Global
Fixed Income
Research

European Insurance Glossary

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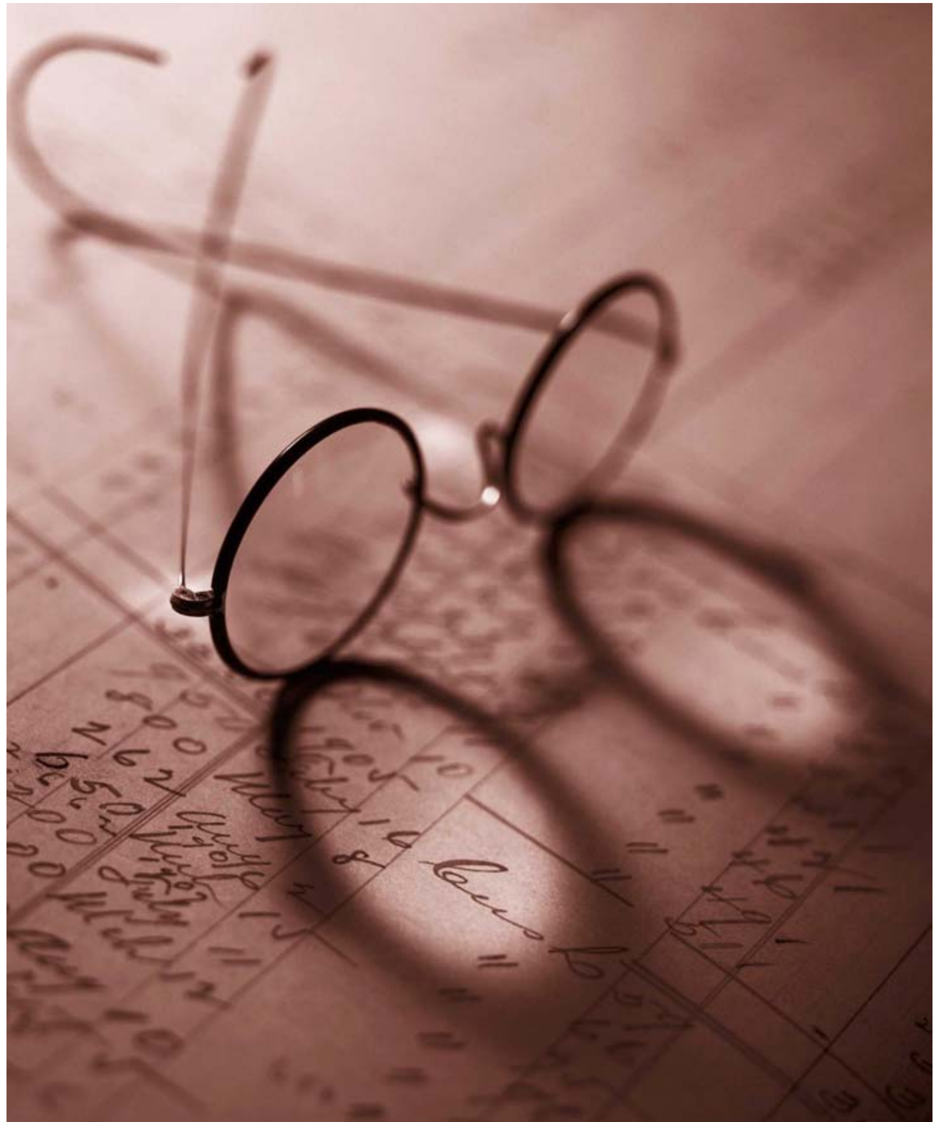

- **The jargon explained:** 250 terms used by credit research analysts. We cover key terms in life insurance, non-life insurance and reinsurance, and focus on the terminology used in the credit analysis of European insurance companies.
- **Welcome to the joy of insurance regulation** – Regulatory and accounting terms found in insurance companies' accounts under EU and UK regulation.
- **A practical guide for credit analysts** – Whenever appropriate, we provide further comments on the use of key insurance concepts in credit research.

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European Insurance Glossary

Definitions are our own, not regulatory definitions, and are necessarily simplified for the purpose of this publication; in a few cases, however, we have used the terminology of the Association of British Insurers (Statement of Recommended Practice on Accounting for Insurance Business).

The European insurance industry remains diverse as far as financial reporting is concerned: readers should note different definitions may exist in the industry, and in some cases, there is no clear commonly accepted definition for a given concept. The calculation of ratios can also vary: this is the case, for instance, for the free asset ratio in the UK. Some of the concepts only apply to specific markets, and we have tried to be as detailed as possible. We do not aim to cover the more specific terminology of the Lloyd's market.

Source: UBS Warburg.

