Interpretation Notes for Module C of the Guideline on Group Supervision (“GL32”)

Contents

Introduction

The Insurance Authority ("IA") issues these Interpretation Notes to supplement the guidance provided to designated insurance holdings companies in Module C of GL32 on the Insurance (Group Capital) Rules (Cap. 41O) ("Group Capital Rules") which the IA made under sections 95ZI and 129 of the Insurance Ordinance (Cap. 41).

These Interpretation Notes set out the IA's views as to how certain provisions of the Group Capital Rules operate, by reference to illustrative examples. These Interpretation Notes do not, however, have the force of law and should not be interpreted in a way that would override the provision of any law. Further, these Interpretation Notes are not intended to be a comprehensive guide and do not constitute legal advice. Persons who have questions on the Group Capital Rules are advised to seek professional advice. The IA reserves the right to review and update these Interpretation Notes from time to time.

Unless otherwise specified, words and expressions in these Interpretation Notes shall have the same meanings as given to them in the Group Capital Rules and GL32, as relevant.

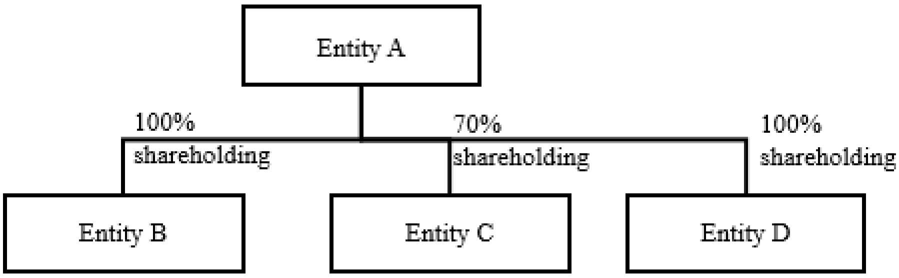
Examples 1 to 6 describe the treatment of double-counting in the determination of Group Minimum Capital Requirement, Group Prescribed Capital Requirement, Eligible Group Capital Resources and allocation to Tier 1 Group Capital and Tier 2 Group Capital.

Example 1: Supervised group member holds shares in another supervised group member

a) Description of the supervised group

In this example, the supervised group comprises four supervised group members: "Entity A", "Entity B", "Entity C" and "Entity D".

"Entity B" and "Entity D" are wholly-owned subsidiaries of "Entity A". "Entity C" is a 70% owned subsidiary of "Entity A".



"Entity A" is the designated insurance holding company. "Entity A", "Entity B" and "Entity C" are authorised to carry on insurance business in jurisdiction a, jurisdiction b and jurisdiction c respectively. "Entity D" is authorised to carry on securities business in jurisdiction d. In other words, "Entity A", "Entity B", "Entity C" and "Entity D" are regulated entities.

In accordance with the laws relating to regulatory capital in jurisdiction a, the minimum capital requirement ("MCR"), prescribed capital requirement ("PCR") and eligible capital resources of "Entity A" are <u>not</u> determined based on consolidating together the assets, liabilities and capital resources of "Entity A", "Entity B", "Entity C" and "Entity D". They are instead determined by referring only to the assets, liabilities and capital resources of Entity A (i.e. on an unconsolidated/standalone basis). As such, Rules 8(2) and 8(3) of the Group Capital Rules do not apply.

The value of the shares owned by "Entity A" in "Entity B", "Entity C" and "Entity D" are, however, included in the assets of "Entity A" for the purpose of determining the eligible capital resources of "Entity A". As such, Rule 8(7) of the Group Capital Rules needs to be considered (which requires the amount of any, inter alia, direct holding by a supervised group member in the shares of another supervised group member to be deducted from the eligible capital resources of the supervised group, to the extent such amount has already been included in the eligible group capital resources of the supervised group by reason of Rule 6(1) of the Group Capital Rules).

b) Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Entity A	a	$MCR_a(A)$	$PCR_a(A)$	$CR_a(A)$
Entity B	b	$MCR_b(B)$	$PCR_b(B)$	$CR_b(B)$
Entity C	c	$MCR_c(C)$	$PCR_c(C)$	$CR_c(C)$
Entity D	d	$MCR_d(D)$	$PCR_d(D)$	$CR_d(D)$

c) Calculations

$GMCR = 100\% \times MCR_a(A) + 100\% \times MCR_b(B) + 70\% \times MCR_c(C) + 100\% \times MCR_d(D)$

$GPCR = 100\% \times PCR_a(A) + 100\% \times PCR_b(B) + 70\% \times PCR_c(C) + 100\% \times PCR_d(D)$

Eligible group capital resources = $100\% \times CR_a(A) + 100\% \times CR_b(B) + 70\% \times CR_c(C) + 100\% \times CR_d(D)$ – the amount of shares which “Entity A” holds in “Entity B”, “Entity C”, and “Entity D”.

d) Numerical Example (please refer to section (c) for the relevant formulae)

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Entity A	a	50	70	100
Entity B	b	100	150	200
Entity C	c	180	220	300
Entity D	d	1	2	10

Notes:

(1) Assume that the amount for the shares which "Entity A" holds in "Entity B", "Entity C", and "Entity D" is 90.

(2) Assume also that this amount (90) has already been included in the eligible group capital resources of the supervised group, as part of the resources of "Entity B", "Entity C" and "Entity "D" which count towards meeting the respective MCRs or PCRs applicable to those entities in accordance with the laws relating to regulatory capital in jurisdictions b, c and d respectively (per Rule 6(1) of the Group Capital Rules).

