such liabilities may be offset for the purposes of the aggregation required by paragraph 14 above.

Excess counterparty exposure

17. The amount by which the society is exposed to a counterparty in excess of the permitted counterparty exposure limit shall be calculated by subtracting from the amount of the exposure to such counterparty the amount of the permitted counterparty exposure limit for such counterparty. If the figure arrived at is negative, it shall be taken to be zero. If the society is exposed to a counterparty in excess of the permitted counterparty exposure limit in more than one of the circumstances set out in sub-paragraph (c) of paragraph 4 above, it shall make the deduction required under regulation 32(1)(b) above only in respect of the circumstances leading to the greatest excess exposure.

Excess concentration with a number of counterparties

18. Where there is exposure to a counterparty of the type mentioned in paragraph 4(c)(ii) above, 40 per cent. of the business amount shall be deducted from the aggregate of such exposures. The amount so arrived at shall be the excess concentration with a number of counterparties. Where this amount is negative, it shall be taken to be zero. For the purposes of this paragraph—

- (a) exposure to a counterparty shall be taken into account only up to the level of the permitted counterparty exposure limit for that counterparty;
- (b) exposure to a counterparty shall not be taken into account if it does not exceed 5 per cent. of the business amount; and
- (c) exposure to a counterparty shall not be taken into account if the corresponding permitted counterparty exposure limit does not exceed 5 per cent. of the business amount.

PART II

DESCRIPTION OF ASSET AND CORRESPONDING BUSINESS AMOUNT

19. A piece of land or a number of pieces 5%
of land (or an interest in such pieces of land)
to which in the most recent proper valuation of
such pieces of land an aggregate value is ascribed
which is greater than the aggregate of the value
of each of such pieces of land valued separately

20. A reversionary interest or a remainder not 1%
falling within paragraph 19 above

21. All debts due or to become due from 1%
any one individual (other than an individual
who is connected with the society within the
meaning of section 31(5) of the 1982 Act⁽¹²⁾,
being debts which are fully secured on any
dwelling or any land appurtenant (or in Scotland,
appertaining) thereto owned or to be purchased
by the individual and used or to be used by him
for his own residence

22. All debts due or to become due from ¼%
any one individual, other than debts specified in
paragraph 21 above

⁽¹²⁾ Section 31(5) was amended by regulation 5 of the Insurance Companies (Amendment) Regulations 1994 (S.I. 1994/3132).

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23. All unsecured debts (other than debts 1% arising under the terms of debt securities or debts from a regulated institution) due or to become due from any one counterparty other than an individual, body corporate or group

24. All unsecured debts (other than debts 1% arising under the terms of debt securities or debts from a regulated institution) due or to become due from any one company, taken together with all such debts due or to become due from a connected company of that company

25. All unsecured debts (other than debts 2½% arising under the terms of debt securities or debts from an approved counterparty) due or to become due from any one regulated institution, taken together with (where that institution is a company) all such debts due or to become due from a connected company of that institution

26. All debts, other than debts arising under 5% the terms of debt securities, due or to become due from any one counterparty which is not an approved counterparty taken together with all such debts due or to become due from any connected company (other than an approved counterparty) of that counterparty

27. All debts, other than short-term deposits 10% with an approved credit institution or debts arising under the terms of debt securities, due or to become due from any one approved counterparty, taken together with all such debts due or to become due from any connected company of that approved counterparty

28. All debts due or to become due from 20% an approved credit institution (or a connected company of that institution) taken together

29. The aggregate of debts of the descriptions 5% in paragraphs 22, 23 and 24 above

30. All investments of a kind which may be valued in accordance with regulation 26 of these Regulations (other than secured debt securities, debt securities issued by a regulated institution or investments which are listed and readily realisable) issued by any one issuer taken together with—

a) all units or other beneficial interests in 1% a collective investment scheme falling within regulation 27(1)(c) above issued by that issuer; and with

b) all investments of the kinds mentioned in this paragraph issued by a connected company of that issuer

31. The aggregate of assets of any of the 10% descriptions in paragraphs 20 and 30 above

32. All shares issued by any one issuer taken 2½% together with all such securities issued by a connected company of that issuer

33. All securities issued by any one issuer 5% which is not an approved counterparty taken together with (where that issuer is a company) all securities issued by a connected company, other than an approved counterparty, of that issuer

34. All securities issued by any one 10% counterparty

35. All holdings in any one authorised unit 5% trust scheme or recognised scheme

36. All cash 3%

37. All computer equipment 5%

38. All office machinery (other than 2½% computer equipment) taken together with all furniture, motor vehicles and other equipment

SCHEDULE 2

Regulation 27

[SCHEDULE 6 TO THE 1994 REGULATIONS] PERMITTED LINKS

PART I

DESCRIPTIONS OF PROPERTY BY REFERENCE TO WHICH BENEFITS MAY BE DETERMINED

- 1.** Listed securities which are readily realisable, not being securities which are—
 - (a) approved securities;
 - (b) loans or deposits of the kinds mentioned in paragraph 4 or 7 below;
 - (c) units or other beneficial interests in a collective investment fund; or
 - (d) derivative contracts.
- 2.** Unlisted securities which are readily realisable, not being securities which are—
 - (a) approved securities;
 - (b) loans or deposits of the kinds mentioned in paragraph 4 or 7 below;
 - (c) units or other beneficial interests in a collective investment fund; or
 - (d) derivative contracts.

