STATUTORY REGULATION OF SHORT TERM BUSINESS

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September 1982

1. Introduction

1.1 The law in the United Kingdom has evolved over the centuries into its present mixture of Common Law and Statute Law. Common Law is an "unwritten law", although not unnaturally its rules are to be found in law reports. Statute Law has been enacted by legislation and overrides Common Law. Both laws are dependent for their interpretation on precedent set by court judgements. Inasmuch as UK law is only partially codified, it differs from the systems in other countries such as France and South Africa which are based on the fully codified Roman Law.

1.2 Insurance comes into being when there is a valid contract between the Insurer and the Insured. The law relating to contracts of insurance follows part of the general law of contract. The general principle is that every contract entered into should be enforceable irrespective of the subject matter unless it is either illegal, immoral or contrary to public policy. Illegality can arise by statute or under Common Law. Immorality and public policy may be capable of different interpretations and may vary from time to time. Examples of the latter are contracts to commit crimes and contracts which interfere with the administration of justice.

1.3 This monograph is concerned with the statutory regulation of short-term business. It covers regulatory aspects affecting the contract of insurance and regulation of the insurer. It does not cover tax legislation.

1.4 With its lack of codification, the development of statutory regulation in the UK has been one of reaction to adverse events or to threats of adverse events. As a result the current legislation may be criticised as being somewhat haphazard and with a certain lack of cohesion. The bulk of the legislation has been directed towards the protection of the consumer by:

(i) establishing financial and other constraints on insurers to try to ensure their solvency and their ability to meet their contractual obligations

(ii) controlling the type of product that can be sold

(iii) controlling the way in which the product is sold

(iv) establishing contingency arrangements for ensuring or trying to ensure that contracts are met even if the insurer is insolvent.

Regulations in the UK have not, unlike in some countries, been directed towards price control, i.e. the control of premium rates.

2. A short history

2.1 Until the eighteenth century, common law governed the undertaking of insurance. With certain exceptions, such as fraudulent and excessive gambling and betting on games and sports, no statute law had been introduced. The first statutory restriction on the transaction of insurance business was the Marine Insurance Act 1745. This was a reaction to the concern felt at the time on wager policies; the Act prohibited the issue of certain types of wager policies. A wager policy was one amounting to little more than a wager where the policyholder had no insurable interest (i.e. a pecuniary interest in the event giving rise to a loss). This Act was repealed and replaced by the Marine Insurance Act 1906. Much of this Act is still in force and codifies the law relating to the transaction of marine insurance. This separate legislation for marine business is a major reason why different traditions, conventions and terminology exist between marine and non-marine insurance, with much of the archaic language used in marine business traceable to this Act.

2.2 Other classes of non-life insurance were left unregulated or did not exist (e.g. motor, aviation), although 'insurable interest' for non-life business was established, paradoxically, through the Marine Insurance Act 1788, Life Assurance Act 1774 and Gaming Act 1845, all of which are still in force.

2.3 Insurance companies were left uncontrolled until 1870, when a Life Assurance Companies Act was introduced following the financial difficulties of two life companies, the Albert and the European. This Act, although restricted to life insurance, was an important landmark in that it established the basis of supervision in the UK which, subject to amendments in later years, has regulated the industry ever since. It established the form of supervision which has sometimes been referred to as "freedom with publicity". The supervisory role has been entrusted with what used to be called the Board of Trade and is now the Department of Trade. This contrasts with many other territories where supervision is by the Finance Ministry or Insurance Commissioners.

2.4 The development of legislation in the UK then followed the aim of preserving as much freedom as possible in day to day operations, subject to the publication of sufficient information about each insurance company to enable others to judge its progress and stability. This contrasts with developments in many other countries where the State seeks to achieve the financial stability of insurers by detailed regulation of operational matters such as the control of their investments, policy conditions, premium rates and valuation bases. In recent years some of these traditional UK freedoms have come under scrutiny and in some circumstances have been modified.

2.5 The writing of employers' liability business was restricted by a 1907 Act to companies which had deposited £20,000 into court. This and the 1870 Act were replaced by the Assurance Companies Act 1909 which, again despite its name, also extended the deposit system to fire and accident business. This and further legislation extended the coverage of the legislation to motor business (1930), aviation (1936) and marine and transit business (1946). By 1946 the deposit system changed to a solvency margin requirement of the greater of £50,000 or 10% of annual premium. The various previous Acts were consolidated in 1958 under an Insurance Companies Act.

2.6 There was some concern in the early 1960's with a number of small motor insurers getting into trouble. Part II of the Companies Act 1967 introduced more stringent provisions to try to ensure their solvency, including powers for preventing unfit persons from being associated with insurance companies, giving the appropriate Secretary of State (i.e. the minister responsible for the Department of Trade) power to intervene in the affairs of companies and to control investments, to require investments to be maintained in the UK or to be held in the custody of an approved person. The 1967 Act introduced the phrases 'short-term business' and 'long terms business' for the first time with the latter covering:

(i) ordinary long-term business, i.e. life assurance and annuity contracts, capital redemption contracts and sickness and accident contracts of not less than five years term

(ii) industrial assurance business

This legislation also established enabling powers for regulations to be made on the format of the accounts and forms to be deposited with the Department of Trade. The resultant regulations were produced in 1968 as the Insurance Companies (Accounts and Forms) Regulations and were subject to a number of amendments over the next 12 years. They have now been completely replaced by the Insurance Companies (Accounts and Statements) Regulations 1980, which have in turn been amended.

2.7 Problems related to the solvency of motor insurers and the inability of the legislation to cope with the emergence of linked life insurance led to the Insurance Companies Amendment Act 1973. The Government took powers to extend its financial controls over insurance companies and to control the conduct of business in certain respects. In addition to extending still further the provisions for not allowing unfit persons to control insurance companies and the powers of intervention by the Secretary of State, the Act provided for a legal separation of assets and liabilities attributable to long-term business. The 1973 Act and the Acts of 1958 and 1967 were consolidated (with one or two minor exceptions) into a single Act, the Insurance Companies Act 1974.

2.8 The entry into the EEC in 1969 meant that no longer could the UK regulate its insurance industry without regard to the manner in which the industry is regulated in other member states. The attempt to harmonise the laws relating to insurances has proved a long drawn out procedure and is still a long way from being completed. The member States of the EEC draw up Directives which, when agreed by the Member States, require the various Member States to draw up legislation within a certain time period to give effect to that Directive. In the UK the legislation can be by regulation under the European Communities Act 1972, which gives enabling powers to the appropriate Secretary of State. Alternatively, the legislation can be by Act of Parliament.

2.9 The aim of the EEC in respect of its moves to co-ordinate the regulation of insurance is to permit the freedom of establishment (e.g. the right of a UK insurer to set up a branch or subsidiary in another member state) and the freedom to provide services (e.g. the right of a UK insurer to transact business in another member state even though it may not be established there).

The Directives that have been passed to date are colloquially known as:

(i) the Non-Life Establishment Directive

(ii) the Reinsurance Directive

(iii) the Coinsurance Directive

(iv) the Life Directive.

There has been substantial discussion on a draft Non-Life Services Directive, but there appears, as at August 1982, that there are substantial problems that have to be resolved before the draft can be enacted.

2.10 Over the years there have been very few statutes which have been introduced making certain forms of insurance compulsory. The two major forms of compulsory insurance are for liability to third parties under:

(i) the Road Traffic Act 1972, and

(ii) the Employers' Liability (Compulsory Insurance) Act 1969.