(3) The GMCR, GPCR and eligible group capital resources of the supervised group is calculated as follows:

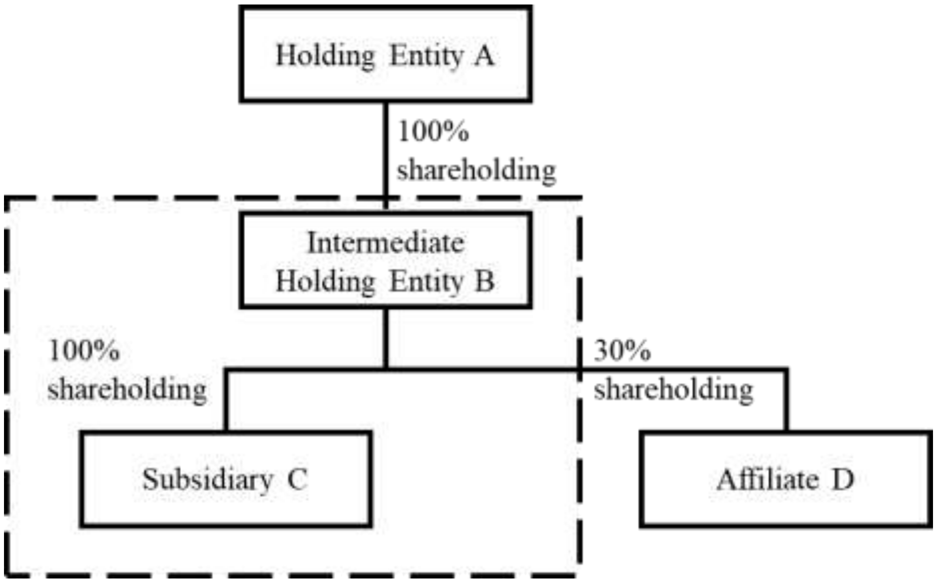
- GMCR = 100% × 50 + 100% × 100 + 70% × 180 + 100% × 1 = 277
- GPCR = 100% × 70 + 100% × 150 + 70% × 220 + 100% × 2 = 376
- Eligible group capital resources
  = 100% × CR_a(A) + 100% × CR_b(B) + 70% × CR_c(C) + 100% × CR_d(D) – the amount of shares which "Entity A" holds in "Entity B", "Entity C", and "Entity D"
  = 100% × 100 + 100% × 200 + 70% × 300 + 100% × 10 – 90 = 430

Example 2: Stacked entities

a) Description of the supervised group

In this example, the supervised group comprises four supervised group members: "Holding Entity A", "Intermediate Holding Entity B", "Subsidiary C" and "Affiliate D".

"Intermediate Holding Entity B" is a wholly-owned subsidiary of "Holding Entity A". "Subsidiary C" is a wholly-owned subsidiary of "Intermediate Holding Entity B". "Affiliate D" is 30% owned by "Intermediate Holding Entity B".



"Holding Entity A" is the designated insurance holding company and it is a non-regulated entity. "Intermediate Holding Entity B", "Subsidiary C" and "Affiliate D" are authorized to carry on insurance business in jurisdiction b, jurisdiction c and jurisdiction d respectively (i.e. they are regulated entities).

b) Definition of quantities

Supervised group member	Jurisdiction of incorporation	MCR	PCR	Eligible capital resources
Holding Entity A	a	0	0	$CR_a(A)$
Intermediate Holding Entity B	b	$MCR_b(B)$	$PCR_b(B)$	$CR_b(B)$
Subsidiary C	c	$MCR_c(C)$	$PCR_c(C)$	$CR_c(C)$
Affiliate D	d	$MCR_d(D)$	$PCR_d(D)$	$CR_d(D)$

Notes:

(1) As "Holding Entity A" is a non-regulated entity, its MCR and PCR are both equal to zero (Rule 4(2)(b) and Rule 5(2)(b) of the Group Capital Rules).

(2) The MCR, PCR and eligible capital resources of Intermediate Holding Entity B, Subsidiary C and Affiliate D (being regulated entities) are determined in accordance with the laws relating to regulatory capital in jurisdictions b, c and d respectively (per Rules 4(2)(a), 5(2)(a) and 6(3)(a) of the Group Capital Rules).

c) Financial statement of “Holding Entity A”

Assets		**Liabilities and Equities**	
Investment in subsidiary (Intermediate Holding Entity B)	$InvSubB_a(A)$	Total liabilities	$Liab_a(A)$
Financial assets	$FinAsset_a(A)$	Share capital	$ShareCap_a(A)$
Intangible assets	$IntanAsset_a(A)$	Retained earnings	$ReEarn_a(A)$

Note:

As “Holding Entity A” is a non-regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(b) of the Group Capital Rules:-

$$CR_a(A) = ShareCap_a(A) + ReEarn_a(A) – IntanAsset_a(A)$$

d) Consolidated financial statement of “Intermediate Holding Entity B”

Assets		**Liabilities and Equities**	
Investment in associate (Affiliate D)	$InvAsoD_b(B)$	Total liabilities	$Liab_b(B)$
Other assets	$OthAsset_b(B)$	Share capital	$ShareCap_b(B)$
		Retained earnings	$ReEarn_b(B)$

Notes:

(1) As “Intermediate Holding Entity B” is a regulated entity, its eligible capital resources are determined, per rule 6(3)(a) of the Group Capital Rules, as its resources and financial instruments which are eligible to be counted towards satisfying the MCR or PCR applicable to “Intermediate Holding Entity B” in accordance with the laws relating to regulatory capital in jurisdiction b.

(2) In accordance with the laws relating to regulatory capital in jurisdiction b, the MCR, PCR and eligible capital resources of “Intermediate Holding Entity B” are determined by consolidating the assets, liabilities and capital resources of “Intermediate Holding Entity B” and “Subsidiary C”. However, the shares owned by “Intermediate Holding Entity B” in “Affiliate D” are included as a separate asset in the balance sheet of “Intermediate Holding Entity B”, for the purposes of determining its MCR, PCR and eligible capital resources (i.e. “Intermediate Holding Entity B” and “Affiliate D” are non-consolidated).

