

Solvency Assessment and Management

Third South African Quantitative Impact Study (SA QIS3)

Draft Technical Specifications

*Part 6 of 6:
Insurance Groups*



2 August 2013

G.1. INTRODUCTION

G.1.1 Aim

G.1.1.1 This section provides specifications for calculating and reporting group capital requirements and group own funds for SA QIS3. The main objective of SA QIS3 is to measure the ~~overall potential~~ impact of ~~a change from the current SA solvency regime to SAM and to test the appropriateness of the proposed methods set out under SAM~~ introducing a group capital solvency calculation. Although there is currently no formal group solvency requirement, this specification sets out a “current” position which introduces a group capital requirement based on the current regulatory requirements for ~~sole S.A. South African~~ insurers, and local regulatory requirements for foreign insurers and relevant regulatory requirements for other financial regulated entities. In addition to this “current” requirement, there are ~~a two number of alternatives~~ alternative group solvency calculations tested based on the SAM requirements.

G.1.1.2 As ~~per the solo calculation, insurance groups are asked to use whichever reporting date is most appropriate for the insurance group, given their overall SAM implementation project. specified in V.1, the reporting date to be used by all groups should be end December 2011.~~ Balance sheet items should be valued in accordance with the QIS3 specifications on valuation.

G.1.1.3 Only one group submission will be required by each group – it is not necessary for each licensed entity to submit a group submission along with their solo submission.

~~G.1.1.4 The SAM framework is still in development, and as such, there are still a number of areas relating to the calculation of the group solvency position which is still under discussion. Although it is not certain what will be contained in the final framework, information gathered in the QIS 2 exercise will help inform discussion towards the final framework. In order to inform the discussions going forward, groups are urged to give as much information as possible, especially under the calculations described in SAM Alternative 1 and SAM Alternative 2. In order to accommodate the collection of information, especially for the calculation described in SAM Alternative 2, simplifications are encouraged where it is not possible to collect information under the full calculations. Good progress has been made by the Insurance Groups Task Group in developing the requirements for the group solvency calculation under SAM. This specification has been developed using the outputs of the Insurance Groups Task Group, specifically the following papers:~~

- ~~• Position Paper 27: Group Own Funds~~
- ~~• Position Paper 85: Treatment of insurance operations (in „non-equivalent“ jurisdictions~~
- ~~• Position Paper 92: Assessment of group solvency~~

~~Insurance groups completing the group solvency calculation are encouraged to read these position papers if they require further detail of the methodologies put forward in this section. The Position Papers also provide the rationale from the Insurance Task Groups in setting out their proposals for the group solvency calculation under SAM. These position papers are available on the FSB’s website.~~

~~G.1.1.5 In addition to the Position Papers above, this specification is also aligned with Discussion Document 1: Interim measures for Insurance Groups, especially in relation to specifying the scope of the group calculation. This Discussion Document is also available on the FSB’s website as a supporting document for the Insurance Laws Ammendment Bill.~~

~~G.1.1.4 — Where simplifications have been used in the calculations, insurers are asked to specify what simplifications have been made.~~

~~G.1.1.5 — Groups planning to submit a QIS 2 group submission are encouraged to read the SAM Discussion Document 85 dealing with the treatment of insurance operations in the solvency of South African groups. The document includes, as an appendix, an example of a group calculation which may be helpful. However, please note that the application of the calculation of the group solvency position will be different to the calculation set out in Discussion Document 85, and will vary by different SAM alternative calculation set out in this specification.~~

G.1.2 Calculation of the group solvency: description of the methods

G.1.2.1 Groups participating in SA QIS3 should calculate their group Solvency Capital Requirement and their group own funds according to the methods listed below and further detailed in the following sections:

Current method: Deduction and Aggregation of current capital requirements

G.1.2.2 The sum of the current capital adequacy requirements and solo capital resources of the participating insurance undertaking¹ (adjusted to remove the treatment of intragroup transactions from the solo SCR and own funds) and the proportional share of each related insurance undertaking in the group with the current FSB requirements applied to South African entities and local requirements applied to non-South African entities.

SAM Alternative 1: Deduction & Aggregation (D&A) (using local rules for non-South African entities)

G.1.2.3 The sum of the standard formula solo SCR and solo own funds of the participating insurance undertaking (adjusted to remove the treatment of intragroup transactions from the solo SCR and own funds) and the proportional share of each related insurance undertaking in the group, ~~with SAM requirements applied to South African insurers and local requirements applied to non-South African insurers.~~

SAM Alternative 2: Deduction & Aggregation (D&A) (using SAM rules for non-South African entities)

~~G.1.2.4 — The sum of the standard formula solo SCR and solo own funds (adjusted to remove the treatment of intragroup transactions from the solo SCR and own funds) of the participating insurance undertaking and the proportional share of each related insurance undertaking in the group with SAM requirements applied to both South African and non-South African insurers.~~

~~G.1.2.5 — It is acknowledged that this can be difficult to complete, due to the availability and constraints of modelling in some non-South African insurers. To accommodate the collection of information, groups are encouraged to use simplifications where possible. A list of possible simplifications is given in section G2.5, but these should not be taken as an exhaustive list of simplifications.~~

~~G.1.2.6 — In addition, where it is not possible to calculate the position of all non-South African insurers using the SAM rules, groups are requested to calculate the SAM positions for the most material non-South African insurers.~~

SAM Alternative 3: Deduction & Aggregation (D&A) (using solo internal model results)

~~G.1.2.7 — The sum of the internal model solo SCR (where the internal model numbers are available) and the standard formula SCR (where the internal model numbers are not available) to calculate the~~

¹ In these specifications any reference to insurance undertaking also includes reinsurance undertaking.

~~group SCR. The sum of the solo own funds of the participating insurance undertaking and the proportional share of each related insurance undertaking in the group with SAM requirements applied to South African entities and local requirements applied to non-South African entities.~~

SAM Alternative 4~~2~~: Accounting Consolidation based on the standard formula

~~G.1.2.8~~~~G.1.2.4~~ The standard formula for the calculation of the Solvency Capital Requirement (SCR) applied to the consolidated assets and liabilities.

~~G.1.2.9~~ For mutual groups, combined accounts should be used instead of consolidated accounts.

SAM Alternative 5: Combination of deduction & aggregation and accounting consolidation methods

~~G.1.2.10~~ Where the exclusive application of Alternative method 4 would not be appropriate, groups may apply a combination of the deduction & aggregation method and the Alternative method 4.

~~G.1.2.11~~ The table below summarises the various methods of calculations that are described in this section.

Summary of methods which are required /optional		
	Section where the method is described	Comments
Current calculations using a D&A approach	G2.3	
SAM Alternative 1: D&A (local requirements applied to non-South African entities)	G2.4	
SAM Alternative 2: D&A (SAM applied to the non-SA entities)	G2.5	This calculation is not needed for a group which has no non-SA entities, as this result will be no different to the result calculated in SAM Alternative 1
SAM Alternative 3: D&A (solo internal model results used for South African entities, where available)	G2.6	This calculation is not needed where the group does not have an internal model that is capable of calculating the solo SCR for one or more of the solo insurance entities within the group.
SAM Alternative 4: Accounting Consolidation	G3	
SAM Alternative 5: combination of D&A and accounting consolidation	G4	

G.1.3 Comparison of the methods

G.1.3.1 It is important that the same set of group entities is included in all the calculations to ensure the comparability of the results of the different methods applied.