In addition there are other Acts covering third party insurance for nuclear installations and riding establishments.

3. <u>The Insurance Companies Acts 1974-82</u>

3.1 The 1974 Insurance Companies Act was mainly a consolidating Act. Normally an Act of Parliament can be amended only by another Act, e.g. subsequent Insurance Companies Acts. However, regulations under the enabling European Communities Act modified the 1974 Act for various aspects of EEC directives relating to non-life insurance, other than reinsurance. The 1981 Insurance Companies Act was primarily introduced to implement the requirements of the Life Directive directly and to provide the enabling legislation from which regulations follow. However, this Act also brought the previous modifications in directly and repealed the relevant regulations. The tradition in the UK has been for reinsurance companies to be supervised in a similar fashion to direct writing companies. This contrasts with the remainder of the EEC where more reliance has been placed on the supervision of the gross business of a direct insurer. The EEC directives refer only to direct business, and it is for this reason that the extension of the EEC rules to reinsurance has to be covered by an Act rather than regulations.

3.2 The 1974 and 1981 Acts have now been consolidated into the Insurance Companies Act 1982. There was also a 1980 Act which was purely a technical measure transferring the supervision of insurance companies in Northern Ireland from the Department of Commerce in Belfast to the Department of Trade in London.

3.3 An insurer with a head office in one country may, unless it sets up a subsidiary, transact business in another country through a branch. UK legislation now adopts the principle enshrined in the EEC directives which thrusts the main supervisory responsibility on to the head office's supervisor, provided the head office is in the EEC. There may be local supervision of a branch, albeit on a less stringent basis, e.g. the branch may be obliged to cover its local technical reserves with local assets, leaving the solvency margin requirement to be covered on a global basis by the head office. The application of this principle in the UK has resulted in the creation of three categories of insurers:

(i) a United Kingdom company, with a head office in the United Kingdom

(ii) a (non-UK) Community company, with a head office in the EEC, other than in the UK

(iii) an external company (but see 3.9)

Furthermore, because the EEC directives do not cover companies writing purely reinsurance business, there is a further category:

(iv) a pure reinsurer.

The requirements of the Insurance Companies Act and consequential regulations vary by category of insurer. Unless otherwise specified, this monograph relates to UK companies.

3.4 The 1982 Act, which now forms the main basis of the legislation for insurance companies and for various aspects of the conduct of insurance business. It is split into six parts.

PART I: Conditions for Authorisation

3.5 Insurance business can be carried on only by bodies which are authorised under Part I of the Act or are specifically exempted from being authorised by the Act. The exemptions are:

(i) Lloyd's (see section 9)

(ii) Friendly Societies

(iii) Provident or strike benefits of trade unions or employers' associations.

Authorisation will be given by the Insurance Division of the Department of Trade after the Division has investigated the financial position of the applicant and the fitness of its management. The DoT may reject an application for authorisation if the requirements set out in Part I of the Act are not met.

3.6 The DoT may issue an authorisation restricted to one or more classes of business. Until 1978 these classes of business were:

(i) ordinary long-term

(ii) industrial long-term

(iii) liability

(iv) marine, aviation and transport

(v) motor vehicle

(vi) pecuniary loss

(vii) personal accident

(viii) property

The short-term classes were changed in 1978 to line up with the seventeen classes appearing in the Non-life directive. The current Act reflects this so that the short-term business authorisation classes are:

1. Accident
2. Sickness
3. Land vehicles
4. Railway rolling stock
5. Aircraft
6. Ships
7. Goods in Transit
8. Fire and natural forces
9. Damage to property
10. Motor vehicles liability
11. Aircraft liability
12. Liability for ships
13. General liability
14. Credit
15. Suretyship
16. Miscellaneous financial loss
17. Legal expenses

3.7 The Act is concerned with insurance business yet, paradoxically, there is no precise definition of insurance business. There is one paragraph which confirms that insurance business includes the effecting and carrying out, unless by a bank, of contracts for fidelity bonds, performance bonds, administration bonds, customs bonds or similar contracts of guarantee (which are not merely incidential) in return for a payment of a premium. Insurance business also includes the provision of benefits in kind, such as the AA breakdown service, but these may be specifically excluded from the scope of the Act by regulation (see 6.5). The payment of a premium (which may not necessarily be given this name, e.g. in medical expense insurance it may be referred to as a contribution) is necessary to establish a contract as insurance business. It was to classify certain treaty reinsurance contracts as insurance that some rather confusing definitions and treatment of 'loss portfolios' and 'outstanding claim portfolios' appear in the legislation (see 5.6.7 and 5.6.9).

3.8 The authorisation issued to a company has to specify the classes of insurance which that company may undertake, with the possibility of an authorisation being restricted to reinsurance business. The application made by the company must be in a form prescribed by regulation and includes a financial plan and forecast. Following on from the EEC directive, no new composite companies are permitted, other than for reinsurance companies where the directive is not applicable.

3.9 An important condition of the authorisation of UK based insurers is that the directors, controllers, managers and main agents (i.e. agents with an authority from the insurer to enter contracts on its behalf without limit on the aggregate of premiums or beyond 10% of gross annual premiums) of the insurer are fit and proper persons, and an authorisation can be refused on these grounds if the Secretary of State for the Department of Trade thinks fit. As the supervision of Community companies is, in the first place, carried out by their own supervisor, the DoT has to seek confirmation from that supervisor that the insurer is authorised in that state. However, in respect of its UK operations, such a non-UK EEC company has to appoint a representative who is a UK resident and authorised to act for the insurer. The fit and proper person provision applies to this representative in addition to local UK officers of the branch. Representatives and similar fit and proper person provisions exist for external companies.

3.10 The external companies must additionally maintain surplus assets in the EEC. The minimum amount of such surplus assets and the manner of their deposit are subject for regulation. This leads to a further sub-categorisation of external companies:

(i) those transacting branch business only in the UK

(ii) those transacting branch business in both the UK and elsewhere in the EEC with the deposit maintained in a non-UK EEC country, i.e. a Community deposit company

(iii) as for (ii) but with the deposit maintained in the UK, i.e., a UK deposit company.

Again the legislation varies slightly by category.

3.11 The Department of Trade may withdraw an authorisation if a company:

(i) fails to meet any obligation as set out in the Act

(ii) would not have satisfied the authorisation requirements if a request for such an authorisation had been made; this means that for instance the fit and proper persons provisions will continue to apply after authorisation

(iii) loses its authorisation elsewhere in the EEC.

PART II

3.12 Part II of the 1982 Act is concerned with the regulation and obligations of insurance companies already authorised. One such obligation, introduced into the 1981 Act to accord with the EEC directive, was that an insurance company shall not carry on any activity otherwise than in connection with or for the purposes of its insurance business. The precise interpretation of this restriction is not yet entirely clear, but any activity may be carried on through a subsidiary.

3.13 A company must prepare each year accounts and statements in a form prescribed by regulations. The current set of regulations are described in section 5. These accounts and statements are in addition to the accounting requirements of the various Companies Acts.

3.14 The accounts and balance sheets, including any statements required (unless subject to a minor exception) must be audited. All accounts, and auditors statements must be deposited with the Department of Trade within six months of the financial year end. The deposited documents are available for public inspection, but each policyholder and shareholder has a right to receive directly a printed copy of the returns submitted. In practice most companies would make their returns freely available.