(3) Assume, for the purposes of this example, that in accordance with the laws relating to regulatory capital in jurisdiction b the eligible capital resources of “Entity B” are determined as follows:-

$$CR_b(B) = ShareCap_b(B) + ReEarn_b(B)$$

e) Calculations

$GMCR = 100\% \times 0 + 100\% \times MCR_b(B) + 30\% \times MCR_d(D)$

$GPCR = 100\% \times 0 + 100\% \times PCR_b(B) + 30\% \times PCR_d(D)$

Eligible group capital resources = $100\% \times CR_a(A) + 100\% \times CR_b(B) + 30\% \times CR_d(D) - InvSubB_a(A) - InvAsoD_b(B)$

Notes:

(1) "Holding Entity A" owns 100% of "Intermediate Holding Entity B". However, the assets, liabilities and capital resources of "Holding Entity B" are not consolidated on the balance sheet of "Holding Entity A" for the purpose of determining the MCR and PCR of "Holding Entity A". Rather, the investment of "Holding Entity A" in the shares of "Intermediate Entity B" are included as a separate asset in the balance sheet of "Holding Entity A". Accordingly, Rules 8(2) and 8(3) of the Group Capital Rules do not apply and the MCR, PCR and eligible capital resources of both "Holding Entity A" and "Intermediate Holding Entity B" are included in the calculation of the GMCR, GPCR and eligible group capital resources of the supervised group.

(2) "Intermediate Holding Entity B" owns 100% of "Subsidiary C". The MCR and PCR applicable to "Intermediate Holding Entity B" are determined by consolidating assets, liabilities and capital resources of both "Intermediate Holding Entity B" and "Subsidiary C". In order to avoid double counting, therefore, the MCR and PCR of "Subsidiary C" are not included in the GMCR and GPCR respectively by virtue of Rules 8(2)(b) and 8(3)(b) of the Group Capital Rules. The capital resources of Subsidiary C are included in the eligible group capital resources if and only to the extent that they are eligible to be counted towards satisfying the MCR and PCR of "Intermediate Holding Entity B" (see Rules 8(2)(c) and 8(3)(c) of the Group Capital Rules).

(3) Rules 8(2) and 8(3) of the Group Capital Rules, however, do not apply in relation to "Intermediate Holding Entity B"'s investment in the shares of "Affiliate D" (as the assets, liabilities and capital resources of "Intermediate Holding Entity B" and "Affiliate D" are not consolidated for the purposes of determining the MCR and PCR applicable to "Intermediate Holding Entity B"). As such, the MCR and PCR applicable to Affiliate D and the eligible capital resources of "Affiliate D" are included separately in the GMCR and GPCR and eligible group capital resources of the supervised group. Per Rules 4(4), 5(4) and 6(4)

of the Group Capital Rules, however, only 30% of the MCR and PCR and eligible capital resources of “Affiliate D” are included for this purpose to reflect the fact that Intermediate Holding Entity’s shareholding in “Affiliate D” is only 30%.

(4) With regards to the value of the shares held by “Holding Entity A” in “Intermediate Holding Entity B”, Rule 8(7)(a) of the Group Capital Rules applies, such that the value of such holding is deducted from the eligible group capital resources of the supervised group (so as to avoid double-counting with the eligible capital resources of “Intermediate Holding Entity B” which are also included in the calculation of the eligible group capital resources). Similarly with regards to the value of the shares held by “Intermediate Holding Entity B” in “Affiliate D”, Rule 8(7)(a) of the Group Capital Rules applies, such that the value of such holding is deducted from the eligible group capital resources of the supervised group (so as to avoid double counting with the eligible capital resources of “Affiliate D” which are also included in the calculation of the eligible group capital resources). No deduction needs to be made in relation to “Intermediate Holding Entity B”’s shareholding in “Subsidiary C”, given that (per Rules 8(2) and 8(3) of the Group Capital Rules) Subsidiary C’s eligible capital resources have only been included once, as part of the eligible capital resources which count towards satisfying the MCR and PCR of “Intermediate Holding Entity B” (hence there is no double-counting) – see Note (2).

f) Numerical Example (please refer to section (e) for the relevant formulae)

Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Holding Entity A	a	0	0	$CR_a(A)$
Intermediate Holding Entity B	b	170*	220*	$CR_b(B)$*
Subsidiary C	c	25	45	55
Affiliate D	d	250	450	700

*Includes consolidated assets and liabilities of both "Intermediate Holding Entity B" and "Subsidiary C" for the purpose of determining the MCR and PCR applicable to "Intermediate Holding Entity B", and the capital resources of "Subsidiary C" to the extent that they are eligible to be counted to towards satisfying the MCR and PCR of "Intermediate Holding Entity B".

Financial statement of "Holding Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary (Intermediate Holding Entity B)	50	Total liabilities	180
Financial assets	200	Share capital	20
Intangible assets	10	Retained earnings	60

$CR_a(A) = 20 + 60 – 10 = 70$

Consolidated financial statement of "Intermediate Holding Entity B"

Assets		**Liabilities and Equities**	
Investment in associate (Affiliate D)	150	Total liabilities*	400
Other assets*	550	Share capital	50
		Retained earnings	250

*Includes consolidated assets and liabilities of both "Intermediate Holding Entity B" and "Subsidiary C" for the purpose of determining the MCR and PCR applicable to "Intermediate Holding Entity B", and the capital resources of "Subsidiary C" to the extent that they are eligible to be counted to towards satisfying the MCR and PCR of "Intermediate Holding Entity B".