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3. Land (including any interest in land) in an EEA State, Australia, Canada, the Channel Islands, Gibraltar, Hong Kong, the Isle of Man, New Zealand, the Republic of South Africa, Singapore or the United States of America.

4. Loans—

- (a) which are fully secured by mortgage (or in Scotland, by standard security) or charge on land (or any interest in land) which—
 - (i) is situated in any of the countries specified in paragraph 3 above, and
 - (ii) in the case of a loan made to a person other than a body corporate, is not used wholly or mainly for domestic purposes, and
- (b) in relation to which the rate of interest and the due dates for the payment of interest and the repayment of principal can be fully ascertained from the terms of any agreement relating to the loan.

5. Units or other beneficial interests in—

- (a) a scheme falling within Council Directive [85/611/EEC](#) of 20th December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities;
- (b) a collective investment fund which satisfies the following conditions—
 - (i) the property of the fund comprises property of any of the descriptions in paragraphs 1 to 10 of this Schedule;
 - (ii) the units are readily realisable at a price which represents the net value per unit of the assets and liabilities of the fund; and
 - (iii) the price at which the units may be bought and sold is published regularly.

6. Approved securities.

7. Loans to or deposits with an approved credit institution, an approved financial institution or an approved investment firm.

8. Income due, or to become due, in respect of property of any of the descriptions specified in the foregoing paragraphs of this Schedule.

9. Permitted derivative contracts.

10. Cash.

11. Units, by whatever name called, in a real or notional fund (not being a scheme or undertaking of a kind mentioned in paragraph 5 above) which is limited to the descriptions of property mentioned above, not being property falling within sub-paragraphs (a) to (d) of paragraph 17 below, and which under the contract is to be managed either—

- (a) wholly by the society; or
- (b) wholly or to any extent by another person being a person for whose acts and omissions in managing the fund the society assumes responsibility towards the policyholder as if they were the acts or omissions of the society, and otherwise (if at all) by the society.

PART II

INDICES BY REFERENCE TO WHICH BENEFITS MAY BE DETERMINED

12. An approved index.

PART III

INTERPRETATION

13. Unless the context otherwise requires, words or expressions contained in this Schedule bear the same meaning as in Part IV of these Regulations.

14. For the purposes of this Schedule, “approved index” means either—

- (a) an index which is—
 - (i) calculated independently;
 - (ii) published at least once every week;
 - (iii) based on constituents, each of which is property falling within paragraphs 1 to 8 or 10 above; and
 - (iv) calculated on a basis which is made available to the public and which includes both the rules for including and excluding constituents and the rules for valuation which must use an arithmetic average of the value of the constituents; or
- (b) a national index of retail prices published by or under the authority of a government of a State belonging to Zone A as defined in Council Directive [89/647/EEC](#) of 18th December 1989 on a solvency ratio for credit institutions; or
- (c) an index which is—
 - (i) based on constituents, each of which is property falling within paragraphs 1 to 8 or 10 above; and
 - (ii) in respect of which a derivative contract is listed.

15.—(1) For the purposes of this Schedule, “permitted derivative contract” means a derivative contract which—

- (a) is covered and—
 - (i) is held in connection with property of the type described in paragraph 15(2) below for the purposes of reduction of investment risks or efficient portfolio management; or
 - (ii) has the effect of a permitted derivative contract held in connection with such property for such purposes; and
 - (b) satisfies the conditions in regulation 30(6) to (8) above except that for this purpose the references in regulation 30 to “an asset for the valuation of which provision is made in this Part of these Regulations” shall be construed as a reference to permitted connected property.
- (2) The property described in this paragraph is either—
- (a) permitted connected property, not being a contract or asset having the effect of a derivative contract; or
 - (b) a permitted derivative contract or a contract or asset having the effect of a permitted derivative contract either of which when taken together with the permitted derivative contract mentioned first in paragraph 15(1) above has the effect that the society holds either permitted connected property or a permitted derivative contract in connection with such property.
- (3) For the purposes of this paragraph—
- (a) a derivative contract shall be deemed to be covered if it would not require a significant provision (within the meaning of regulation 30(4)) to be made in respect of it pursuant to regulation 36 of these Regulations if it were a derivative contract to which Part IV of these Regulations applied; and

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- (b) “permitted connected property” means property of any of the descriptions in paragraphs 1 to 8 or 10 above and which is not property falling within paragraph 17(a) to (d) below.