3.15 The Act requires that separate margins of solvency are maintained for both short-term and long-term insurance. The amount of these margins are prescribed by regulations (see section 6):

(i) a UK company or a pure reinsurer must maintain a "worldwide" margin of solvency

(ii) an external direct writing company must maintain both a "worldwide" margin of solvency and a UK margin of solvency relating to UK assets and liabilities. However if such companies operate elsewhere in the EEC (i.e. Community and UK deposit companies), the rules get more complex.

A company failing to cover the margin of solvency must:

(i) submit a plan for the restoration of a sound financial position

(ii) modify the plan if the above submission is considered inadequate

(iii) give effect to the approved plan.

3.16 The solvency regulations also specify a "guarantee fund" level which is lower than the minimum solvency margin. If a company fails to cover this level it must prepare, amend and get approval and effect a short-term financial plan. Failure to implement such a scheme gives the Department of Trade grounds for more positive intervention.

3.17 A non-UK Community company must ensure that the UK liabilities are adequately covered by identified assets which, subject to 3.18, need not be UK assets.

3.18 The EEC directive sets out requirements to cover the localisation and matching of assets and liabilities and the Act gives the DoT enabling power to make regulations on this subject. (See section 6.7).

3.19 Regulations may prescribe that an insurance company may not undertake a liability, the maximum amount of which is uncertain at the time the contract is entered into. To date no such regulations have been issued.

3.20 The DoT is empowered to intervene in the affairs of an insurance company if the company has failed to give proper information under the Act or if it has failed to satisfy any of its obligations under the Act in respect of such matters as authorisation, fitness of director, etc., or solvency. It may also intervene to protect policyholders or potential policyholders against the risk that the company may not meet its liabilities. The following restrictions may be imposed:

(i) the prohibition from making certain types of investment or the realisation of certain of its existing investments

(ii) the maintenance in the UK of assets equal to the whole or part of its domestic liabilities

(iii) the custody of some or all of the assets by a trustee who may not release them without the consent of the Secretary of State

(iv) the limitation of the premium income written by the company, either gross or net of reinsurance

(v) the acceleration of the normal information required by the accounting provisions of the Act

(vi) the production of company records and other information.

The DoT also has a residual power to take action beyond the above powers for the protection of policyholders. However this power does not extend to the direction of assets other than in certain tightly defined circumstances which include the submission of a statement of liabilities not in accordance with valuation regulations or when the guarantee fund is not covered.

3.21 The Act sets out the terms and conditions whereby an insurance company may transfer all its rights and obligations under a portfolio of policies to another insurance company.

3.22 All proposed changes of director, controller or chief executive of a UK company must be notified to the Secretary of State, who has the power to veto the appointment of a controller or manager if he is not satisfied as to the fitness of the person concerned. Anyone who is being appointed as a managing director or chief executive must signify that he has consented to the proposed appointment. Similar provisions apply in respect of the principal UK executive and the authorised UK representatives of non-UK companies.

PART III - V

3.23 Part III of the Act relates to various provisions on the conduct of insurance business, whether by an authorised company or otherwise, e.g. Lloyds, Part IV is concerned with special classes of insurers including Lloyds and Part V with various supplementary provisions.

3.24 The Act provides for regulations to be made governing the form and contents of insurance advertisements. The term "advertisement" is interpreted widely, and includes films, television and broadcasting. Penalties will be imposed on persons giving misleading statements inducing persons to buy insurance. At present, only advertisements by unauthorised insurers (e.g. overseas companies) are subject to regulation. However it is worth noting that a self regulatory system of control is already in existence for all adverts and insurers would be expected to subscribe to a 'Code of Advertising Practice'.

3.25 Regulations can and have been made under the Act governing the information which must be given by an intermediary to a prospective buyer of insurance concerning the intermediary's connection, if any, with the insurance company.

3.26 Part V of the Act provides for regulations to be made with respect to the determination of the value of assets and the amount of liabilities whenever valuations in accordance with the regulations are required under the Act. These regulations govern the valuation of assets for purposes of the annual accounts and the periodic valuation of liabilities and also govern valuations made for the purposes of determining solvency etc.

3.27 The 1981 Act, introduced the provision that a branch of a non-EEC insurer must keep proper accounts and records in the UK. DoT guidance notes exist on what constitutes proper records.

Regulations

3.28 The Insurance Companies Acts allow for various regulations to be made. The Act itself is a major piece of legislation which, like all Acts of Parliament, has to pass through three readings in both the House of Commons and the House of Lords, as well as the appropriate Parliamentary Committee stages. The regulations are "statutory instruments" which are laid before Parliament and normally rubber stamped. The powers for making and the scope of possible regulations are set out in the Acts. There have been a large number of such regulations and amendments in the last ten or so years, but the opportunity has been taken to consolidate the regulations. The current regulations are:

(i) The Insurance Companies (Accounts and Statements) Regulations 1980, and subsequent amendments (1981, 1982)

(ii) The Insurance Companies Regulations 1981 and subsequent amendments (1982)

4. Companies Act Legislation

4.1 Other than those insurers registered under the various friendly society Acts, all insurers are subject to the various Companies Acts 1948-81. Insurers have to prepare accounts in accordance with these Acts which give a "true and fair" view of the company's affairs. This is in contrast with the Returns made under the Insurance Companies Act 1974 which, following the Accounts & Statements Regulations 1980, have to be "in accordance with the regulations".

4.2 The Companies Acts sets out various requirements including the requirements for a balance sheet, a profit and loss account (including a statement of turnover) and a directors' report. There is no requirement for a revenue account, although most companies do provide one. The various statutes are augmented and clarified by "Statements of Standard Accounting Practice" issued by the Accounting Standards Committee (whose membership comes from the various professional accounting bodies).The 'true and fair view' is one which follows the four fundamental accounting concepts, described in SSAP 2 on "Disclosure of Accounting Policies", of

(i) the "going-concern" concept - i.e. the insurer will continue in operational existence for the foreseeable future

(ii) The "accruals" concept - i.e. revenue and costs are recognised as they are incurred, not as money is received (unless this is inconsistent with prudence)

(iii) The "consistency" concept - i.e. consistency of like items within a period and from one period to the next

(iv) the concept of "prudence" - i.e. revenue and profits are not anticipated and provision is made for all known liabilities.

4.3 Exemptions are granted to insurance companies from several of the normal Companies Act requirements, namely:

(i) in respect of assets

- from splitting investments into listed/unlisted

- from valuing fixed assets in the manner laid down in the 1948 Act

- from showing the market value of listed investments

- from commenting where directors consider current assets are, or may be, overvalued

- from giving particulars of any charge on assets to cover liabilities of any other person

(ii) in respect of liabilities (including shareholders' funds)

- from distinguishing between provision and reserves. (This technical distinction was included in the 1948 Act, with a provision defined as being for a known liability of which the amount cannot be determined with substantial accuracy; a reserve is "not a provision". However, EEC directives refer to technical reserves rather than technical provisions. In practice, many actuaries regard the words as interchangeable).

- from showing details of transfers to or from reserves and provisions

- from showing the general nature of any contingent liabilities not provided for

(iii) in respect of the profit and loss account

- from showing amount charged to revenue for depreciation

- from showing transfers to or from reserves or provisions

- from showing a breakdown of investment income between income from listed and unlisted investments and rents.

4.4 The exemptions on market value are now of little importance as the information is available from the DoT Returns. An auditor can still declare the accounts to be "true and fair" even if the insurer has taken advantage of these exemptions.