$CR_b(B) = 50 + 250 = 300$

Calculations

GMCR = 100% × 0 + 100% × 170 + 30% × 250 = 245

GPCR = 100% × 0 + 100% × 220 + 30% × 450 = 355

Eligible group capital resources
= 100% × $CR_a(A)$ + 100% × $CR_b(B)$ + 30% × $CR_d(D)$ – $InvSubB_a(A)$ – $InvAsoD_b(B)$
= 100% × 70 + 100% × 300 + 30% × 700 – 50 – 150 = 380

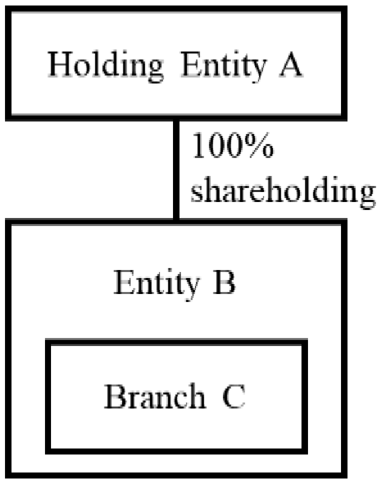
Example 3: Branch

a) Description of the supervised group

In this example, the supervised group comprises two supervised group members: “Holding Entity A” and “Entity B”.

“Entity B” is a wholly-owned subsidiary of “Holding Entity A”.

“Holding Entity A” is the designated insurance holding company and it is a non-regulated entity. “Entity B” is authorized to carry on insurance business in jurisdiction b, which is also the jurisdiction in which “Entity B” is incorporated or formed. “Entity B” is also authorized to carry on insurance business in jurisdiction c and has a place of business in jurisdiction c (referred to as “Branch C”). Thus, Company B is a regulated entity in two jurisdictions.



b) Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Holding Entity A	a	0	0	$CR_a(A)$
Entity B	b	$MCR_b(B)$ $MCR_c(B)$	$PCR_b(B)$ $PCR_c(B)$	$CR_b(B)$ $CR_c(B)$

Notes:

(1) Since “Holding Entity A” is a non-regulated entity, its MCR and PCR are both equal to zero (Rule 4(2)(b) and Rule 5(2)(b) of the Group Capital Rules).

(2) Entity B is a regulated entity in two jurisdictions. $MCR_b(B)$, $PCR_b(B)$ and $CR_b(B)$ are the MCR, PCR and eligible capital resources for “Entity B” in accordance with the laws relating to regulatory capital in jurisdiction b. $MCR_c(B)$, $PCR_c(B)$ and $CR_c(B)$ are the MCR, PCR and eligible capital resources for “Entity B” in accordance with the laws relating to regulatory capital in jurisdiction c (in respect of the insurance business carried on by “Branch C”).

c) Financial statement of “Holding Entity A”

Assets		**Liabilities and Equities**	
Investment in subsidiary (Entity B)	$InvSubB_a(A)$	Total liabilities	$Liab_a(A)$
Financial assets	$FinAsset_a(A)$	Share capital	$ShareCap_a(A)$
Intangible assets	$IntanAsset_a(A)$	Retained earnings	$ReEarn_a(A)$

Note:

Since “Holding Entity A” is a non-regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(b) of the Group Capital Rules:-

$$CR_a(A) = ShareCap_a(A) + ReEarn_a(A) – IntanAsset_a(A)$$

d) Calculations

$GMCR = 100\% \times 0 + 100\% \times MCR_b(B)$

$GPCR = 100\% \times 0 + 100\% \times PCR_b(B)$

Note: Since “Entity B” is a regulated entity in both jurisdiction b (where it is incorporated or formed) and in jurisdiction c (where it has “Branch C”), only the MCR and PCR applicable to “Entity B” in jurisdiction b are included in the GMCR and GPCR, per Rules 8(5)(a) and 8(5)(b) of the Group Capital Rules. The MCR and PCR applicable in jurisdiction c (where “Branch C” is located) are not included in the GMCR and GPCR.

Eligible group capital resources

$= 100\% \times CR_a(A) + 100\% \times CR_b(B) - InvSubB_a(A)$

Notes:

(1) In accordance with Rule 8(5)(c) of the Group Capital Rules, the capital resources of “Branch C” would be included in the eligible group capital resources of the supervised group if they are eligible to be counted towards satisfying the MCR or PCR of “Entity B” in jurisdiction b (where “Entity B” is incorporated and formed).

(2) In accordance with Rule 8(7)(a) of the Group Capital Rules, the value of the shares held by “Holding Entity A” in “Entity B” is deducted from the eligible group capital resources of the supervised group.

e) Numerical Example (please refer to section (d) for the relevant formulae)

Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Holding Entity A	a	0	0	$CR_a(A)$
Entity B	b	100 75	200 150	250 200

Financial statement of "Holding Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary (Entity B)	100	Total liabilities	200
Financial assets	250	Share capital	50
Intangible assets	50	Retained earnings	150

$CR_a(A) = 50 + 150 – 50 = 150$

Calculations

$GMCR = 100\% \times 0 + 100\% \times 100 = 100$

$GPCR = 100\% \times 0 + 100\% \times 200 = 200$

Eligible group capital resources
$= 100\% \times CR_a(A) + 100\% \times CR_b(B) – InvSubB_a(A)$
$= 100\% \times 150 + 100\% \times 250 – 100 = 300$

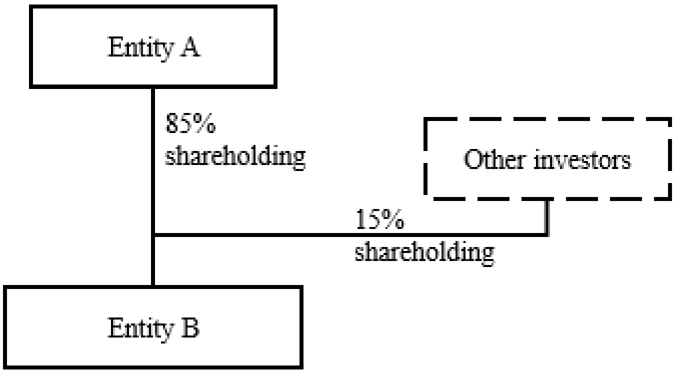
Example 4: Joint-venture structure with intra-group financial instruments

a) Description of the supervised group

In this example, the supervised group comprises two supervised group members, “Entity A”, and “Entity B”.