1. **90/10 fund (UK)** – Refers to a life insurance fund where 90% of declared profits go to policyholders, and 10% to shareholders. In a 100/0 fund, all the profits go to policyholders, shareholders being compensated with explicit management charges. Ongoing regulatory reviews suggest that the industry may be moving to 100/0 funds going forward, which are more transparent for policyholders.
2. **Achieved profits (UK)** – In the UK, achieved profits are embedded value profits and are calculated by discounting back the surplus expected to emerge on the in-force business. They are calculated by using prudent economic and operational assumptions (e.g. investment returns, surrenders, expense inflation). Importantly, they are not cash earnings in the sense that they do not correspond with a cash flow measure, and they are sensitive to assumptions. They do not factor in profits on business to be written in the future. The total profit recognised over the lifetime of a policy is the same as under the modified statutory basis of reporting (MSSB), but the timing of recognition is different. Achieved profits aim to give a more realistic measure of profitability for management and valuation purposes than other reporting measures.
3. **Acquisition costs** – Costs incurred in writing new business. These typically include commissions paid to intermediaries, marketing and other related expenses. In specific accounting systems, acquisition costs are accounted for as an asset and amortised over time (deferred acquisition costs): this leads to a smoothing of up-front expenses. Acquisition costs are often responsible for new business strain, especially in life insurance.
4. **Administrative expenses** – Costs of an administrative nature related to the ongoing management of insurance policies. They contrast with acquisition costs and investment expenses, the latter being related to the cost of managing invested assets. Also known as management expenses.
5. **Admissible (admitted) assets** – Assets admissible to cover policyholder liabilities for the purpose of demonstrating solvency to the regulator. Some assets may be inadmissible because they are not specifically mentioned in the

regulations, or because the company has reached the admissibility limits for the investment class or a given asset.

6. **Adverse selection** – If only policyholders with a high-risk profile seek insurance, there is no averaging of losses for the insurer, which undermines a key insurance principle. Insurance companies need to limit the risk of adverse selection, and ensure that not only the "bad" risks seek insurance. The compulsory coverage of specific risks for all policyholders can be a solution to alleviate the effects of adverse selection.

7. **Alternative risk transfer (ART) –** Use of capital markets to cover insurance risks, e.g. with the securitisation of catastrophe risks.

8. **Amortised cost –** The purchase price of a redeemable fixed income security adjusted by any increase or decrease in value, representing the proportion of any difference between the acquisition price and the final redemption proceeds of the investment.

9. **Annual premium equivalent (UK)** – Annual premium equivalent is a common sales measure in the UK. APE is calculated as total new business regular premium plus 10% of new business single premium. It gives a broadly comparable measure across companies to allow for differences between regular and single premium business.

10. **Annual premium policy** – Also known as a regular or periodic premium policy.

11. **Annuitant** – Policyholder receiving an annuity, typically a person at retirement receiving a pension.

12. **Annuity** – A life insurance policy where an insurance company pays an income stream to an individual, usually until death, in exchange for the payment of a lump sum. Commonly used at retirement when lifetime savings are converted into an income. At death, there is usually no payment to the estate, although many annuities include a provision to pay an income to the spouse. Immediate annuities provide an income from the date the policy is accepted, and deferred annuities at a future date. Unless part of the investment risk is transferred to the annuitant (e.g. in a UK with-profits annuity), annuity business is non-profit business and is usually matched with fixed income investments. Longevity risk is an important consideration for insurance companies, and a possible source of losses if annuitants live longer than initially expected.

13. **Appointed actuary (UK)** – An actuary appointed by a life insurance company, as required by legislation. The main statutory role of the appointed actuary is to carry out a regular valuation of the provisions held to pay future policy benefits.

14. **Appraisal value –** The value of a life insurance company, comprising its embedded value and a goodwill value. The latter is a value for policies not written at the reporting date. The appraisal value is used in the context of M&A operations, for instance. Only the embedded value is published by insurance companies on a regular basis.

15. **Asset share (UK)** – A realistic estimate calculated as the sum of the premiums received and accrued investment returns, less expenses. The asset

share gives an indication of the underlying value of a life insurance policy, in comparison with the amount effectively reserved for under regulatory guidelines. In simple terms, the asset share is what the insurer holds to cover a policy, and reserves are what it needs to cover it.