G.1.3.2 The consolidated group solvency ratio as calculated under the various SAM Alternatives will be compared with the solvency ratio stemming from the current calculation in order to understand the potential overall impact of the move to the group framework under SAM.

~~G.1.3.3 The group SCR as calculated under the deduction and aggregation method as described under SAM Alternative 2 will be compared with the results of the accounting consolidation method to have a measure of diversification benefits.~~

G.1.4 Scope

G.1.4.1 Calculations should be carried out at the level of the ultimate SA holding company, except where the ultimate holding company is a bank holding company. In this case the calculations should be carried out at the ultimate insurance holding company.

G.1.4.2 The scope of the group can include the following:

- (a) Subsidiary which is an entity in which the group has the power to govern the financial and operating policies in which the group has more than 50% of the voting rights or economic interest. All subsidiaries are included in the scope of the group.
- (b) Participations included in a group are those in which the group has between 20% and 50% economic interest, thereby providing significant influence. If the holding is less than 20% the investor will be presumed not to have significant influence unless such influence can be clearly demonstrated. All participations are included in the scope of the group.
- (c) The assessment of significant influence should be consistent, as far as possible, with the consolidated accounts. In other cases, entities that do not fall within the scope of the IFRS principles should be benchmarked against the following materiality concepts:
 - (i) any entity that is significant to the group's capital position or its financial standing;
 - (ii) an entity that is operationally important to the insurance group but does not currently fall within the definition of an insurance group or mixed activity insurance group. Examples may include entities such as a central hub that provides essential information technology services to the group, but is not a subsidiary or a participation; or
 - (iii) any entity that has the potential to create risks that, if realised, could produce significant losses for the group.

G.1.4.3 When considering what entities should be included in the scope of the group calculation, the group should use the IFRS principles for consolidation as a starting point, and then adjust to align with the principles as set out in G.[221.4.2](#).

G.1.4.4 Control and influence should always be assessed at a group level to determine the significance of participations. This ensures that situations where several entities of a group have small participations in the same undertaking are not overlooked

G.1.4.5 All parts of the group, necessary to ensure a proper understanding of the group and the potential sources of risks within the group, have to be included within the scope of group for the purpose of properly assessing group solvency.

- G.1.4.6 At a minimum, the following entities should be considered when determining the scope of the group calculation:
- (a) Non-operating holding companies, including intermediate holding companies
 - (b) Insurers (including sister or subsidiary insurers)
 - (c) Other regulated entities, such as banks and / or securities companies
 - (d) Non-regulated entities (including parent companies, their subsidiary companies and companies substantially controlled or managed by companies within the group)
 - (e) Special purpose entities

G.1.4.7 Undertakings that are part of a wider international group (i.e. where the ultimate worldwide parent undertaking is located outside SA) and that are also part of a SA subgroup are expected to participate in the SA QIS²³ exercise, and are requested to apply the group solvency calculations at the SA subgroup level. The SA subgroup is expected to apply the group calculations in the same manner as an SA group. The scope of the SA subgroup will also be up to the ultimate holding company in SA, except where the ultimate holding company is a bank holding company. In this case the calculations should be carried out at the ultimate insurance holding company.

G.1.4.8 Discussion Document 12 sets out the following different types of groups:

- (f) Category 1: Solo plus (consisting of one insurer and one or more non-financial entities)
- (g) Category 2: Pure insurance group (consisting of two or more insurers, possibly also including one or more non-financial entities)
- (h) Category 3: Financial conglomerates (consisting of at least one insurer and at least one other financial entity).

For the purpose of the group solvency calculations under SA QIS3, only groups falling under Category 2 or Category 3 are required to complete the calculations.

G.1.4.9 Furthermore, the following guidelines on materiality should be used to determine whether or not to include subsidiaries from the group solvency calculation. All entities that may pose a material risk to the solvency of the insurance group should be included in the scope of the calculation. This includes:

- (i) any relevant entity subject to the regulation or supervision of any other supervisor and which entity is subject to separate prudential requirements;
- (j) any relevant entity with assets in excess of one per cent of the consolidated assets of the relevant reporting bank or controlling company, which assets shall in all cases exclude any intragroup balances and which entity shall not be a dormant entity;
- (k) any relevant entity with net income after tax in excess of five per cent of the consolidated net income after tax amount of the relevant reporting bank or controlling company;

² See Discussion Document 1, section 10.2.1. Available on the FSB website www.fsb.co.za

(l) any relevant entity with intragroup exposure or other financial relationship with the relevant insurance group in excess of two per cent of the consolidated amount of group exposure,

provided that in no case shall the aggregate amount of net income after tax or assets of all relevant entities deemed non significant respectively exceed twenty per cent of the said consolidated net income after tax or ten per cent of the said consolidated assets of the insurance group.

The remainder of this section sets out the specification for the calculation of the group solvency calculation for the various calculations required:

Current calculation (using the deduction approach) in section G.2.

SAM Alternative 1: Deduction and Aggregation approach in section G.3.

SAM Alternative 2: Accounting Consolidation approach in section G.4.

G.2. CURRENT CALCULATION *(USING THE DEDUCTION AGGREGATION APPROACH)*

G.2.1 Introduction

G.2.1.1 This section details the application of the deduction and aggregation (D&A) method for calculating the group solvency position for the purpose of the current calculation.

~~G.2.1.2 The D&A method is used for the calculation for the following methods tested in SA QIS 2:~~

~~(b) The Current method~~

~~(c) SAM Alternative 1~~

~~(d) SAM Alternative 2~~

~~(e) SAM Alternative 3~~

~~G.2.1.3 This section first describes the D&A method in general, and then consider specifics for each of the calculations mentioned above.~~

~~G.2.1.4~~G.2.1.2 Under this method, group solvency is assessed through the sum of the adjusted solo solvency capital requirements and own funds of the participating undertakings and of the proportional³ share of its related undertakings. The treatment of participations in particular types of entities at solo level will be reflected in the aggregated group SCR. For participations in non-financial entities, the equity risk charge as described in section SCR.1.B2. in the solo SCR of the participating entity should be applied to ensure a consistent approach with the accounting consolidation ~~other~~ methods.

³ The proportional share will be based on the economic interest in the participation, not the voting rights of the participation

~~G.2.1.5~~G.2.1.3 The table below summarises the treatment of different subsidiaries and participations for the purpose of the deduction and aggregation method. The table sets out the SCR and Own Funds to be counted towards the group SCR and Group Own Funds prior to any adjustments for intragroup transactions as described in sections G2.1 and G2.2 below.

Treatment of different subsidiaries and participations		
	SCR	Own Funds
<u>Treatment by type of entity</u>		
South African <u>Regulated insurer</u>	Solo SCR <u>Capital Adequacy Requirement</u>	Solo Own Funds <u>Capital resources on regulatory basis</u>
Non-South African <u>regulated insurer</u>	<u>Current local regulatory capital requirement</u>	<u>Current local regulatory capital resources</u>
Other financial regulated entity	Regulatory capital requirement as per the relevant sectoral rules	Regulatory capital resources as per the relevant sectoral rules
Non-regulated financial entity	Stress as set out in section SCR. 1.B2	Valuation as set out in section SCR. 15 <u>14.2</u>
Non-financial entity	Stress as set out in section SCR. 1.B2	Valuation as set out in section SCR. 15 <u>14.2</u>
Holding company	Stress as set out in section SCR. 1.B2	Valuation as set out in section SCR. 15 <u>14.2</u>
Special purpose entity	Stress as set out in section SCR. 1.B2	Valuation as set out in section SCR. 15 <u>14.2</u>
<u>Treatment by nature of holding</u>		
Subsidiary (as per G.22)	Proportion of SCR in line with economic interest	Proportion of Own Funds in line with economic interest.
	If the subsidiary is in deficit (Own Funds < SCR), the full deficit will be taken into account	
Participation (as per G.22)	Proportion of SCR in line with economic interest	Proportion of Own Funds in line with economic interest
Holding of less than 20% with no significant influence	This holding will not be considered as an entity within the scope of group supervision, and will be taken <u>treated</u> as any other equity investment	

G.2.2 Aggregated group SCR

G.2.2.1 The aggregated group SCR is the sum of the following:

- (a) the SCR of the participating-parent undertaking;
- (b) the proportional share of the SCR of the related undertakings⁴.