“Entity B” is 85% owned by “Entity A”. The remaining 15% shareholding in “Entity B” is owned by several other investors that do not belong to the supervised group.

“Entity A” is the designated insurance holding company and it is a non-regulated entity. “Entity B” is authorized to carry on insurance business in jurisdiction b and, hence, is a regulated entity.



b) Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Entity A	a	0	0	$CR_a(A)$
Entity B	b	$MCR_b(B)$	$PCR_b(B)$	$CR_b(B)$

Note:

Since "Entity A" is a non-regulated entity, its MCR and PCR are both equal to zero (Rule 4(2)(b) and Rule 5(2)(b) of the Group Capital Rules).

c) Financial statement of "Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary (Entity B)	$InvSubB_a(A)$	Total liabilities	$Liab_a(A)$
Subordinated loans to subsidiary (Entity B)	$LoansB_a(A)$	Share capital	$ShareCap_a(A)$
Financial assets	$FinAsset_a(A)$	Retained earnings	$ReEarn_a(A)$
Intangible assets	$IntanAsset_a(A)$		

Note:

Since "Entity A" is a non-regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(b) of the Group Capital Rules:-

$$CR_a(A) = ShareCap_a(A) + ReEarn_a(A) – IntanAsset_a(A)$$

d) Financial statement of "Entity B"

Assets		Liabilities and Equities	
Total assets	$Asset_b(B)$	Total liabilities, of which- Subordinated loans from Entity A	$Liab_b(B)$, of which- $Loan_b(B)$
		Share capital	$ShareCap_b(B)$
		Retained earnings	$ReEarn_b(B)$

Notes:

(1) Since "Entity B" is a regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(a) of the Group Capital Rules i.e. as the resources and financial instruments of "Entity B" that are eligible to be counted towards satisfying the MCR or PCR applicable to "Entity B" in accordance with the laws relating to regulatory capital in jurisdiction b.

(2) Assume, for the purposes of this example, that in accordance with the laws relating to regulatory capital in jurisdiction b the eligible capital resources of "Entity B" are determined as follows:-

$$CR_b(B) = ShareCap_b(B) + ReEarn_b(B) + Loan_b(B)$$

e) Calculations

GMCR = 100% × 0 + 85% × $MCR_b(B)$

GPCR = 100% × 0 + 85% × $PCR_b(B)$

Eligible group capital resources = 100% × $CR_a(A)$ + 85% × $CR_b(B)$ – $InvSubB_a(A)$ – $LoansB_a(A)$

Notes:

(1) Given that “Entity A” owns 85% of “Entity B”, per Rules 4(4) and 5(4) of the Group Capital Rules, only 85% of the MCR and PCR applicable to “Entity B” are included in the GMCR and GPCR.

(2) Similarly, given that “Entity A” owns 85% of “Entity B”, per Rule 6(4) of the Group Capital Rules, only 85% of the eligible capital resources of “Entity B” are included in the eligible group capital resources of the supervised group.

(3) With regards to the value of the shareholding held by “Entity A” in “Entity B” and the subordinated loan from “Entity A” to “Entity B” which is an asset on the balance sheet of “Entity A”, Rule 8(7)(a) of the Group Capital Rules applies, such that the value of such shareholding and subordinated loan (being a financial instrument issued by “Entity B” to “Entity A”) are deducted from the eligible group capital resources of the supervised group (so as to avoid double-counting with the eligible capital resources of Entity B which are also included in the calculation of the eligible group capital resources).

f) Numerical Example (please refer to section (e) for the relevant formulae)

Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Entity A	a	0	0	$CR_a(A)$
Entity B	b	180	220	$CR_a(B)$

Financial statement of "Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary (Entity B)	85	Total liabilities	180
Subordinated loans to subsidiary (Entity B)	20	Share capital	20
Financial assets	145	Retained earnings	60
Intangible assets	10		

$CR_a(A) = 20 + 60 – 10 = 70$

Financial statement of "Entity B"

Assets		**Liabilities and Equities**	
Total assets	750	Total liabilities, of which- Subordinated loans from Entity A	370, of which- 20
		Share capital	100
		Retained earnings	280

$CR_b(B) = 100 + 280 + 20 = 400$

Calculations

GMCR = 100% × 0 + 85% × 180 = 153

GPCR = 100% × 0 + 85% × 220 = 187

Eligible group capital resources

$= 100\% \times CR_a(A) + 85\% \times CR_b(B) - InvSubB_a(A) - LoansB_a(A)$

$= 100\% \times 70 + 85\% \times 400 - 85 - 20 = 305$

Example 5: Tiering

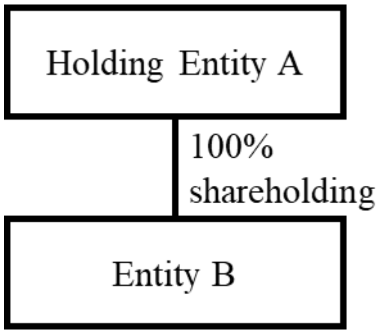
a) Description of the supervised group

In this example, the supervised group comprises of two supervised group members: “Holding Entity A” and “Entity B”.

“Entity B” is a wholly-owned subsidiary of “Holding Entity A”.