4.5 Where the insurer is a holding company, it must provide a consolidated balance sheet and profit and loss account for the group. In this respect the Companies Act accounts differ from the Returns to the DoT.

4.6 An accounting standard on "current cost accounting", a version of inflation accounting, was issued in March 1980 and will apply to most listed companies and large entities. Insurers have been excepted, but the possible removal of this exception is currently being reviewed.

4.7 There are already in existence a number of EEC directives on Company Law. The Fourth directive deals with the form and content of companies accounts for shareholders. Insurance companies were excluded from this directive, but an insurance version of the Fourth is fairly imminent and will involve changes in the accounting formats. Further down the pipeline is a Seventh directive on Group accounts which may have a significant effect on the consolidation process.

4.8 It should be noted that there is no need for the Companies Act accounts of an insurer to agree with the returns submitted under the Insurance Companies Act (see section 5.). This could even be true for a purely UK insurer with no subsidiaries. However, it is believed that most companies internally effect a reconciliation to explain the differences.

5. The Insurance Companies (Accounts and Statements) Regulations 1980

5.1 The accounts, balance sheets and statements referred to in 3.13 are prescribed in the 1980 Accounts and Statements Regulations. The 1980 Regulations replaced the 1968 Accounts and Forms Regulations. The older regulations had specified the information required but had not specified the precise format in which it was to be presented to the DoT. The 1980 regulations, with certain exceptions, have changed this situation. Now a significant proportion of the information submitted to the DoT is on pre-printed forms which standardise the information presented by the different companies and can be readily input to by the DoT computer.

5.2 The annual returns to the DoT are in six parts, or schedules:

Schedule 1 is deemed to represent the balance sheet which every insurer has to complete.

Schedule 2 represents the revenue account and attaching statements in respect of the general business.

Schedule 3 represents the additional information required showing revenue account for long-term business, changes in the business over the year and statements on the expected investment income and the distribution by term of the fixed interest investments.

Schedule 4 is the abstract of the report of the appointed actuary.

Schedule 5 is the statement of long-term business that is required every five years with the intention of providing sufficient data to enable an alternative valuation to be carried out by an independent actuary.

Schedule 6 contains the various certificates of the directors and also the auditors report.

It is assumed that the reader will have obtained for reference and familiarisation a copy of a UK insurers 1981 or later DoT Returns for reference.

5.3 The purpose of the regulations is:

(i) to demonstrate that the solvency margin requirements have been met and that directors and auditors have provided the appropriate certificates.

(ii) to provide the DoT with backing data by which it may form its own assessment on the value given to the company's assets and liabilities and the potential fluctuations arising therefrom (although this assessment may be limited by the non-classification by term of the fixed interest stocks).

(iii) to impose certain straitjackets on the production of information, thereby facilitating industry comparisons.

(iv) to establish a body of data which could provide screening tests or early warning systems which might identify problem areas or problem companies.

(v) to satisfy the concept of "freedom with publicity".

Whether or not the regulations will achieve this purpose is a matter of some debate.

5.4 The regulations are, at the time of writing, in need of some modification to allow for the introduction of a life solvency margin and other features of the consolidated 1981 regulations. It should be noted that the provision of a life solvency margin could, in certain circumstances, affect the non-life solvency margin.

5.5 Schedule 1:

5.5.1 Form 10 - Statement of solvency

Inasmuch as this form covers business other than long-term, this Form shows the aggregate amount of assets and liabilities, both valued in accordance with the valuation regulations (see 6.9). The liabilities are then deducted from the admissible assets and the result is compared with the required solvency margin for the test of solvency.

5.5.2 Forms 11 & 12 - Calculation of required solvency margin.

These two forms detail the calculation of the solvency margin (see 6.3), Form 11 relating to the premium basis and Form 12 to the claim basis.

5.5.3 Form 13 - Analysis of admissible assets

This is produced separately for long-term and short-term funds. A basic principle adopted in the returns is that all amounts due to and from an insurer have to be shown gross (e.g. money due from agents must be shown as an asset and money due to agents as a liability) - they cannot be netted against the other. An exception to this principle occurs in that amounts due to the company from any one person may be netted. However, so that the DoT may recognise a situation of over-dependence on any one debtor, a note has to be made if more than 25% of such amount due is due from one intermediary.

5.5.4 Form 14 - Long-term business

5.5.5 Form 15 - Liabilities (other than long-term business)

This analysis consists of the General Business technical reserves, other insurance liabilities and other liabilities. Within technical reserves, the following entries are itemised:

- unearned premiums. In this context the provision is net of deferred acquisition costs although elsewhere in the returns unearned premiums are shown gross of such costs.

- additional amount for unexpired risks. This is equivalent to the term unexpired risks in the 1968 Regulations and makes amends for the previous misuse of the term. Thus by implication the unexpired risk reserve is the higher of the unearned premium reserve and the amount needed to meet the future outgo relating to the risks still to be borne after the year end on contracts already entered into.

- claims outstanding (less amounts recoverable from reinsurers). This has to be split between reported claims and IBNR.

- expenses for settling claims outstanding. This reserve has never been shown separately before and may well have been previously provided for as a margin within the reserve for outstanding claims.

- funds. Marine and aviation business has traditionally been accounted for on a funded bases and now excess of loss treaty reinsurance business must also be accounted for on a three-year funded basis. Proportional reinsurance business is accounted for on a special two-year basis (see Form 28).

- claims equalisation and other. These are voluntary entries.

This form may have a supplementary note itemising contingent liabilities (e.g. tax on unrealised capital gains) not normally included under the above headings.

5.5.6 Form 16 - Statement of other income and expenditure

This brings together the items normally found in a profit and loss account and ends with an "excess of income over expenditure". In the Companies Act accounts, this item would be the increase in retained profits and would be taken through to the balance sheet. Form 10 is more in the nature of a statement of assets and liabilities than a balance sheet and does not contain an item labelled retained profits. Furthermore balance sheets may not reflect movement in asset values and even if they do, these movements are shown as a separate reconciliation item.

5.6 Schedule 2 (Forms 20 - 30)

Forms 20 to 30 of Schedule 2 relate only to General Business and cover the Revenue Account and additional information required. Whereas Schedule 1 was concerned with General Business in aggregate, Schedule 2 is concerned with an analysis by accounting class. Classes 1 to 8 are, with very minor exceptions, coincident with the authorisation classes of business introduced in 1978 (see 3.6). The table shows the accounting classes with both the corresponding new and old authorisation classes.

	Accounting class	Authorisation classes	Pre-78 classes
1.	Accident and Health	1, 2	(vii)
2.	Motor Vehicle	3, 10	(v)
3.	Aircraft	5, 11	)
4.	Ships	6, 12	) (iv)
5.	Goods in transit	7	)
6.	Property damage	4, 8, 9	(viii)
7.	General liability	13	(iii)
8.	Pecuniary loss	14, 15, 16, 17	(vi)
9.	Non-proportional treaty reinsurance	-	-
10.	Proportional treaty reinsurance	-	-

Accounting classes 1, 2, 6, 7 and 8 cover direct business and facultative reinsurance only. Accounting classes 3, 4 and 5 may include the relevant treaty reinsurance (such treatment may be considered normal). It is also the normal pattern to see accounting classes 1, 2, 6, 7 and 8 accounted for on a one year basis and classes 3, 4 and 5 on a three year basis. These marine and aviation classes follow the traditional Lloyd's accounting basis of recording premiums net of commission. This has led to the introduction in Form 25 of an adjustment to gross-up the premiums so that the premium used in the solvency margin calculation on Form 11 is defined in accordance with the EEC directive definition. The student should remember, however, that normal GI parlance interprets net premiums as meaning net of reinsurance. This contrasts with the actuarial usage of the phrase in life business.