G.2.2.2 However, the D&A method need all SCRs to be adjusted for intra-group transactions^{5 6} in order to produce an accurate group solvency position. In the deduction and aggregation method adjustments are needed to eliminate any intra-group transactions in the aggregated group SCR to ensure that those risk charges are not added twice (i.e. there is no double charge by adding the risk charges in both the participating and related undertaking).

$$\text{adjusted SCR}_{\text{group}} = \sum \text{SCR}_{\text{solo-adjusted}}$$

G.2.2.3 Examples of adjustments made for intragroup transactions are described in G.2.3.238.

G.2.2.4 Groups may take into account materiality considerations in calculating the adjustment for intra-group transactions. In that case, groups should explain what materiality rule was used, as well as its rationale. Groups may wish to focus on the most material intra-group transactions.

G.2.3 Aggregated group own funds

G.2.3.1 The aggregated group eligible own funds are the sum of the following:

- (a) the own funds eligible for the SCR of the participating undertaking;
- (b) the proportional share of the participating undertaking in the own funds eligible for the SCR of the related undertakings⁷.

G.2.3.2 In order to eliminate the potential for double gearing, the own funds in each group entity should be based on an assessment of the solo own funds after the deduction of participations and subsidiaries and removal of other intra-group arrangements. As under this option no diversification benefits are being considered in assessing the group SCR, there should be no adjustments in the capital resources reflecting diversification benefits.

Examples of impact of removing intragroup transactions		
	Impact on SCR	Impact on Own Funds
Intragroup Loan	The SCR for the lender should be adjusted to remove the counterparty default risk associated with the risk that the borrower does not repay the loan.	The Own Funds for both the borrower and the lender should be adjusted to remove the value of the loan from the balance sheet.
Insurance	The equity or participation charge associated	The value of the subsidiary or participation

⁴ Any share which is owned by a third party, where that third party has the option to return the shareholding should not be included in the group SCR calculation

⁵ ~~For the purpose of SA-QIS2, no adjustments will be made for intragroup reinsurance~~

⁶ Intragroup transactions will only relate to those that are done within the SA Group. Where a SA Insurance Groups form part of a wider international group intragroup transactions made to the wider group will be regarded as third party transactions.

⁷ Any share which is owned by a third party, where that third party has the option to return the shareholding should not be included in the group own funds

company holding any subsidiary or participation	with the subsidiary or participation holding should be removed from the insurer's SCR	holding should be removed from the insurer's balance sheet
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G.2.3.3 When conducting the adjustments described, the group should only focus on the adjustments which are considered to be material at the group level. It is up to each group to consider what is deemed to be material.

G.2.4 Eligible group own funds

G.2.4.1 In order to be considered eligible to cover the group SCR, the available group own funds must comply at group level with the tier limits applied at solo level.

G.2.4.2 As regards the undertakings operating in the other financial sectors⁸, the elements eligible at group level are those that qualify in accordance with the relevant sectoral rules.

G.2.5 Availability of certain own funds for the group

G.2.5.1 There may be restrictions on availability of certain own funds, which have to be considered when assessing the available own funds at group level.

G.2.5.2 Groups should consider whether own funds available to cover the SCR at solo level cannot effectively be made available for the group on the basis of the following criteria:

- (a) The national legal or regulatory provisions applicable to those own funds are such that they are dedicated to absorb only certain losses;
- (b) The national legal or regulatory provisions applicable to the assets representing those own funds are such that transferring those assets to another insurance or reinsurance undertaking is not allowed;
- (c) Making those own funds available for the group would not be possible within a maximum of 9 months.

For each of the points listed above, groups should provide information on the amounts and indicate the relevant national or regulatory provisions.

According to the criteria set out in this paragraph, any **equalization reserves** established at solo level should be admitted to contribute to the coverage of the group SCR only in so far as they are admitted for covering the SCR of the related undertaking and up to the contribution of the related undertaking to the group SCR.

In addition to conditions set out in paragraph G.432.5.2, groups should pay particular attention to at least the following items:

Eligible ancillary own funds

G.2.5.3 Under SAM, any ancillary own funds of a related insurance undertaking for which the group solvency is calculated may only be included in the calculation in so far as the ancillary own

⁸ Consistent with method 1 of the European Financial Conglomerate Directive, where relevant.

funds have been duly authorised by the supervisory authority responsible for the supervision of that related undertaking.

- G.2.5.4 For the purpose of SA QIS3, ancillary own funds may be included in the group calculation only in so far as they are eligible for covering the SCR of the related undertaking according to the specifications set out in [the section 5](#) (Own Funds) of these technical specifications and up to the contribution of the related undertaking to the group SCR.

Hybrid capital and subordinated liabilities

- G.2.5.5 Hybrid capital and subordinated debts cannot, in principle, be considered as available to cover the SCR of the participating undertaking if they are not issued or guaranteed by the ultimate parent undertaking of the group. This depends on the rights of the subscribers to the revenues from these instruments. In particular, subordinated liabilities issued by group undertakings are normally only available to support the business of the issuing undertaking because of its legal liability to subscribers to those debts.
- G.2.5.6 Hybrid capital instruments and subordinated liabilities issued by undertakings other than the ultimate parent undertaking should be admitted to contribute to the coverage of the group SCR only in so far as they are admitted for covering the SCR of the related undertaking and up to the contribution of the related undertaking to the group SCR.
- G.2.5.7 The same instruments issued by an undertaking operating in another financial sector can contribute to the coverage of the group SCR only in so far as they are eligible to meet capital adequacy requirements as established in applicable sectoral legislation, and only within the limits provided therein.
- G.2.5.8 If the subordinated liabilities contribute to the group SCR for a total in excess of their contribution to the solo SCR, groups are requested to indicate the amount of such contribution, explain the methods applied to derive the contribution and indicate the relevant national rules.

Eligible own funds related to deferred tax assets

- G.2.5.9 Where the taxation regime applicable to insurance groups does not allow them to benefit from tax integration for all the entities part of the group (e.g. groups that are not part of the same fiscal group), eligible own funds related to deferred tax assets may be included in the calculation of the group own funds only in so far as they are eligible for covering the SCR of the related undertaking and up to the contribution of the related undertaking to the group SCR.

Participations in non-SA (re)insurance entities

- G.2.5.10 All (re)insurance undertakings of the group are captured in the group SCR calculations, including any non-SA insurance undertakings.
- G.2.5.11 As regards the calculation of group own funds, there may be specific cases where the own funds in excess of the solo SCR are effectively non available for use elsewhere in the group within a maximum period of time of 9 months
- G.2.5.12 In such cases, eligible own funds in non-SA (re) insurance entities are available to meet the SCR of the participating undertaking only in so far as they are admitted for covering the SCR of the non-SA undertaking and any excess own funds is not available at group level.