“Holding Entity A” is the designated insurance holding company and it is a non-regulated entity. “Entity B” is authorized to carry on insurance business in jurisdiction b, which is also the jurisdiction in which “Entity B” is incorporated or formed. “Entity B” is, therefore, a regulated entity.

The eligible capital resources of “Holding Entity A” are not determined by consolidating the assets, liabilities and capital resources of “Holding Entity A” and “Entity B”. They are instead determined by referring only to the assets, liabilities and capital resources of “Holding Entity A” (i.e. on an unconsolidated/standalone basis). However, the value of the shares owned by “Holding Entity A” in “Entity B” are included in the assets of “Holding Entity A” for the purpose of determining the eligible capital resources of “Holding Entity A”.



b) Definition of quantities

Supervised group member	Jurisdiction of incorporation	MCR	PCR	Eligible capital resources
Holding Entity A	a	0	0	$CR_a(A)$
Entity B	b	$MCR_b(B)$	$PCR_b(B)$	$CR_b(B)$

Note:

Since "Holding Entity A" is a non-regulated entity, its MCR and PCR are both equal to zero (Rule 4(2)(b) and Rule 5(2)(b) of the Group Capital Rules).

c) Financial statement of "Holding Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary	$InvSubB_a(A)$	Total liabilities, of which- Tier 2 financial instruments (subordinated debts)	$Liab_a(A)$, of which- $T2Debt(A)$
Other assets	$OtherAsset_a(A)$	Share capital	$ShareCap_a(A)$
Intangible assets	$IntanAsset_a(A)$	Retained earnings	$ReEarn_a(A)$

Notes:

(1) Since "Holding Entity A" is a non-regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(b) of the Group Capital Rules. Accordingly:-

$$CR_a(A) = ShareCap_a(A) + ReEarn_a(A) – IntanAsset_a(A) + T2Debt(A)$$

(2) Since "Holding Entity A" is a non-regulated entity, the allocation of its eligible capital resources to tier 1 group capital, tier 1 limited group capital or tier 2 group capital is determined in accordance with Rules 7(1)(b), 7(2) and 7(3)(b) of the Group Capital Rules. In general terms, this requires the allocation to be determined by reference to the criteria for tier 1 group capital or tier 1 limited group capital in Schedule 1 of the Group Capital Rules or the criteria for tier 2 group capital in Schedule 2 of the Group Capital Rules. For the purposes of this example, it is assumed that:

- Eligible capital resources of "Holding Entity A" to be allocated to tier 1 group capital = $ShareCap_a(A) + ReEarn_a(A) – IntanAsset_a(A) = CR_a(A) – T2Debt(A)$; and

- Eligible capital resources of "Holding Entity A" to be allocated to tier 2 group capital = $T2Debt(A)$

d) Financial statement of "Entity B"

Assets		**Liabilities and Equities**	
Total assets	$Assets_b(B)$	Total liabilities	$Liab_b(B)$
		Share capital	$ShareCap_b(B)$
		Retained earnings	$ReEarn_b(B)$

Notes:

(1) Since "Entity B" is a regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(a) of the Group Capital Rules i.e. as the resources and financial instruments of "Entity B" that are eligible to be counted towards satisfying the MCR or PCR applicable to "Entity B" in accordance with the laws relating to regulatory capital in jurisdiction b. Assume, for the purposes of this example, that in accordance with the laws relating to regulatory capital in jurisdiction b the eligible capital resources of "Entity B" are determined as follows:-

$$CR_b(B) = ShareCap_b(B) + ReEarn_b(B)$$

(2) Since "Entity B" is a regulated entity, the allocation of its eligible capital resources to tier 1 group capital, tier 1 limited group capital or tier 2 group capital is determined in accordance with rules 7(1)(a) and 7(3)(a) of the Group Capital Rules. In general terms, the allocation would depend on whether the laws relating to regulated capital in jurisdiction b (where "Entity B" is a regulated entity), adopt a tiering approach to regulatory capital. If the laws relating to regulatory capital in jurisdiction b adopt a tiering approach to regulatory capital, the allocation of the eligible capital resources of "Entity B" follows that approach. However, if the laws relating to regulatory capital in jurisdiction b do not adopt a tiering approach to regulatory capital, the eligible capital resources of "Entity B" are allocated to tier 1 group capital.

(3) For the purposes of this example, it is assumed that the laws relating to regulatory capital in jurisdiction b adopt a tiering approach to regulatory capital and in accordance with that approach, the allocation of the eligible capital resources of "Entity B" to the appropriate tier of group capital is as follows:-

- Eligible capital resources of "Entity B" to be counted towards tier 1 group capital = $CR_b(B)$

- Eligible capital resources of "Entity B" to be counted towards tier 2 group capital = 0

e) Calculations

$GMCR = 100\% \times 0 + 100\% \times MCR_b(B)$

$GPCR = 100\% \times 0 + 100\% \times PCR_b(B)$

Eligible group capital resources = $100\% \times CR_a(A) + 100\% \times CR_b(B) - InvSubB_a(A)$

Tier 1 group capital = $100\% \times (CR_a(A) - T2Debt(A)) + 100\% \times CR_b(B) - InvSubB_a(A)$

Tier 2 group capital = $100\% \times T2Debt(A) + 100\% \times 0$

Note:

(1) In accordance with Rule 8(7)(a) of the Group Capital Rules the value of any holding in the shares of "Entity B" by "Holding Entity A" that is included in the eligible group capital resources of the supervised group, is deducted from eligible group capital resources. This serves to avoid double-counting as these values are already reflected by the inclusion of the share capital of "Entity B" in the supervised group's eligible group capital resources.