5.6.1 FORM 20 - General business: Revenue account

This represents a major change in the public presentation of revenue accounts in that it seeks to isolate the balance of the current year's business (other than funded business) from prior year "run-offs". The balance of the current year's underwriting is the difference between the underwriting income, in the shape of earned premiums and the additional amount for unexpired risks, and underwriting expenditure, which includes expenses on an earned rather than an incurred (i.e. written) basis.

5.6.2. FORM 21 - General business: Analysis of premiums for direct insurance and facultative reinsurance business

This form, which relates to non-funded business premiums gross and net of reinsurance as well as the reinsurance premiums payable, splits the premiums by month of inception into the portion earned in the year and unearned at the end of the year. Special provision is made for non-annual policies and policies incepted in one year but debited in the following year. The regulations normally expect insurers to be able to allocate premiums to month of inception and thus expect the basis of arriving at unearned premiums to be at least as accurate as the 1/24ths method, although minor exceptions are allowed where date of debit is used. Form 21 is for the aggregate of worldwide business but also requires a split of the written premiums for the year between UK and Overseas business.

5.6.3 FORM 22 - General business: Analysis of claims and expenses for direct insurance and facultative reinsurance business

This shows the build up of items appearing in Form 20. Thus current year and the aggregate of prior year claims are shown, gross and net of reinsurance, as the sum of outstanding claims estimated at the end of the year and claims paid in the year less outstanding claim estimates carried forward from the previous year. Claim handling expenses are also treated in this way. Commission and expenses are the amounts paid in the year plus the amount brought forward less the amount carried forward. There are as yet no regulations relating to these amounts carried forward.

This form also shows the split of current and prior year claims between those reported and IBNR.

5.6.4 FORM 23 - General business: Analysis of claims outstanding net of reinsurance recoveries for direct and facultative reinsurance business

This form contains data which enables the eventual construction for years subsequent to 1980 of net run-off statements, by accounting class only, for the aggregate of territories which are not de minimis (see Form 31). Where the aggregation covers different currencies the run-off patterns will be distorted by variable rates of exchange.

5.6.5 FORM 24 - General business (three year accounting): Analysis of premiums, claims, expenses and funds

All amounts are shown allocated to one of the three preceding years or to prior years. Premiums are split between direct and reinsurance business both inwards and outwards. Special provision has been made for the treatment of "portfolio premiums and portfolio claims", i.e. the premiums receivable for taking over the liability for unearned premiums or outstanding claims under a reinsurance treaty.

5.6.6 FORM 25 - General business (three year accounting): Additional information relating to premiums

This form splits the written premiums in the previous form between UK and Overseas business. The previous form also allows premiums to be shown net of commission and Form 25 allows for these net premiums to be grossed up for commission. It is the gross amount which is to be used in the calculation of the required solvency margin.

5.6.7 FORM 26 - General business: Analysis of premiums for non-proportional treaty reinsurance business

This is additional to Form 24 and further analyses the portfolio premium and portfolio claim aspects.

5.6.8 FORM 27 - General business: Revenue analysis of proportional treaty reinsurance business

There are substantial delays in receiving treaty accounts and this method of accounting has an open year which builds up a fund of the excess of premiums recorded under the treaties received less the outgo recorded under those treaties, which may include an estimate of unearned premiums or outstanding claims. Thus no profit is released at the end of the open year although a loss may be anticipated by a transfer from the shareholders account. The remaining treaty accounts are presumed to be rendered in the following year, when the profit or loss is established. The sum of the open year in the previous year's returns plus the current open year would look like a one-year account.

5.6.9 FORM 28 - General business: Analysis of premiums for proportional treaty reinsurance business

This is equivalent to Forms 25 and 26 for non-proportional business.

Schedule 3 Part III Form No. 300

Year of account ending on 31st December 19.80..

CLAIM SETTLEMENT ANALYSIS of the ASSURANCE COMPANY LIMITED

For DoT use:	Company ref.	Country	Class	Risk group	Year of origin	Year of account	No of claims
300	71805				1971	1980	

Country:	Class:	Risk group:	Year of origin:	Total number of claims attributable to the year of origin:
UNITED KINGDOM	MOTOR VEHICLE insurance business	PRIVATE CAR	1971	18,706

Financial Year 1		Number of claims closed in the year: at no cost 2	Number of claims closed in the year: at some cost 3	Number of claims outstanding at the end of the year 4	Amount of payments made in the year in settlement or on account 5 £	Aggregate payments made up to the end of the year 6 £	Claims outstanding at the end of year: Payments on account included in column 6 7 £	Claims outstanding at the end of year: Estimated payments remaining to be made 8 £	Total amount paid and outstanding at the end of the year (Total of cols 6+8) 9 £
19.71..	1	2,344	7,593	9,147	887,003	887,003	300,804	782,898	1,669,901
19.72..	2	2,027	4,988	1,777	494,662	1,381,665	202,488	260,673	1,642,338
19.73..	3	259	751	801	128,145	1,509,810	177,514	194,746	1,704,556
19.74..	4	194	412	81	60,920	1,570,730	81,047	213,829	1,784,559
19.75..	5	25	32	54	79,619	1,650,349	65,106	178,287	1,828,636
19.76..	6	2	40	35	152,492	1,802,841	154,893	45,825	1,848,666
19.77..	7	1	28	15	42,987	1,845,828	94,371	8,072	1,853,900
19.78..	8	2	8	8	8,209	1,854,037	11,506	5,661	1,859,698
19.79..	9	NIL	5	4	3,031	1,857,068	1,232	2,773	1,859,841
19.80..	10	NIL	3	2	221	1,857,289	967	2,410	1,859,699
19.....	11								

The entries above include the following number of reopened claims:

In line 2	12			
In line 3	13			
In line 4	14			
In line 5	15			
In line 6	16	NIL	3	6
In line 7	17	2	4	1
In line 8	18	NIL	NIL	1
In line 9	19	NIL	NIL	1
In line 10	20	NIL	NIL	1

C2903

5.6.10 FORM 30 - General business: Summary of reinsurance business ceded

This form, which is the only form in Schedules 1 and 2 which does not have to be completed on a pre-printed format and is not subject to audit, is a description of the insurer's reinsurance programme. The DoT are particularly interested in the spread of the programme between reinsurances and whether these reinsurers are authorised in the UK.

5.7 Schedule 2 (Forms 31 - 37)

There were three forms produced under the 1968 Accounts and Statements regulations which are of particular importance in an assessment of the insurer's claim reserves. In essence the forms provided development patterns of claim payments by year of origin of a claim, with related data on outstanding estimates, claim numbers and premium exposure (and vehicle year exposure in the case of motor business).

The forms have over the period 1971 to 1980 provided a useful reservoir of information (1970 data proved untrustworthy). A typical example of a Claims Settlement Analysis is shown on the opposite page.

The analysis was:

(i) in respect of business gross of reinsurance, thus for example the forms could show a gross reserving deficiency arising but with no indication as to whether this deficiency was reflected in the net position.

(ii) given separately for each country in which an insurer operated. There were de minimus provisions whereby no analysis was given in respect of territories providing less than 2½% of written premiums.