Minority interests

G.2.5.13 Any minority interests in the available own funds exceeding the SCR of a related undertaking should not be considered as effectively available for the group.

~~G.2.6 — Current method~~

~~G.2.6.1 — When applying the D&A methodology in the current calculation, the approach above will be adopted by replacing the SCR with either the CAR for South African life insurers or the current FSB capital requirement for the South African short term insurers⁹.~~

~~G.2.6.2 — It is still important to adjust the capital requirement for intragroup transactions to avoid double counting of the capital charge. Specifically, adjustments will be needed to allow for the exposure to participations, as well as for intragroup reinsurance.~~

~~G.2.7 — SAM Alternative 1~~

~~G.2.7.1 — When applying the D&A methodology to SAM Alternative 1, the approach outline above should be followed without any adjustments. It is however, important to only apply the SAM rules for South African entities, with non South African entities using the local requirements to setting capital requirements and own funds.~~

~~G.2.8 — SAM Alternative 2~~

~~G.2.8.1 — When applying the D&A methodology to SAM Alternative 2, the approach outline above should be followed without any adjustments, with the SAM rules applied to both the South African and non South African entities. This calculation should be applied to all insurance entities, regardless of whether they are or are not likely to be deemed “equivalent” under the EU Solvency II regime.~~

~~G.2.8.2 — When applying the D&A methodology to SAM Alternative 2, significant simplifications may be applied in order to calculate the contribution to group capital requirements and group own funds from the non South African subsidiaries.~~

~~G.2.8.3 — A few possible simplifications are outlined below, although it should be noted that these are not intended to be an exhaustive list, but rather to illustrate possible simplifications that could be used.~~

~~Simplification 1~~

~~G.2.8.4 — If the equivalent South African capital requirement is known for a specific non South African operation, the ratio of the South African life insurer’s SCR to CAR could be used to estimate the SCR for the non South African life insurance business. In this case, the formula would be~~

$$\text{SCR}_{\text{non-SA}} = \text{SCR}_{\text{SA}} * (\text{CAR}_{\text{non-SA}} / \text{CAR}_{\text{SA}})$$

~~G.2.8.5 — The above formula does make many assumptions, specifically that the risk profile in the South African business is similar to the risk business in the non South African business. It is very unlikely that this will be appropriate for the whole insurer, but this type of simplification could be used by basing the ratio on South African business which is similar to the non South African business for which the SCR is being estimated.~~

~~G.2.8.6 — A similar approach could be used in order to estimate other parts of the calculations needed, for example technical provisions or own funds.~~

⁹As with the calculation for solo insurers, the current capital requirement for short term insurers are taken to be the calculation as per the interim measures as described under Board Notice 169 of 2011.

Simplification 2

~~G.2.8.7— There may be some components of the SAM calculations that could be obtained through rough estimates, especially where these components are unlikely to form a significant part of the overall SAM balance sheet. Examples of these include:~~

- ~~(b) Risk margin— this could be estimated by applying a percentage of best estimate liabilities based on that obtained for similar business sold in South Africa~~
- ~~(c) Components of the SCR standard formula calculation— in a similar way to the risk margin estimates, some of the standard formula modules could be estimated based on the results obtained for the South African business where there are similar risk drivers.~~

Simplification 3

~~G.2.8.8— In order to ease the calculations, a flat risk free rate of 10% may be assumed for non South African entities, especially where there is no market data available to derive a risk free rate in line with the SAM methodology.~~

G.2.9— SAM Alternative 3

~~G.2.9.1— When applying the D&A methodology to SAM Alternative 1, the approach outline above should be followed, but using the results from the internal model where available for the SCRs of the South African business. Any assumptions made for the adjustments required to the SCRs for intragroup transactions should be consistent to the assumptions used in the internal model.~~

G.3. SAM ALTERNATIVE 1: DEDUCTION AGGREGATION METHOD

G.3.1 The Deduction Aggregation approach described in section G.2 should be followed with the following changes.

Treatment of South African insurers

G.3.2 The SCR and Own Funds that should be used in this methodology are the numbers as calculated for the solo SA QIS3 specifications. As per section G.2, these SCR and Own Funds numbers will then need to be adjusted to take into account intragroup transactions.

Treatment of non-South African insurers

G.3.3 For the purpose of SA QIS3 insurers in OECD countries should be treated as equivalent, and as such it is appropriate to use the local regulatory rules to determine the SCR and Own Funds for these insurers.

G.3.4 Non-OECD countries should be treated as non-equivalent for the purpose of SA QIS3, and as such they should follow the treatment as set out in Position Paper 85. This means that the entities are not required to be included within the group solvency calculation if:

- (a) The particular operation is not regarded as strategically important, or
- (b) The group is prepared to include the particular operation at nil value in the calculation of the group own funds (and the group SCR) and the particular operation is solvent based on the local statutory solvency rules.

G.3.5 For the purposes of the above, an entity is deemed to be strategically important if

- (a) The particular operation uses the brand/name of the group or a brand/name that is closely associated with the group, or
- (b) The group has provided explicit guarantees, commitments, letters of comfort or cross-default commitments to the particular entity, or
- (c) The group has management and/or board control over the entity, or
- (d) The group consolidates the financial results of the entity in its accounts.

G.4. SAM ALTERNATIVE 2: ACCOUNTING CONSOLIDATION-BASED METHOD

G.4.1 Scope of the accounting consolidation method

G.4.1.1 As set out in Position Paper 92, it is envisaged that the group solvency calculation under SAM will only allow for diversification benefits between South African insurers. For this reason, the accounting consolidation approach described below will only apply to South African insurance entities within the group. All remaining entities within the group will need to be aggregated as per the deduction and aggregation approach as set out in section G.3

G.4.1G.4.2 Group technical provisions

G.4.1.1G.4.2.1 The group best estimate of insurance liabilities should be the sum of solo best estimate of insurance liabilities with only the elimination of the part of the best estimate resulting from internally reinsured activities in order to avoid double counting of commitments as in the consolidated accounts.

G.4.1.2G.4.2.2 The risk margin of technical provisions for a group should be equal to the sum of the following:

- (a) the risk margin of the participating insurance or reinsurance undertaking;
- (b) the proportional share of the participating undertaking in the risk margin of the related insurance or reinsurance undertakings.

G.4.2G.4.3 Treatment of participations in the consolidated group SCR

G.4.2.1G.4.3.1 This subsection describes the calculation of the group SCR according to the accounting consolidation-based method (alternative method 2).

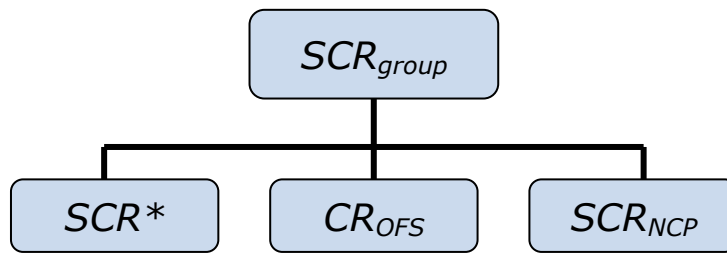
G.4.2.2G.4.3.2 The treatment of participations at group level should be based on the following criteria:

- (a) the assessment of the participation should be based on economic principles, not just on legal grounds. Control and influence should always be assessed at a group level to determine the significance of participations. This ensures that situations where several entities of a group have small participations in the same undertaking are not overlooked;
- (b) in general, the consolidation approach used for accounting purposes should be used for solvency purposes to the extent that consolidation is based on economic principles suitable for a solvency assessment.