(2) Given that the capital resources in "Entity B" is counted towards tier 1 group capital (rather than tier 2 group capital), the holding of shares in "Entity B" by "Holding Entity A" is deducted from the tier 1 group capital.

f) Numerical example (please refer to section (e) for the relevant formulae)

Definition of quantities

Supervised group member	Jurisdiction of incorporation	MCR	PCR	Eligible capital resources
Holding Entity A	a	0	0	$CR_a(A)$
Entity B	b	20	50	$CR_b(B)$

Financial statement of "Holding Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary	130	Total liabilities, of which- Tier 2 financial instruments (subordinated debts)	150, of which- 50
Other assets	60	Share capital	30
Intangible assets	10	Retained earnings	20

$CR_a(A) = 30 + 20 – 10 + 50 = 90$

Eligible capital resources of "Holding Entity A" to be counted towards tier 1 group capital = 30 + 20 – 10 = 40

Eligible capital resources of "Holding Entity A" to be counted towards tier 2 group capital = 50

Financial statement of "Entity B"

Assets		**Liabilities and Equities**	
Total assets	920	Total liabilities	800
		Share capital	130
		Retained earnings	-10

$CR_b(B) = 130 – 10 = 120$

Eligible capital resources of "Entity B" to be counted towards tier 1 group capital = 130 – 10 = 120

Eligible capital resources of "Entity B" to be counted towards tier 2 group capital = 0

Calculations

GMCR = 100% × 0 + 100% × 20 = 20

GPCR = 100% × 0 + 100% × 50 = 50

Eligible group capital resources
$= 100\% \times CR_a(A) + 100\% \times CR_b(B) - InvSubB_a(A)$
$= 100\% \times 90 + 100\% \times 120 – 130 = 80$

Tier 1 group capital
$= 100\% \times (CR_a(A) – T2Debt(A)) + 100\% \times CR_b(B) - InvSubB_a(A)$
$= 100\% \times 40 + 100\% \times 120 – 130 = 30$

Tier 2 group capital
$= 100\% \times T2Debt(A) + 100\% \times 0 = 100\% \times 50 = 50$

Example 6: Tiering with loan to subsidiary

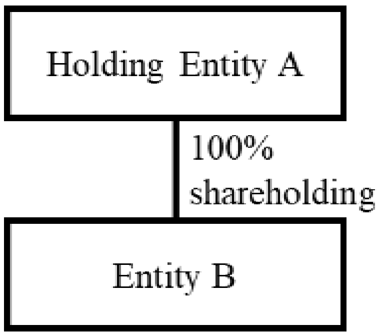
a) Description of the supervised group

In this example, the supervised group comprises of two supervised group members: “Holding Entity A” and “Entity B”.

“Entity B” is a wholly-owned subsidiary of “Holding Entity A”.

“Holding Entity A” is the designated insurance holding company and it is a non-regulated entity. “Entity B” is authorized to carry on insurance business in jurisdiction b, which is also the jurisdiction in which “Entity B” is incorporated or formed. “Entity B” is, therefore, a regulated entity.

The eligible capital resources of “Holding Entity A” are <u>not</u> determined by consolidating the assets, liabilities and capital resources of “Holding Entity A” and “Entity B”. Rather, they are determined by reference solely to the assets, liabilities and capital resources of “Holding Entity A” (i.e. on an unconsolidated/standalone basis). However, the value of the shares owned by “Holding Entity A” in “Entity B” are included in the assets of “Holding Entity A” for the purpose of determining the eligible capital resources of “Holding Entity A”.



b) Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**MCR**	**PCR**	**Eligible capital resources**
Holding Entity A	a	0	0	$CR_a(A)$
Entity B	b	$MCR_b(B)$	$PCR_b(B)$	$CR_b(B)$

Note:

Since “Holding Entity A” is a non-regulated entity, its MCR and PCR are both equal to zero (Rule 4(2)(b) and Rule 5(2)(b) of the Group Capital Rules).

c) Financial statement of "Holding Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary	$InvSubB_a(A)$	Total liabilities, of which- Tier 2 financial instruments (subordinated debts)	$Liab_a(A)$, of which- $T2Debt(A)$
Subordinated loans (issued by "Entity B")	$LoanB_a(A)$	Share capital	$ShareCap_a(A)$
Other assets	$OtherAsset_a(A)$	Retained earnings	$ReEarn_a(A)$
Intangible assets	$IntanAsset_a(A)$		

Notes:

(1) Since "Holding Entity A" is a non-regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(b) of the Group Capital Rules. Accordingly:

$$CR_a(A) = ShareCap_a(A) + ReEarn_a(A) – IntanAsset_a(A) + T2Debt(A)$$

(2) Since "Holding Entity A" is a non-regulated entity, the allocation of its eligible capital resources to tier 1 group capital, tier 1 limited group capital or tier 2 group capital is determined in accordance with Rules 7(1)(b), 7(2) and 7(3)(b) of the Group Capital Rules. In general terms, this requires the allocation to be determined by reference to the criteria for tier 1 group capital or tier 1 limited group capital in Schedule 1 of the Group Capital Rules or the criteria for tier 2 group capital in Schedule 2 of the Group Capital Rules. For the purposes of this example, it is assumed that:

- Eligible capital resources of "Holding Entity A" to be allocated to tier 1 group capital = $ShareCap_a(A) + ReEarn_a(A) - IntanAsset_a(A) = CR_a(A) - T2Debt(A)$

- Eligible capital resources of "Holding Entity A" to be allocated to tier 2 group capital = T2Debt(A)

d) Financial statement of "Entity B"

Assets		**Liabilities and Equities**	
Total assets	$Assets_b(B)$	Total liabilities, of which- Subordinated loans from "Holding Entity A"	$Liab_b(B)$, of which- $Loan_b(B)$
		Share capital	$ShareCap_b(B)$
		Retained earnings	$ReEarn_b(B)$

