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Dear___________

Treatment of Deferred Tax Asset

In June 2009 we wrote to a number of parties on the matter, making some suggestions and inviting comments on alternative treatments.

The essence of the June 2009 suggestion was that the matter should be treated as a reduction to policy liabilities. The responses indicated that nearly all companies employed an alternative method of treating the recovery as an asset. Most companies pointed out that although the recovery from policyholders was the first method of recovery there were other methods and that treatment as an asset was more appropriate in such cases.

Accordingly the Financial Regulator is proposing not to restrict the treatment to any particular format but require that companies communicate to us what method they use. We are however proposing guidance on the maximum value that should be set on such expected recoveries, on Actuarial treatment and on liquidity issues. This is being issued on a "comply or explain" basis to apply with effect from 31st December 2009, so if a company believes that such guidance is inappropriate then it should contact us to discuss why it holds this belief.

From the responses to the initial suggestions it is believed that this is largely a formalisation of existing practice and is accordance with sound financial and actuarial practice. Therefore we are not envisaging any further consultation. However if any party has a question or query on (or believes there is a mistake in) this guidance please contact us.

Proposed Overall Guidance on Expected Recoveries

For the purpose of meeting technical provisions or Solvency Margin Requirements, Companies may take value for expected recoveries provided it is reasonable for them to expect value for such recovery on a prudent basis. This may be done either by treatment of the expected recovery as a reduction in liabilities (if appropriate) or by treatment as an asset.

The value taken must not exceed the maximum value as set out in guidance below.

The value taken must not cause breach of the guidance on liquidity as set out below.

The Company must comply with requirements on disclosure as set out below.

Proposed Guidance on Maximum Values to be taken on Expected Recoveries

The maximum value that can be placed on the expected recoveries should be obtained by discounting at an appropriate rate of interest to the expected date of recovery.

The expected date of recovery should be the date at which the company may, on prudent assumptions expect to receive value for the recovery.

The consideration of appropriate rates of interest and the expected date of recovery will vary according to the expected source of recovery.

A: Deductions made from payments to Policyholders

If the expected source of recovery is through deductions made from payments to policyholders:-

a. The minimum rate of discount should reflect the expected return on the policyholder assets as used in the cash reserve calculation (e.g. the return on the unit linked assets if it is a unit linked policy)

b. The expected date of recovery should be based on the maturity date of the policy and allow for the expected recovery at that date. Lapsation may be taken into account but this must be on a prudent basis.

B: Relief against Other Group tax

If the expected source of recovery is through relief on other taxation liabilities of the group to which the insurance company belongs, then there must be a binding agreement within the group that there will be payment for surrender of such relief. The value taken must be based on the expected payment and:-

a. The minimum rate of discount should reflect the market interest rate that would be required by the market on loans issued by the group of that duration (determined by reference to actual loan stock or by reference to loan stock of similar entities of the same credit rating)

b. The expected date of recovery must reflect the actual date on which cash is expected to be received

C: Recovery from the Italian Tax Authorities

If the expected source of recovery is through recovery from the Italian Tax Authorities then

a. The rate of discount should reflect the market interest rate on Italian Government stock of appropriate duration

b. The expected date of recovery should be increased by two years from the date at which the recovery would be theoretically possible to reflect administrative delays unless the Company has actual experience of achieving such recoveries in which case the date should be based on experience.

D: Recovery from Future Advanced Payments

As these are the replacement of one possible recovery by another, value should not be taken through this route without more detailed Actuarial consideration (see below).

Proposed Guidance on Liquidity

Tax recoveries are not liquid in the short term. Therefore in matching rectangles and for purposes of Paragraph 3 of Annex IV of SI 360 of 1994 they should be treated appropriately.

The restricted liquidity may mean that the tax recovery will not be treated as an asset matching technical provisions. However if such does apply then the appropriate resilience test must be applied in the Actuarial valuation.

Proposed Guidance on Future Payments

The impact of future tax payments and their recovery should be taken into account in cash flow projections undertaken by the Appointed Actuary for the purposes of valuation. It is possible to do this is a number of ways and it is not intended to specify the method. However whatever method is used, the discount rate, timing of

described above. For purposes of completing Regulatory returns it should be noted that no new business and no lapses are normally assumed, however if assuming a lapse rate leads to higher reserves then a prudent lapse should be allowed for.

Proposed Guidance on Disclosure

Unless no value is being taken for expected recoveries, full disclosure of the treatment and value taken must be made with annual returns. This would not form part of the formal returns, it would not need to be formally audited (though auditors should be given copies) and would not form part of the publically disclosed documents. Quarterly disclosure is only necessary should the treatment have changed since the last disclosure. The disclosure should take the form of:-

a. A table showing, split by Company accounting year, the amounts paid to the tax authorities, the amounts already recovered (split by method of recovery), amounts remaining to be recovered and expected value of these recoveries.
b. Explanation of the method of calculation of expected value of recoveries (i.e. A, B or C above or a combination of these methods)
c. The interest rate (or rates) used in discounting and the expected date of recovery
d. If method B is adopted then such information as is relevant to establishing the likelihood that such recovery will be made in practice; the nature of the guarantee and details of any historic payments that might indicate that the guarantee had been called upon. In addition if the guarantee is predicated on there being other group taxes to be set against then details of tax payments by the group would indicate the likelihood of the tax advance being recoverable.
e. Descriptions of the approach used in to calculate the liability for future tax payments.

No disclosure is necessary from companies unaffected by this issue.

Yours sincerely,

Tony Jeffery

Deputy Head of Insurance Supervision