G.4.2.3G.4.3.3 The component of group SCR in respect of the controlled (dominant influence) insurance entities, SPVs, insurance holding companies and ancillary entities is denoted SCR^* . This component is calculated by applying the standard formula to the consolidated data as if it were a single entity and based on QIS2 solo specifications. This means that diversification benefits are recognised between these groups' entities.

G.4.2.4G.4.3.4 The group SCR – denoted as SCR_{group} – is then calculated as the sum of SCR^* , the capital requirement for other financial sectors assessed on the basis of sectoral rules (CR_{OFS}), and the

SCR for non-controlled (significant influence) participations (SCR_{NCP}). This can then be shown as a sum of the SCR components as in the diagram below:



G.4.2.5G.4.3.5 Further details on specific elements of SCR^* , CR_{OFS} and SCR_{NCP} are set out below.

Participations in insurance entities

G.4.2.6G.4.3.6 When the group's participation in a (re)insurer is regarded as a dominant influence, according to the definition of the Solvency Assessment and Management (SAM) Framework, this will imply a full integration of the participation in the accounts or a proportional integration (if there is jointly shared control). In case of a fully integrated participation, minority interests would in turn contribute to cover part of the group SCR, with some limitations. The same treatment applies to an SPV over which dominant influence is exercised.

G.4.2.7G.4.3.7 When the group's participation in a (re)insurer is regarded as a significant influence, according to the definition of the SAM Framework, the contribution to the group SCR in respect of the participation should be calculated as the group's share in the participation multiplied by the solo SCR of this participation. This approach is considered consistent with the equity accounting method described in IAS 28. Where data from the previous year are not available, data for the previous regulatory capital requirement may be used as a proxy. The contribution of the participation in an SPV is calculated following the IFRS consolidation rules. The contribution of the insurance undertakings and SPV in which the group has a significant influence will form SCR_{NCP} (SCR of non-controlled participations) which is to be added to SCR^* without recognition of any diversification effects.

G.4.2.8G.4.3.8 If groups deem that following the IFRS consolidation rules for the treatment of SPV leads to inappropriate outcomes they can remove the SPV from the consolidated accounts. Groups would then need to perform the deconsolidation and provide confirmation that the SPV does not provide a source of risk. Groups are invited to comment on the method applied and on any problems/instances encountered following IFRS consolidation, in particular with reference to its effect on the group own funds and to the group SCR.

G.4.2.9G.4.3.9 When the group's interest in a (re)insurer is lower than 20% and is not regarded as a significant influence, the contribution to the group SCR should be calculated by applying the relevant capital charges (inter alia equity risk charge and the concentration risk charge) to the value of the group's interest.

Participation in insurance holding companies

G.4.2.10G.4.3.10 Controlled insurance holding companies should be consolidated. This means a full integration of the participations in the intermediate insurance holding company and the insurance undertakings in which the intermediate insurance holding company holds participations is required.

~~G.4.2.11~~G.4.3.11 The insurance holding company will, for the purpose of the calculation of the group solvency capital requirement and group own funds, be treated as an insurance entity.

Participation in ancillary services undertakings

~~G.4.2.12~~G.4.3.12 Controlled ancillary services undertakings should be consolidated through a full integration of the participation in the accounts.

~~G.4.2.13~~G.4.3.13 Ancillary services undertakings are entities whose principal activity consists of:

- (a) owning or managing property
- (b) managing data-processing services
- (c) or any other similar activity which is ancillary to the principal activity of an insurance undertaking.

~~G.4.2.14~~G.4.3.14 Ancillary services undertakings that are subject to a significant influence should be consolidated through the equity method.

~~G.4.2.15~~G.4.3.15 Ancillary services undertakings which are not a subsidiary undertaking should be treated according to the provisions set out in the section SCR.~~1.B2~~.

Participations in other financial sector entities

~~G.4.2.16~~G.4.3.16 The contribution to the group SCR of participations (both dominant and significant influence) which are held in other financial sectors should be determined according to the requirements of that other financial sector in line with the regulatory valuations and capital requirements as prescribed by the relevant regulator.

~~G.4.2.17~~G.4.3.17 In case of financial non-regulated entity a notional solvency requirement should be calculated. The notional solvency requirement should be the capital requirement with which such an entity would have to comply with under the relevant sectoral rules as if it were a regulated entity of that particular financial sector.

~~G.4.2.18~~G.4.3.18 When participations in another financial sector form a group for which a specific capital requirement exists, the latter, (instead of the sum of the requirements of each solo entity) should be used.

~~G.4.2.19~~G.4.3.19 The sum of the capital requirements of participations in other financial sectors will form CR_{OFS} which is to be added to SCR^* without recognition of any diversification effects.

Participations in non financial sector

~~G.4.2.20~~G.4.3.20 As a general principle, participations in entities outside the financial sector (both dominant and significant influence) should be consolidated through the equity method, this means that the relevant capital requirements (inter alia equity risk capital requirement and the concentration risk capital requirement) are to be calculated on the value of that participation on the basis of the provisions set out in the section SCR.~~1.B2~~.

G.4.3G.4.4 Additional guidance for the calculation of the consolidated group SCR

Market risk (currency risk)

~~G.4.3.1~~G.4.4.1 Currency risk at group level needs to take into account the currency risk towards the currency of the group's consolidated accounts. Therefore, the local currency referred to in the currency

risk calculation of the standard formula is the currency used for the preparation of the group's consolidated financial statements.

Double use of the loss absorbing capacity of technical provisions

- | ~~G.4.3.2~~G.4.4.2 The double counting of the loss-absorbing capacity of technical provisions should be avoided. This double counting occurs because the standard formula SCR is calculated according to a modular approach. The overall risk that the undertaking is exposed to is divided into several sub-risks. The capital requirement for each sub-risk is quantified separately and then aggregated to arrive at the solvency requirement for the overall risk.
- | ~~G.4.3.3~~G.4.4.3 Undertakings should pay attention to the adjustment done in the standard formula to ensure that there is no double use of the loss absorbing capacity of technical provisions. In the case of a group that includes several entities with participating business, ensuring that there is no double use is even more complex. For example, where there are several entities writing assets-backing participating policies within a group, a comparison with the overall value of future discretionary bonuses may not detect a double counting of the risk-mitigating effect relating to one kind of benefits. The limitation of the loss-absorbing effect of future profit participation to the amount of Future Discretionary Benefits (FDB) on the pre-stressed balance sheet needs to be applied to both the loss-absorbing effect at the group level and at the solo level.