(iii) by risk group, which were sub-divisions of the accounting classes only vaguely defined in the regulations as, in the directors opinion, homogeneous groupings. There has been a substantial variation in practice regarding risk groups. Liability is commonly split between employers and other; motor between private car, commercial vehicle, motor cycle and possibly fleet; consequential loss is often separately identified within pecuniary loss; property may see a commercial fire risk group but quite often the major risk grouping of household business is not separately identified.

(iv) restricted to non-marine business (direct and facultative) and certain marine business written on a one-year basis.

The modifications introduced in the 1980 regulations were a reaction to the criticism that the forms were inadequate in tracing through reconciliations. Forms 31 - 36 have emerged as a result of this criticism, expanding the detail and introducing crosschecks which improves the validity of the data. Risk groups remain as before, except that there is now a compulsory split of private car between comprehensive and non-comprehensive business. The position of home foreign business has also been clarified. This is business written in the United Kingdom primarily relating to risks situated outside the United Kingdom. Typically the majority of such business would consist of coinsurance on facultative reinsurance risks which have been broked through the London market. Insurances on marine, aviation and transport risks which commence in the UK (e.g. insurance related to a particular voyage of a ship) is excluded from the definition. Home foreign business is classified as UK business as the contract was made in the UK, but for the purposes of the Forms 31-36 it is regarded as a separate territory for which, unless it is de minimis, separate forms have to be produced.

5.7.1 <u>FORMS 31 (32) - General business: Analysis of exposure to risk measured by premiums (vehicle years)</u>

These forms allow for non-annual policies and delays between date of inception and date of debit.

5.7.2 <u>FORM 33 - General business: Analysis of claims by number and cost</u>

This is equivalent to the old Claim Settlement Analysis, but only shows the run off in the current year. Thus it will not be possible to examine the run off by reference to data in the latest returns but the examination would have to extract data from current and previous returns. On the other hand the data is more detailed and properly takes into account re-opened claims and the estimation of IBNR numbers.

5.7.3 <u>FORMS 34 (35) - General business (three year accounting): Analysis of premiums (claims by cost)</u>

These are the three year accounting equivalents of Forms 31 and 32. They will eventually produce distribution patterns of gross premium, claims payments and individual estimates by underwriting year, but will not provide a test of the run-off of a reserve figure.

5.7.4 <u>FORM 36 - Currency rates</u>

This chronicles the exchange rates used in Forms 31 to 35.

5.7.5. <u>FORM 37 - General business: Analysis of gross premium receivable through participation in Community co-insurance operations</u>

This form was introduced in the 1982 amendment regulations and relates to a segment of the home foreign portfolio. It results from an agreement between EEC supervisors on the collection of statistics on co-insurance business with the leading insurer in one EEC country and the follow insurer in another.

5.8 The various certificates required are now brought together as Schedule 6, Part I of which relates to certificates by directors, Part II to the actuary's certificate (not relevant to general insurance) and Part III to the auditor's certificate. The certificates required vary depending on the category of the insurer.

5.8.1 For a UK company the certificates required in connection with its short-term business are:

(a) Proper records have been maintained and an appropriate system of control of these records exists

(b) Assets are valued in accordance with regulations

(c) Liabilities are valued in accordance with the regulations

(d) Assets held are in accordance with matching and localisation localisation requirements

(e) The amount of the required solvency margin and the amount of the companies net assets

(f) For business accounted for on a funded basis (basically marine and treaty reinsurance) no profits have been released in the open years, the closing fund is sufficient to meet outstanding liabilities.

If the certificates cannot be given, the directors must state this fact.

Variations of this certificate are required for other parts of the 1981 Insurance Companies Regulations.

5.8.2 Part III of Schedule 6 is the auditor's report. Forms 10-28 and 31-37 have to be audited and the auditors have to state that in their opinion:

(i) the audited forms have been properly prepared, and

(ii) the Part I certificate has been properly signed and that it it was reasonable for the signatories to sign.

6. The Insurance Company Regulations 1981

6.1 These regulations consolidated a number of previous regulations and introduced some fresh ones consequential to the 1981 Act. The regulations have seven parts:

(a) Part I is the preliminary which gives definitions that are used throughout the regulations
(b) Part II deals with the required margins of solvency
(c) Part III deals with the deposits that are required in respect of UK branches of overseas insurers
(d) Part IV deals with benefits in kind, currency matching, the documentation for seeking approval of a change of control or new authorisation.
(e) Part V deals with the valuation of assets and is described in section 7 of this monograph
(f) Part VI deals with the valuation of liabilities
(g) Part VII deals with the way in which insurance business is sold.

6.2 The required margins of solvency for short-term business (see 3.13) are in accordance with the EEC non- life directive, extended to cover pure reinsurance companies. In accordance with the life directive, the solvency margin rules in respect of long-term business do not come into operation until 1984. This will also give time, for those few companies where it may prove necessary, to readjust their affairs. Only the solvency margin required for a UK company is described below; there are slight variations for a branch of a Community company or a branch of an external company.

6.3 The formula for the solvency margin is the higher of:

(i) the premium basis: 18% of the first 10 million units of account and 16% of the remaining premium income (including general reinsurance accepted but excluding reinsurance ceded) for the last financial year multiplied by ratio of net to gross "claims incurred" in the last financial year, subject to a minimum ratio of 50%. Health insurance satisfying certain conditions is based on ratios of 6% and 5.33% instead of 18% and 16%.

(ii) the claim basis: 26% of the first 7 million units of account and 23% of the average "claims incurred" for the last three years (or seven years for storm, hail and frost insurance) multiplied by the same ratio as the premium basis. The 26% and 23% ratios are replaced by 8.67% and 7.67% for certain health insurance business. If the company has not been in existence for three (or if appropriate, seven) years then the premium basis is automatically taken as the required solvency margin.

The "unit of account" (EUA) is that known as the European Currency Unit (ECU) but subject to a minimum rate of £0.4166 per Unit. The value at October 1981, used in the December 1981 Returns, was £0.587.

6.4 The guarantee fund (see 3.15) is one third of the above calculation, subject to a minimum of 400,000 EUA if authorised for at least one of classes 10-15, 300,000 EUA otherwise unless only class 9 or 17 is written, in which case the minimum guarantee fund is 200,000 EUA.

6.5 A clause in the Insurance Companies Act allows organisations which provide only benefits in kind to be exempted from the authorisation requirements. However, the exempted benefits in kind must be defined by regulations. To date the exemption given is to the motor breakdown assistance service provided by organisations such as the AA or RAC.

6.6 The matching and localisation rules in Part IV are another requirement stemming from the EEC directives on insurance. They reflect an agreement, called a protocol, reached by the various insurance supervisory bodies of the EEC. Matching in this context means having assets and liabilities in the same currency. Localisations means having the assets and liabilities in the same country. The matching and localisation provisions are restricted to business carried on in the United Kingdom and exclude reinsurance, i.e. restriction is to home foreign and to domestic business. The UK rules would not cover established overseas branch business, although similar matching rules would be applied by the supervisors of the overseas branch (subject to a possible disallowance of reinsurance). They would appear to cover a very limited amount of business other than normal UK contracts which are likely to fall below a de minimis limit of 5% of all liabilities. At least 80% of the liabilities in a currency above the de minimis limit have to be matched and localised.