Notes:

(1) Since "Entity B" is a regulated entity, its eligible capital resources are determined in accordance with Rule 6(3)(a) of the Group Capital Rules i.e. as the resources and financial instruments of "Entity B" that are eligible to be counted towards satisfying the MCR or PCR applicable to "Entity B" in accordance with the laws relating to regulatory capital in jurisdiction b. Assume, for the purposes of this example, that in accordance with the laws relating to regulatory capital in jurisdiction b the eligible capital resources of "Entity B" are determined as follows:-

$$CR_b(B) = ShareCap_b(B) + ReEarn_b(B) + Loan_b(B)$$

(2) Since "Entity B" is a regulated entity, the allocation of its eligible capital resources to tier 1 group capital, tier 1 limited group capital or tier 2 group capital is determined in accordance with rules 7(1)(a) and 7(3)(a) of the Group Capital Rules. In general terms, the allocation would depend on whether the laws relating to regulated capital in jurisdiction b (where "Entity B" is a regulated entity), adopt a tiering approach to regulatory capital. If the laws relating to regulatory capital in jurisdiction b adopt a tiering approach to regulatory capital, the allocation of the eligible capital resources of "Entity B" follows that approach. However, if the laws relating to regulatory capital in jurisdiction b do not adopt a tiering approach to regulatory capital, the eligible capital resources of "Entity B" are allocated to tier 1 group capital.

(3) For the purposes of this example, it is assumed that the laws relating to regulatory capital in jurisdiction b adopt a tiering approach to regulatory capital and in accordance with that approach, the allocation of the eligible capital resources of "Entity B" to the appropriate tier of group capital is as follows:-

- Eligible capital resources of "Entity B" to be allocated to tier 1 group capital = $CR_b(B) – Loan_b(B)$

- Eligible capital resources of "Entity B" to be allocated to tier 2 group capital = $Loan_b(B)$

e) Calculations

$GMCR = 100\% \times 0 + 100\% \times MCR_b(B)$

$GPCR = 100\% \times 0 + 100\% \times PCR_b(B)$

Eligible group capital resources = $100\% \times CR_a(A) + 100\% \times CR_b(B) - InvSubB_a(A) - LoanB_a(A)$

Tier 1 group capital = $100\% \times (CR_a(A) - T2Debt(A)) + 100\% \times (CR_b(B) - Loan_b(B)) - InvSubB_a(A)$

Tier 2 group capital = $100\% \times T2Debt(A) + 100\% \times Loan_b(B) - LoanB_a(A)$

Notes:

(1) In accordance with Rule 8(7)(a) of the Group Capital Rules the value of any holding in the shares of "Entity B" by "Holding Entity A", or any financial instrument issued by "Entity B" to "Holding Entity A", that is included in the eligible group capital resources of the supervised group, is deducted from the eligible group capital resources of the supervised group. This serves to avoid double accounting as these values are already reflected by the inclusion of the share capital of "Entity B" in the supervised group's eligible group capital resources.

(2) Given that the share capital in "Entity B" is counted towards tier 1 group capital, the holding of shares in "Entity B" by "Holding Entity A" is deducted from the tier 1 group capital.

(3) Given that the subordinated loan issued to "Holding Entity A" by "Entity B" is treated as a tier 2 financial instrument in the financial statements of "Entity B", as per the laws relating to regulatory capital in jurisdiction b (and is therefore included in tier 2 group capital of the supervised group), the deduction of the same subordinated loan as it appears in the financial statement of "Holding Entity A" is deducted from the tier 2 group capital.

f) Numerical example (please refer to section (e) for the relevant formulae)

Definition of quantities

Supervised group member	**Jurisdiction of incorporation**	**Minimal capital requirement**	**Prescribed capital requirement**	**Capital resources**
Holding Entity A	a	0	0	$CR_a(A)$
Entity B	b	20	50	$CR_b(B)$

Financial statement of "Holding Entity A"

Assets		**Liabilities and Equities**	
Investment in subsidiary	100	Total liabilities, of which- Tier 2 financial instruments (subordinated debts)	150, of which- 50
Subordinated loans (issued by "Entity B")	30	Share capital	30
Other assets	60	Retained earnings	20
Intangible assets	10		

$CR_a(A) = 30 + 20 – 10 + 50 = 90$

Eligible capital resources of "Holding Entity A" to be counted towards tier 1 group capital = 30 + 20 – 10 = 40

Eligible capital resources of "Holding Entity A" to be counted towards tier 2 group capital = 50

Financial statement of "Entity B"

Assets		Liabilities and Equities	
Total assets	920	Total liabilities, of which- Subordinated loans from "Holding Entity A"	830, of which- 30
		Share capital	100
		Retained earnings	-10

$CR_b(B) = 100 – 10 + 30 = 120$

Capital resources of "Entity B" to be counted towards tier 1 group capital = 100 – 10 = 90

Capital resources of "Entity B" to be counted towards tier 2 group capital = 30

Calculations

GMCR = 100% × 0 + 100% × 20 = 20

GPCR = 100% × 0 + 100% × 50 = 50

Eligible group capital resources
$= 100\% \times CR_a(A) + 100\% \times CR_b(B) - InvSubB_a(A) - LoanB_a(A)$
$= 100\% \times 90 + 100\% \times 120 - 100 - 30 = 80$

Tier 1 group capital
$= 100\% \times (CR_a(A) - T2Debt(A)) + 100\% \times (CR_b(B) - Loan_b(B)) - InvSubB_a(A)$
$= 100\% \times 40 + 100\% \times 90 - 100 = 30$

Tier 2 group capital
$= 100\% \times T2Debt(A) + 100\% \times Loan_b(B) - LoanB_a(A)$
$= 100\% \times 50 + 100\% \times 30 - 30 = 50$