Adjustment for the loss-absorbing capacity of deferred tax liabilities and assets

- | ~~G.4.3.4~~G.4.4.4 Where the taxation regime applicable to insurance groups does not allow them to benefit from tax integration for all the entities which are part of the group (e.g. groups that are not part of the same fiscal group), the adjustment for the loss-absorbing effect of deferred taxes at group level should be corrected to take this into account. For entities included in the calculation of SCR* (for which diversification is recognised), groups may use the following simplification to assess the adjustment for the loss-absorbing effect of deferred taxes at group level:

$$Adj_{DT}^{Group} = \sum_i Adj_{DT,i}^{solo} \times \frac{SCR^*}{\sum_i SCR_i^{solo}}$$

where:

the index (*i*) covers all entities of the group included in the calculation of the SCR* and

$Adj_{DT,i}^{solo}$ is the solo Adjustment for the loss-absorbing effect of deferred taxes of entity *i* (at solo level)

SCR_i^{solo} is the solo SCR of entity *i* (at solo level), after adjustment for the risk absorbing capacity of technical provisions and before adjustment for loss absorbing capacity of deferred taxes

$\frac{SCR^*}{\sum_i SCR_i^{solo}}$ the ratio should be considered as a proportional adjustment due to diversification effects

~~G.4.3.5~~G.4.4.5 Whenever possible, the above mentioned simplification should be calculated net of intra-group transactions as regards the solo SCR and the adjustment for deferred taxes at solo level in order to improve the accuracy of the simplification.

~~G.4.4~~G.4.5 **Floor to the group SCR**

General considerations

~~G.4.4.1~~G.4.5.1 A group SCR floor applies when using the accounting consolidation method (not when using the D&A method) and is equal to the sum of the of the following:

- (a) the MCR of the participating insurance and reinsurance undertakings
- (b) the proportional share of the MCR of the related insurance undertakings.

~~G.4.4.2~~G.4.5.2 The solo MCR used for the group SCR floor calculation should be the MCR as described in section 4 of these technical specifications (Calculation of the MCR).

~~G.4.4.3~~G.4.5.3 The calculation b) above should consider the proportional share of the related undertaking that is included in the consolidated accounts (i.e. covered with minority interests when these are included as group own funds).

~~G.4.4.4~~G.4.5.4 Therefore, when the proportional share used in the consolidated accounts is 100% for a related undertaking (either corresponding group participation or minority interests participations treated as group own funds), the proportional share should be 100 per cent.

~~G.4.4.5~~G.4.5.5 The contribution of non-SA entities to the group SCR floor should be the local capital requirement corresponding to the final intervention point of the local supervisor.

~~G.4.4.6~~G.4.5.6 The floor SCR so calculated only applies to SCR*.

Guidance for the calculation of the equivalent of the MCR for non- SA entities

~~G.4.4.7~~G.4.5.7 The local MCR for non-SA entities to be taken into account when calculating the group floor should be the legal level under which the authorisation will be withdrawn in the third country.

~~G.4.4.8~~G.4.5.8 Some jurisdictions include a formulaic approach to measure available and required capital and hence derive a mathematical result that could be compared to the MCR. The local triggers for some of these jurisdictions are suggested below for SA QIS2. Comments are welcomed on the appropriateness of these local MCR (level under which the authorisation will be withdrawn in the non SA jurisdiction). The suggestions below do not of course pre-judge the outcome of any eventual work on determination of equivalence:

- (a) Japan: 200% of the Solvency Margin Ratio (SMR). The SMR ratio is multiplied by a factor of two. So, to ascertain the real solvency ratio, all reported values should be halved. Therefore twice the SMR should be used as the MCR (consistent with a ratio of available capital to required capital at 100%).
- (b) United States: the US regulator has defined 5 action levels to the RBC calculation; for the purpose of SA QIS2 the Authorized Control Level should be used as the MCR (100% of the Authorized Control level - first point where the ability of the company to write new business is affected- the regulations also allow the supervisor to take over control of the entity).
- (c) Switzerland: the Swiss Solvency Test (SST) defines three intervention thresholds based on the SST ratio. Only the threshold 3 implies that ultimate action will be taken by the regulator to protect policyholders. Where it is not possible for an insurance undertaking to initiate

suitable measures and where the measures ordered by the regulator do not also result in success in the short term, the regulator will revoke the insurance undertaking's authorisation. Therefore threshold 3 (33% of the Target Capital) should be used as the MCR.

G.4.5G.4.6 Consolidated group own funds

G.4.5.1G.4.6.1 When applying the accounting consolidation method, eligible own funds at group level should be assessed as follows.

Step 1 - Balance sheet according to accounting consolidation rules

G.4.5.2G.4.6.2 The balance sheets of all entities belonging to the group, including both SA and non-SA entities, should be consolidated according to the accounting consolidation rules. As a result, intra-group transactions and internal creation of capital should be eliminated.

Step 2 - Balance sheet according to SAM rules

G.4.5.3G.4.6.3 Balance sheet items should be valued in accordance with the specifications on valuation set out for the solo insurance and reinsurance undertakings of the group.

G.4.5.4G.4.6.4 Own funds related to other financial sectors should be valued according to the relevant sectoral rules¹⁰.

Step 3 - Contribution of non available own funds of the related undertakings to group own funds (Minority interests are treated separately)

G.4.5.5G.4.6.5 In addition to surplus funds and any subscribed but not paid-up capital, other own funds could also be considered as not effectively available to cover the SCR of the participating insurance undertaking for which the group solvency is calculated. Such non-available own funds may cover the group SCR only in so far as they are eligible to cover the SCR of the related undertaking.

G.4.5.6G.4.6.6 The group should pay particular attention to own funds which are indicated in subsection G.3.6 below when assessing their availability at group level.

G.4.5.7G.4.6.7 For each related undertaking, the global amount of solo non-available own funds should be considered available for covering the group SCR up to the contribution of solo SCR to group SCR.

G.4.5.8G.4.6.8 In order to assess the contribution of solo SCR to group SCR from entity j ($Contr_j$) included in the calculation of SCR^* (the entities for which diversification is recognised), the following proxy should be used:

$$Contr_j = SCR_j \times \frac{SCR^*}{\sum_i SCR_i^{solo}}$$

where:

(a) the index (i) covers all entities of the group included in the calculation of the SCR^*

¹⁰ This should be done consistent with the European Financial Conglomerates Directive, where relevant.

(b) SCR_i^{solo} is the solo SCR of entity i

(c) SCR_j is the SCR of undertaking j

(d) the ratio can be considered as a proportional adjustment due to diversification effects

~~G.4.5.9~~G.4.6.9 Without such a limitation of availability of solo own funds, own funds available to cover the SCR^* would be overestimated, as shown in the example in Annex R.

~~G.4.5.10~~G.4.6.10 This proposed approach results in a simplification, since there is no specific reason for which diversification benefits should come ‘equally’ from each undertaking of the group (that is to say that the possible reduction of the SCR obtained at group level comes equally from each undertaking, in proportion of their solo SCR). The effect of such limitation of availability of solo own funds (using the theoretical contribution of the solo SCR to the group SCR) may affect the extent to which eligible own funds in subsidiaries are included in group available own funds.

~~G.4.5.11~~G.4.6.11 As regards undertakings operating in other financial sectors, the same non available own funds can contribute to the coverage of the group SCR only in so far as they are eligible to meet capital adequacy requirements as established in the applicable sectoral legislation, and only within the limits provided therein.

~~G.4.5.12~~G.4.6.12 As a result, the global amount of non available solo own funds which are available to cover the group SCR is equal to the amount up to the sum of the contributions to group SCR at solo level, after the elimination of double use of eligible own funds, and it does not stem directly from the consolidated balance sheet.

~~G.4.5.13~~G.4.6.13 For undertakings using an internal model the attribution of diversification can be carried out using the internal model. Groups should explain the method used for allocating diversification effects when using an internal model.