6.7 The information required from applicant UK companies seeking an authorisation to transact short-term business is set out in Schedule 5 of the regulations. Information is required on:

(a) the company, i.e. details of incorporation; summary of company objectives; solvency margin cover available; auditors; bankers; directors, controllers, managers and their links with agents and reinsurers

(b) classes of business to be authorised

(c) a scheme of operations covering sources of business; nature of commitments to be taken on; tariffs to be applied; guiding principles on reinsurance; assets covering the guarantee fund; estimated costs of installing an organisation to get and handle business and the financial resources needed to cover those costs

(d) projections for three years forecasting balance sheet, detailed estimates of income (with premiums gross and net of reinsurance) and expenditure and financial resources needed to cover liabilities and solvency margin

(e) other information on investment programme; drafts of reinsurance treaties, agreements with brokers, with managers and with main agents

6.8 The forms relating to the change of control appear as Schedule 6. They need to discover, inter alia, the qualifications and experience of the new controllers in insurance and allied matters; any past convictions (even those which would be regarded as spent under the Rehabilitation of Offenders Act 1974); any previous dismissals from employment or professional conduct problems; any past bankruptcies; any associations with insolvent companies. These fit in with the 'fit and proper person' aspects of supervision, but even so there may be problems in application. One recent case has been taken to the European Court on Human Rights.

6.9 Regulation of the method of valuing short-term business is limited to a requirement that the amount of the liabilities shall be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurance companies. There is one small exception on community co-insurance to fit in with the Co-insurance directive. A follow insurer must, in percentage terms, maintain a provision at least as great as that of the lead insurer.

6.10 There are powers in the Act to prescribe the wording of insurance advertising. So far the Department of Trade have exercised their powers in a limited fashion in Part VII so that:

(i) an unauthorised insurer (e.g. Channel Island company) has to prominently state the fact that it is unauthorised in the UK, and, if it names an agent in the UK, the fact that the agent is not independent

(ii) no statement of the authorised capital of an insurer may be made without stating the subscribed capital.

The industry has to date been able to avoid further regulation on advertising by self-regulation through a code of advertising practice.

6.11 Part VII also covers the regulations which ensure that a statement of interest is made by "connected persons" (i.e. non-independent intermediaries) to the intending purchaser on the sale (or offer for sale) of an insurance policy. There are further regulations on the statutory notice to be given on the issue of a policy giving the purchaser ten days to withdraw from the transaction. There are many dubious selling practices which have so far avoided legislation. Instead the insurance industry, through the Life Offices' Association and the British Insurance Association, has tried to put its own house in order through a code.

7. Valuation of Assets Regulations

7.1 Regulations on the valuation of assets under the Insurance Companies Acts were made for the first time in 1974 and were superseded by a new set of regulations in 1976. Since then there have been a number of amending regulations as the existing set were found to be wanting in certain respects or as new forms of investment evolved. The regulations now appear as Part V of the Insurance Companies Regulations 1981, but may still colloquially be referred to as the asset valuation regulations.

7.2 The regulations are concerned with both the way in which assets are valued and limitations on the extent to which the values of certain types of asset may be taken into account for the purpose of the Insurance Companies Acts. By this means a certain amount of negative control is exercised by the supervisory authority. The control is not positive, as it is in many other countries, in that it does not direct a certain proportion of assets into certain types of investment, e.g. Government securities. Nor does it directly stop a company from making any type of investment. The stance of the legislation is to try to ensure that there is no undue concentration of risk which would imperil the solvency of a company. Regulation which directs investment in a positive fashion may probably be more concerned with other objectives of a government, such as its own funding requirements or balance of payments, rather than the twin consumer objectives of solvent insurers selling products offering good value.

7.3 The regulations, which are equally applicable for both long-term and short-term business, are basically valuing assets at market value where this can be determined.

7.4 Broadly speaking the permitted values are based on a reasonable market price (mid-market values for listed securities). Consistent with this, loans and debts are discounted at a market rate of interest, although these assets may be taken at face amount if they are due, or could be called in, within one year. Unlisted shares are valued as the product of the FT-Actuaries price/earnings ratio for the industrial group and the average earnings of the unlisted company for the last three years. Land must have been valued within the last three years by a qualified valuer on an open market sale basis. Computer equipment must be written off evenly over four years and other office machinery, cars etc. over two years.

7.5 Complicated rules exist for the valuation of holdings in dependent companies. A company is a dependent of another if the holding company has a third or more of the voting power. In broad terms the regulations "look through" to the assets and liabilities of the dependent company. Where the dependent company is a general insurance company, the dependent is valued as the excess of assets (in accordance with the asset valuation regulations) over the liabilities and a "solvency margin". The 1976 Regulations referred to the old UK statutory minimum solvency margin (roughly 10% of net premiums), but with the introduction of the various EEC requirements the opportunity was taken in the 1981 amendments to simplify and standardise the computation to 20%. Where the dependent carries on long-term business, there can be no look-through to the long-term fund. If this fund does not cover the long-term solvency margin, a further amount may be deducted from the value of the dependent. Inadmissible assets in the general business fund of the dependent may be rendered admissible in the valuation of the parent company's assets on application of the admissibility percentages to the parent company's general business account.

7.6 Assets not described in the Regulations cannot normally be taken into account and, generally, assets other than securities guaranteed by any government or public authority may be taken into account only to the extent that the value of the assets does not exceed a prescribed percentage of the "general business amount" as defined in the Regulations. In the case of general business, the general business amount is the aggregation of general business liabilities and the greater of 20% of premiums or 400,000 EUA. The general business liabilities are the sum of the technical reserves and other insurance liabilities (see Form 15).

The maximum percentages are:

(i)	Any single property	5%
(ii)	Any mortgage, other than one granted to an individual or to a dependent	5%
(iii)	Debts other than mortgages and debentures due within one year from any one company	2½%
(iv)	Debts other than mortgages or debentures due after one year from any one company	1%
(v)	Listed shares and debentures in any one company (subject to the lower limit of 2½% in respect of listed equity shares)	5%
(vi)	Unlisted shares in any one company	1%
(vii)	Options in any one company	0.1%
(viii)	Debts, including debentures, shares and options in any one company subject to the limits above for each category of investment in that company	7½%
(ix)	Debts due from any individual (other than home loans where the limit is 1%)	½%
(x)	Computer equipment	5%
(xi)	Office machinery, furniture, motor cars, etc.	2½%

In addition, credit cannot generally be taken for outstanding premiums (less any rebates, refunds and commission) in excess of 30% of net premium income.

8. The Policyholders Protection Act 1975

8.1 The purpose of this Act is to guarantee sizeable payment to UK policyholders of any monies due to them in accordance with their insurance policies if an insurer defaults. This is achieved by the establishment of a Policyholders Protection Board financed by levies from all companies and certain intermediaries engaged in the insurance industry. Expenditure by the Board on long-term and short-term business is separately identified, with levies separately collectable from companies authorised to transact each type of business.

8.2 The duty of the Board in respect of short-term business arises when a company is in liquidation or in financial difficulties, where financial difficulties mean that there is a court order in existence for its winding-up or some compromise arrangement is being made with creditors. The Board has to ensure that a sum equal to 90% of the liability attaching to UK policies is paid towards priviate policyholders as soon as reasonably practicable after the beginning of the liquidation. The whole of the liability under compulsory insurances is covered and there is a safeguard provision for a reduction in the 90% figure if the benefits are considered excessive.