16. In this Schedule—

“collective investment fund” includes a collective investment scheme; and

“readily realisable”, in respect of an investment, has the meaning set out in paragraph 2 of Schedule 5 to these Regulations.

PART IV

RESTRICTIONS ON DETERMINATION OF BENEFITS BY REFERENCE TO PROPERTY DESCRIBED IN PART I

17. Benefits payable under any contract to which regulation 51 applies shall not be determined by reference to—

- (a) property of any of the descriptions specified in paragraphs 2, 5(b) and 7 above if the value of such property is determined, either wholly or partly, by reference to the value of, the income from, fluctuations in the value of or fluctuations in the income from, property other than property of the descriptions in Part I of this Schedule;
- (b) property of the description specified in paragraph 2 above in excess of 10 per cent. of the aggregate property linked benefits under the contract;
- (c) property of the description specified in paragraph 5(b) above which in aggregate value exceeds 10 per cent. of the property linked benefits, unless the contract under which the benefits are payable has been marketed in accordance with any legal restrictions which apply to the marketing of the corresponding collective investment fund; or
- (d) property of any of the descriptions specified in Part I of this Schedule which has the effect of a derivative contract other than a permitted derivative contract.

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations make amendments to Parts II to VII of the Friendly Societies (Insurance Business) Regulations 1994. They principally concern the valuation of assets and the determination of liabilities of societies for the purposes of the Friendly Societies Act 1992. They also amend Schedule 2 to the 1994 Regulations, concerning the determination of the required margin of solvency in respect of general business (*regulation 25*), regulation 51 of those Regulations, concerning the methods by which benefits payable to policyholders under linked long-term contracts of insurance may be determined (*regulations 22 and 27*), and regulations 53 and 56, concerning insurance statistics (*regulations 23 and 24*).

Regulations 2 and 3 further implement the Agreement on the European Economic Area signed at Oporto on 2nd May 1992 (O.J. No. L1, 3.1.94, p. 3) as adjusted by the Protocol signed at Brussels on 17th March 1993 (O.J. No. L1, 3.1.94, p. 572) by substituting for references to the “European

Community” in regulations 17 and 18 (governing localisation of assets and exclusions from the matching and localisation rules) references to the European Economic Area.

Regulations 4 and 5 update the provisions for interpretation of Part IV, largely as a consequence of the changes to that Part.

Regulation 6 makes drafting changes to regulation 20 and new provision concerning the treatment under Part IV of contracts for the conversion of currency.

Regulation 8 introduces a new regulation 22A dealing with the valuation of certain sale and repurchase transactions.

Regulation 9 substitutes a new regulation 23, concerning the valuation of debts and other rights owed to a society. The main change is the introduction of provision for the treatment of “initial margin”.

Regulation 10 substitutes a new regulation 26 for the valuation of securities and beneficial interests in limited partnerships.

Regulation 11 substitutes a new regulation 27 for the valuation of beneficial interests in collective investment schemes.

Regulation 12 substitutes a new regulation 28 for the valuation of deferred acquisition costs.

Regulation 13 substitutes a new regulation 30 dealing with the valuation of derivative contracts.

Regulation 14 substitutes a new regulation 31 dealing with contracts and assets having the effect of derivative contracts.

Regulation 15 substitutes a new regulation 32 dealing with the extent to which certain assets can be taken into account for the purposes of valuation.

Regulations 16 and 18 make minor changes to regulations 33 and 37 concerning the treatment of general business liabilities.

Regulation 17 substitutes a new regulation 36 making provision for adverse changes.

Regulations 23 and 24 further implement the Third Life Directive (Council Directive [92/96/EEC](#) on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives [79/267/EEC](#) and [90/619/EEC](#) (O.J. No. L360, 9.12.92, p. 1)) and the Third Non-Life Directive (Council Directive [92/49/EEC](#) on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and amending Directives [73/239/EEC](#) and [88/357/EEC](#) (O.J. No. L228, 11.8.92, p. 1)) so as to require societies to produce statements of commissions and gross claims (in addition to gross premiums).

Regulation 26 substitutes a revised Schedule 5 which makes provision for the calculations required by regulation 32.

Regulation 27 substitutes a revised Schedule 6 concerning the property and values which may be used for the determination of policyholder benefits under linked long-term contracts.

Regulation 28 makes transitional provision preventing the amendments made by the Regulations to regulation 51 (linked long term contracts) from applying to contracts entered into before the commencement of the Regulations.

Compliance Costs

Compliance Cost Assessments were prepared in respect of the Friendly Societies Act 1992 (Amendment) Regulations 1994, the Friendly Societies (Insurance Business) Regulations 1994 and the Friendly Societies (Accounts and Related Provisions) Regulations 1994 and copies are available from the Secretary, Friendly Societies Commission, 15 Great Marlborough Street, London W1V 2LL. These assessments concluded that the cost impact of the Regulations was broadly neutral. These Regulations will not impose any new burden on business, and a further Compliance Cost Assessment has not been prepared.

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