Step 4 - Available group own funds

~~G.4.5.14~~G.4.6.14 The available group own funds to cover the group SCR can be calculated by deducting from the group own funds the sum of non available solo excess own funds (determined for each entity included in the consolidated balance sheet).

Step 5 - Eligible group own funds

~~G.4.5.15~~G.4.6.15 In order to be considered eligible to cover the SCR^* and SCR_{NCP} the available group own funds must comply at group level with the tier limits applied at solo level.

~~G.4.5.16~~G.4.6.16 As regards the undertakings operating in the other financial sectors¹¹, the elements eligible at group level are those that qualify in accordance with the relevant sectoral rules.

G.4.6G.4.7 Availability of certain own funds for the group

~~G.4.6.1~~G.4.7.1 As mentioned above, there may be restrictions on availability of certain own funds, which have to be considered when assessing the available own funds at group level.

~~G.4.6.2~~G.4.7.2 Groups should consider whether own funds available to cover the SCR at solo level cannot effectively be made available for the group on the basis of the following criteria:

¹¹ Consistent with method 1 of the European Financial Conglomerate Directive, where relevant.

- (a) The national legal or regulatory provisions applicable to those own funds are such that they are dedicated to absorb only certain losses;
- (b) The national legal or regulatory provisions applicable to the assets representing those own funds are such that transferring those assets to another insurance or reinsurance undertaking is not allowed;
- (c) Making those own funds available for the group would not be possible within a maximum of 9 months.

For each of the points listed above, groups should provide information on the amounts and indicate the relevant national or regulatory provisions.

According to the criteria set out in this paragraph, any **equalization reserves** established at solo level should be admitted to contribute to the coverage of the group SCR only in so far as they are admitted for covering the SCR of the related undertaking and up to the contribution of the related undertaking to the group SCR.

In addition to conditions set out in paragraph G.119, groups should pay particular attention to at least the following items:

Eligible ancillary own funds

- | ~~G.4.6.3~~G.4.7.3 Under SAM, any ancillary own funds of a related insurance undertaking for which the group solvency is calculated may only be included in the calculation in so far as the ancillary own funds have been duly authorised by the supervisory authority responsible for the supervision of that related undertaking.
- | ~~G.4.6.4~~G.4.7.4 For the purpose of SA QIS2, ancillary own funds may be included in the group calculation only in so far as they are eligible for covering the SCR of the related undertaking according to the specifications set out in section 5 (Own Funds) of these technical specifications and up to the contribution of the related undertaking to the group SCR.

Hybrid capital and subordinated liabilities

- | ~~G.4.6.5~~G.4.7.5 Hybrid capital and subordinated debts cannot, in principle, be considered as available to cover the SCR of the participating undertaking if they are not issued or guaranteed by the ultimate parent undertaking of the group. This depends on the rights of the subscribers to the revenues from these instruments. In particular, subordinated liabilities issued by group undertakings are normally only available to support the business of the issuing undertaking because of its legal liability to subscribers to those debts.
- | ~~G.4.6.6~~G.4.7.6 Hybrid capital instruments and subordinated liabilities issued by undertakings other than the ultimate parent undertaking should be admitted to contribute to the coverage of the group SCR only in so far as they are admitted for covering the SCR of the related undertaking and up to the contribution of the related undertaking to the group SCR.
- | ~~G.4.6.7~~G.4.7.7 The same instruments issued by an undertaking operating in another financial sector can contribute to the coverage of the group SCR only in so far as they are eligible to meet capital adequacy requirements as established in applicable sectoral legislation, and only within the limits provided therein.
- | ~~G.4.6.8~~G.4.7.8 If the subordinated liabilities contribute to the group SCR for a total in excess of their contribution to the solo SCR, groups are requested to indicate the amount of such contribution, explain the methods applied to derive the contribution and indicate the relevant national rules.

Eligible own funds related to deferred tax assets

G.4.6.9G.4.7.9 Where the taxation regime applicable to insurance groups does not allow them to benefit from tax integration for all the entities part of the group (e.g. groups that are not part of the same fiscal group), eligible own funds related to deferred tax assets may be included in the calculation of the group own funds only in so far as they are eligible for covering the SCR of the related undertaking and up to the contribution of the related undertaking to the group SCR.

Participations in non-SA (re)insurance entities

G.4.6.10G.4.7.10 All (re)insurance undertakings of the group are captured in the group SCR calculations, including any non-SA insurance undertakings.

G.4.6.11G.4.7.11 As regards the calculation of group own funds, there may be specific cases where the own funds in excess of the solo SCR are effectively non available for use elsewhere in the group within a maximum period of time of 9 months

G.4.6.12G.4.7.12 In such cases, eligible own funds in non-SA (re) insurance entities are available to meet the SCR of the participating undertaking only in so far as they are admitted for covering the SCR of the non-SA undertaking and any excess own funds is not available at group level.

Minority interests

G.4.6.13G.4.7.13 Any minority interests in the available own funds exceeding the SCR of a related undertaking should not be considered as effectively available for the group.

G.4.6.14G.4.7.14 Given that the SCR of the group is less than the sum of the solo requirements due to the recognition of some diversification benefits, it will not be possible to calculate directly the contribution of minority interest of a subsidiary to the group SCR.

G.4.6.15G.4.7.15 In order to calculate such a contribution from the minority interests of subsidiary j, $Contr_{mi-j}$ for which diversification is recognised, the following proxy should be used:

$$Contr_{mi-j} = SCR_{mi-j} \times \frac{SCR^*}{\sum_i SCR_i^{solo}}$$

where:

- (a) the index (i) covers all entities of the group included in the calculation of the SCR^*
- (b) SCR_{mi-j} refers to the contribution of the minority interest of the subsidiary j to the solo SCR
- (c) the ratio $\frac{SCR^*}{\sum_i SCR_i^{solo}}$ can be considered as a proportional adjustment due to diversification effects

G.4.6.16G.4.7.16 The effect of such theoretical assessment of the contribution to the group SCR may affect the inclusion within eligible group own funds of a minority interest in the SCR of a subsidiary. Groups are invited to suggest any alternative method for allocating diversification effects when using an internal model.

G.5. COMBINATION OF METHODS

- G.5.1 As mentioned in subsection G.1.2. groups may choose to perform an optional calculation which combines the accounting consolidation and deduction and aggregation methods. In practice, this means that at least one entity within the scope of the group is subject to a different method. The objective of this option is to have a measure of the diversification benefits that can be obtained with the accounting consolidation method compared to the deduction and aggregation method.
- G.5.2 The group supervisor may, after consulting the other supervisors concerned and the group itself, allow for the use of the accounting consolidation method or a combination of both methods. Possible situations where supervisors would assess the use of the alternative method, include:
- (a) The availability of a group internal model
 - (b) High quality and amount of information enabling a consolidated view
- G.5.3 In QIS2, under the Alternative method groups are free to decide, which entities are subject to each method.
- G.5.4 When using the combination of both methods, the group SCR floor should be applied. In such case, the group SCR floor defined in subsection G.3.4 should only apply to the (re)insurance part of the group covered by each method respectively (i.e. by comparing the sum of the MCR of the entities covered by the consolidated method to the part of the group SCR calculated with that method).

G.6. TREATMENT OF PARTICIPATING BUSINESSES AND RING-FENCED FUNDS

G.6.1 General comments on group SCR calculation and loss absorbing capacity of technical provisions

G.6.1.1 On the loss-absorbing capacity of technical provisions, groups should refer to the relevant section of these technical specifications (section SCR.23).