8.3 The rationale behind this legislation in serving policyholders needs is immediately apparent. The introduction of such regulation has not been without opposition; the main arguments against the Act are firstly that, by indemnifying policyholders against the consequences of insurance companies being unable to meet their liabilities, it led to a weakening of the responsibility which ought to be exercised by:

(i) any insurance company in managing their business with prudence

(ii) the Department of Trade in performing its supervisory role

(iii) the policyholder in selecting policies on cost grounds without due regard for the security offered

(iv) insurance brokers who ought to have regard to the security offered rather than commission or ease of placement,

and secondly that the levies would fall on the soundly managed companies.

9. Lloyd's

9.1 If the phrase "freedom with publicity" has underlined the supervision of insurance companies in the UK over the last century, then the phrase "Lloyd's is a unique organisation" has been equally applicable. Supervision of the companies market has been through Acts which give the Department of Trade the appropriate powers of supervision and regulation. Lloyd"s is unique in that exceptions are made in the insurance company legislation to allow for the lloyd's market to be self-regulated, with the Acts of Parliament being restricted to setting up an appropriate self-regulatory framework.

9.2 Business is derived at Lloyd's on behalf of 20,145 underwriting members. All members accept insurance risks for their personal profit or loss and are liable to the full extent of their personal furtunes. These members are grouped into 431 syndicates, each of which has an underwriter who has the authority to accept or refuse risks on behalf of his syndicate.

9.3 The members of Lloyd's are classified either as working members who occupy themselves principally with the conduct of business at Lloyd's, and external members who do not. Henry Cooper, the ex-UK heavyweight boxing champion is one of the more well publicised external members. Allexternal members and many working members may appoint an underwriting agent, or agents, to act on their behalf. These agents may be members agents advising the member as to which syndicate to join, thereby delegating the underwriting to another underwriting agent under a Sub-agency agreement. Alternatively, they may employ an underwriter who writes the business for all members of the syndicates.

9.4 The members of Lloyd's had voluntarily formed a Society with its own deed of association back at the beginning of the nineteenth century. A more definitive legal framework was established when a private bill went through parliament to become the Lloyd's Act 1871. This Act incorporated the members of Lloyd's into the Society and Corporation of Lloyd's and made provision for a Committee of members to manage the Society's affairs. There was subsequent updating legislation of the Society's powers in 1888, 1911, 1925 and 1951. The Corporation of Lloyd's is the corporate entity, financed by subscriptions from members, which provides the premises, administrative staff and services which enable to underwriting members to transact the business of insurance. The various departments of the Corporation are directed by the Committee.

9.5 The insurance legislation that has been passed since 1871 in the UK has always recognised Lloyd's as something different for which an exception can be made. Even with the entry of the UK into the EEC and the emergence of a non-life directive, exceptions have been made to accommodate the interest of Lloyd's. Commercially, insurance has been by far the most important factor in the City of London's invisible earnings, and two-thirds of these earnings have come through Lloyd's. Nevertheless, the Lloyd's system showed signs of problems emerging with a number of well publicised affairs. Lloyd's itself recognised the dangers to its self-regulatory basis and set up a committee under the chairmanship of Sir Henry Fisher to review the situation. The committee, within the overall context of self-regulation, produced a number of modifications to the lloyd's Act. The route was set for a stormy passage through parliament of a private bill which has become the Lloyd's Act 1982. This may not be enough.

9.6. The 1982 Act has recogfnised the potential conflict of interest between working and external members by establishing:

(i) a Council of Lloyd's, containing 16 working members, 8 external members and 3 nominated members whose appointment must be confirmed by the Governor of the Bank of England

(ii) a Committee of Lloyds consisting of the above 16 working members.

The Council was new in the 1982 Act, the Committee was established back in 1871 but the electorate has now been restricted to working members. The external members are the electorate of the eight Councillors. The Council has assumed powers that could previously only be resolved by cumbersome general meetings of the members. The administration is delegated to the Committee which, inter alia, is responsible for the election of new underwriting members, the review of requirements for underwriting membership and the reules governing financial security to which all members must adhere.

9.7 The Lloyd's Acts preclude underwriters from conducting their insurance business directly with the public. All insurance is brought to them through the medium of brokers approved by the Committee of Lloyd's who are known as "Lloyd's brokers". The are 270 such approved brokers.

9.8 One of the more contentious articles in the 1982 Lloyd's Act was a requirement for the severance of links between Lloyd's brokers and underwriting agents. The argument for the severance was simple. There was a conflict of interest between the underwriters, whose duty was the protection of, and producing profits on, their names' capital, and brokers, whose duty was to secure the lowest rate for their client. The arguments against were that the links had become considerable over the passage of time and that their severance might lead to a disruption of the commercial standing of London as an insurance centre. There might well also be the fear that arguments of conflict of interest could also be advance outside the Lloyd's arena, e.g. between insurance brokers and insurance company.

9.9. The 1982 Insurance Companies Act does contain a few requirements in respect of Lloyd's business. These are expressed as requirements with which a Lloyd's member has to comply if it is to be exempted from the normal requirement of the Act:

(i) All premiums must be put to a trust fund

(ii) Accounts have to be provided annually by an accountant approved by the Committee of Lloy's, and the audit certificate has to be submitted in a prescribed form to the Committee and to the DoT

(iii) Furnish the Committee of Lloyd's with information which enables that Committee to deposit with the DoT a statement summarising the extent and character of the insurance business done by the members of Lloyd's.

The Act imposes two further requirements:

(iv) The solvency margin and asset requirements (see 3.15 to 3.18) must apply to the members of Lloyd's taken together, and

(v) Transfers of business regulations (see 3.2) extend to transfers between a member of Lloyd's and a UK insurance company.

9.10 The collective solvency margin requirement described above was considered essential in the negotiation of the special provisions for Lloyd's in the EEC directive. Above all, however, the financial strength of the Lloyd's operation rests on the wealth of its members and the risks to their entire personal fortune.

Each underwriting member or "name" provides financial deposits which are fixed as a ratio of the volume of underwriting business to be accepted. A member's deposits are held in trust and are available solely as security for his underwriting liabilities. The level of deposits is regularly reviewed by the Committee.

The security behind a name consists of two things:

a) His readily realisable assets (or Means show), which may include his house. The name must at all time maintain such assets at a minimum ratio of 50% (or 66.7% for overseas names) of the premium written in his name. The amount of risk he may accept is only based on these assets.

b) His other assets, e.g. works of art, furniture, private company shares etc.

The requirements applicable from 1st January 1981 are as follows:

Category	Means Test	Deposit as % of P.I.	Minimum Deposit
Lloyd's Names	Nominal***	35%	£8,750
Lloyd's Names Connected & Associated Names, etc.	£25,000/£37,500*	30%	£7,500
UK, EEC & Commonwealth citizens resident and domiciled in the UK	£50,000/£225,000*	25%	£12,500
UK, EEC & Commonwealth citizens resident or domiciled outside the UK	£100,000/£225,000*	30%	£22,500
Other Foreign Nationals wherever resident	£135,000/ £300,000**	35%	£26,250

Notes * Premium Limit not to exceed twice Means show
** Premium Limit not to exceed 1½ times Means show
*** Premium Limit not to exceed £50,000

9.11 All names contribute to Lloyd's Central Fund, which is available to meet the liabilities of any names who, after applying all their assets, whether at Lloyd's or elsewhere, are still unable to meet their liabilities. The Fund exists to protect the Lloyd's policyholders and not the name. One consequence is that the Policyholders Protection Act is not applicable to policies taken out through Lloyd's.