G.6.1.2 Where undertakings within a group write participating business and there are restricted own funds items that can only be used to cover the liabilities for a limited set of policyholders within a legal entity, then it is important to identify those items at group level. As a result, the straight application of the standard formula to the consolidated accounts is complex and requires specific attention as there can exist several participating businesses stemming from different countries with their own specificities.

G.6.1.3 If an arrangement is considered as ring-fenced fund at solo level, it has also to be considered ring fenced in the consolidated accounts. As a consequence, any adjustment done for the calculation of the capital requirement and own funds at solo level for those funds will apply, mutatis mutandis, at group level when calculating the group SCR and own funds. Therefore, as far as ring-fenced funds are concerned, groups should refer to section SCR.49 of these SA QIS23 specifications.

G.6.1.4 The group net calculation should include the allowance of realistic management actions at the group level and consistent management actions at the solo level in relation to future bonus rates in response to the scenario being tested.

G.6.1.5 Groups should in particular consider whether the loss-absorbing effect of technical provisions may be limited to certain parts of the group because of contractual or legal constraints (e.g. the legal entity of origin). When calculating the adjustment for the loss-absorbing effect of technical provisions at group level, groups should ensure that the assumptions they make are consistent with any such contractual or legal constraints in this regard (see example below).

G.6.2 General comments on available own funds

G.6.2.1 Where the accounting consolidation method is applied the group will need to identify any subsidiary for which a ring fenced fund exists in accordance with section SCR.49 of these technical specifications. Under the deduction & aggregation method the effects of adjustment due to the existence of a ring-fenced fund will automatically be carried forward to the group calculations and no further adjustments are required.

G.6.2.2 If at solo level the only adjustment due to the existence of a ring-fenced fund is the recognition of the impact of a profit participation mechanism in respect of the outcome of bi-directional scenarios, the same methodology as applied at solo level should be adopted at group level (see SCR.49). However, in the group calculation this would have regard to the worst case scenario for the group as a whole.

G.6.2.3 Where at solo level in addition to the SCR impact described, own funds within a ring fenced fund are restricted so that only the amount meeting the notional SCR calculated for the ring fenced fund is treated as available, the same approach will need to be adopted at group level. Own funds within a solo ring fenced fund can be regarded as available group own funds to the extent they are meeting the notional SCR for the ring fenced fund. The notional SCR will need to

be adjusted from that calculated at solo level so that it represents the relevant contribution to the consolidated group SCR. The adjustment methodology set out in step 3 of group own funds calculations should be applied as a proxy to establish the contribution of the notional SCR of the ring fenced fund to the group SCR i.e. the ratio of SCR* to the sum of all solo SCRs should be applied to the notional SCR of the ring fenced fund.

G.6.2.4 Under both the accounting consolidation and deduction & aggregation methods however there will be a need to identify any undertakings which do not have adjustment due to the existence of a ring-fenced fund at solo level but for which restrictions on own funds of this kind exist at group level. This might only arise where the whole of the business of the solo undertaking comprises one ring fenced fund. The solo methodology would then apply as though that undertaking was a ring fenced fund and the group the undertaking of which it forms a part, in respect of the accounting consolidation method. If this situation were to apply in the case of a deduction and aggregation calculation the amount of own funds in excess of the solo SCR would be excluded from available group own funds.

G.6.2.5 It follows from the above that groups will need to ensure that they are aware of the nature of arrangements and the national specificities which apply in the jurisdictions in which their related undertakings operate and which might give rise to ring fenced funds in one jurisdiction even if they do not have the same effect in the jurisdiction of the parent undertaking.

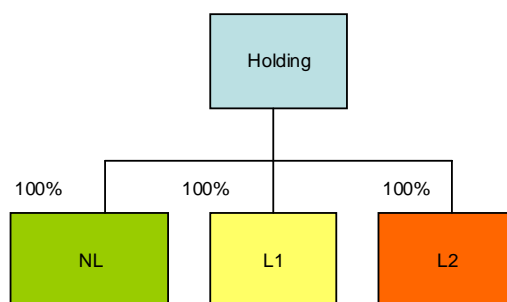
G.6.3 Example for the calculation of the group SCR with the consolidated method in the case of several participating businesses

G.6.3.1 The following example aims at drawing the attention of groups on the calculation of sub-modules or modules of the standard formula via a scenario in a group context.

G.6.3.2 Example: a group has 3 insurance undertakings and one insurance holding company. The only activity of the insurance holding company is to hold the 3 insurance undertakings: NL, L1 and L2:

- (a) NL is a non-life insurance undertaking in country X
- (b) L1 is a life undertaking writing participating business attributing to policyholders the maximum of the minimum guaranteed rate of 2% and 90% of its financial products of L1 in country Y
- (c) L2 is a life insurance undertaking also writing participating business attributing to policyholders 95% of the return on assets of L2 in country Z.

G.6.3.3 The following scheme illustrates the structure of the group where no intra-group transactions occur.



G.6.3.4 For the purpose of the example, the interest rate risk sub-module will be considered.

G.6.3.5 The table below summarises the impact for the solo undertakings and the group of the interest rate shock.

		NL	L1	L2	Group
FDB at t=0	FDB	0	40	10	50
Up shock	Delta NAV IR up gross	-50	-20	+60	-10
	Delta NAV IR up net*	-50	+10	+50	+10
	Demand for FDB	0	30	-10	20
	Offered FDB	0	40	10	50
	Resulting FDB	0	10	20	30
	Resulting Delta NAV IR up net**	-50	+10	+50	+10
Down shock	Delta NAV IR down gross	+20	+10	-45	-15
	Delta NAV IR down net*	+20	-5	-25	-10
	Demand for FDB	0	-15	20	5
	Offered FDB	0	40	10	50
	Resulting FDB	0	55	0	55
	Resulting Delta NAV IR down net**	+20	-5	-35	-20
IR capital charge	Delta NAV IR	-50	-5	-35	-20

* before FDB limit applied

** after FDB limit applied

G.6.3.6 The example illustrates a case where the impact of the interest rate shock is much lower at group level than at solo level as the undertakings within the group have opposing sensitivities to that risk within the group. It also shows the importance being sure that the offsets between positive and negative effects which arise from different part of the groups as observed in the example are fully justified.

G.6.3.7 Looking at the calculation of the down shock in more detail, the global decrease of 20 for the group comes from:

- (a) an increase of 20 for the non-life business coming from NL
- (b) a decrease of 5 for the business of L1

- (c) a decrease of 25 for the business of L2, however the loss-absorbency capacity of the FDBs within L2 is limited to 10 and hence a decrease of 35 for the business of L2 applies.

It should be ensured that all the legal and contractual commitments and appropriate management actions have been included for business of the group underwritten by L1 and L2.

G.6.3.8 It would not seem appropriate not to distinguish the change of net asset value for the assets and liabilities coming from L1, L2 and the rest of the group (NL here). For example, the down shock on interest rate on the business of L2 will have an impact on the liability coming from that entity that depends not only on the change of the discount rate but also on future discretionary benefits for L2 policyholders. Those future discretionary benefits depend only on the return on assets of L2 (and not of the others assets of the group) and that has therefore to be reassessed separately. The rationale also applies when an equivalent scenario is used for group calculation.

G.6.3.9 Once those calculations have been done for each participating business and the rest of the business ensuring that all relevant constraints have been taken into account, then potential offsetting of positive and negative effects can be done to find the global impact of the decrease of interest rate at the group level.