16. **Assets held to cover linked liabilities** – These are assets used to match unit-linked business, where policyholder benefits are expressed in units of an underlying investment vehicle. Investment risk is transferred to policyholders.
17. **Assets under management** – Total assets managed by an insurance company, including those not held on the balance sheet. Many insurance groups manage assets for third parties outside the context of insurance. These assets are reported as off-balance sheet assets under management.
18. **Available assets (UK)** – For a regulated operating insurance company, total assets minus total liabilities. They are the assets available to cover the required minimum margin of solvency. Mathematically, available assets are equivalent to the sum of free assets (excluding future profits) and the required minimum margin of solvency.
19. **Benefits** – Usually refers to benefits paid to policyholders in the form of claims paid, policyholder bonuses, profit-sharing and other accrued benefits.
20. **Bonus** – Usually refers to a non-guaranteed benefit added to life insurance policies. A company will usually have a lot of discretion over the level of bonuses it allocates to contracts. Once allocated, bonuses may or may not be reversed by the insurer in case the contract is terminated early.
21. **Broker** – An independent agent who acts on behalf of the insured in placing business with an insurance company. Brokers are usually compensated with commissions, and may help collect premiums, although they do not provide insurance coverage. In some cases they are compensated with fees paid for by the insured. In the UK, IFAs are brokers. Tied agents or an insurance company's salesforce, on the contrary, sell products from one single provider and are agents of the insurance company.
22. **Bulk purchase annuity (BPA) (UK)** – Describes a contract between an occupational pension fund and an insurance company, whereby an insurance company insures the liabilities of the occupational pension fund. This is usually when the fund is wound-up. The BPA market is concentrated in the hands of a few UK insurance companies with large balance sheets and resources to value and administer the funds.
23. **Business interruption** – A specific type of non-life insurance policy guaranteeing the loss of income resulting from the occurrence of specific risks. As an example, a company can cover its income against the consequences of bad weather on its activity.
24. **Capacity** – The concept is usually used at the Lloyd's market, and with reference to a given insurance market (e.g. reinsurance) and it refers, broadly speaking, to the capital available to subscribe non-life insurance risks. It is dependent upon the capitalisation of the sector and minimum regulatory capital requirements.
25. **Capital at risk** – Under EU regulation, it generally refers to the sum assured on life insurance business (e.g. the amount payable on death) less the

mathematical provision. A charge on capital at risk is made in the solvency ratio.

26. **Captive insurance company** – An insurance company usually set up by a large non-insurance group, such as a multinational organisation, and which aims to provide cheaper insurance coverage than available in the general market. Captives are often set-up in offshore markets with a favourable tax and regulatory framework. They insure the group's operations, and seek insurance/reinsurance externally whenever appropriate.

27. **Casualty insurance** – The type of insurance related to legal liability for losses caused by bodily injury to others or physical damage to the property of others.

28. **Catastrophe bonds** – A bond issued by an insurance or reinsurance company where repayment and/or payment of the coupon are linked to the occurrence of a catastrophic event (e.g. earthquake). This form of financing is part of alternative risk transfer mechanisms.

29. **Ceding insurer (Cedent)** – The insurance company (primary insurer) transfers some of its insurance risks to another insurance company through a reinsurance contract. Policyholders of the primary insurance company have no contractual relationship with the reinsurer: the primary insurer remains liable for insurance coverage even if the reinsurer defaults on its obligations.

30. **Cession** – See reinsurance. The operation by which an insurance company transfers some of its risks to a reinsurance company.

31. **Claim** – The amount payable under an insurance contract and arising from the occurrence of an insured event.

32. **Claims incurred** – A claim is incurred when the event that gives rise to the claim occurs. Claims incurred include paid claims and the change in the provision for outstanding claims, irrespective of whether or not they have been reported.

33. **Claims ratio** – See loss ratio.

34. **Claims reserve** – Provision made to cover reported claims. See loss reserve.

35. **Closed to new business** – An insurance company (or fund) that is closed to new business no longer accepts funds from new clients. It may still receive premiums on existing contracts, e.g. on regular premium business. Liabilities are managed until the last policy expires – which may take years. A company closed to new business may still be able to pay dividends to its shareholders. See run-off.

36. **Co-insurance** – (i) Co-insurance involves the sharing of an insurance risk between two or more primary insurance companies. There is a contractual link between the insured and the various insurance companies: this mechanism differs from reinsurance; (ii) Co-insurance sometimes relates to the sharing of a risk between the insured and an insurance company, with the benefit of a lower premium charged by the latter.

37. **Combined ratio** – In non-life insurance, the ratio of claims and operating expenses as a percentage of premiums; also equivalent to the sum of the loss ratio and the expense ratio. Depending on the definition, the ratio is

calculated with either earned or written premiums. It is expressed gross of reinsurance (i.e., before taking into account the sums received back from reinsurers), or net (i.e., after receiving proceeds from reinsurance protection). It is usually analysed by line of business, and by geography. A ratio inferior to 100% indicates that the company makes an underwriting profit, i.e. premiums more than cover the cost of claims and operating expenses. A ratio superior to 100% indicates the company has an underwriting loss: the higher the ratio, the greater the underwriting loss. A company with a combined ratio greater than 100% can still be profitable, however, because investment income is not factored in. The combined ratio can be volatile in industrial risks/reinsurance, where large claims in a given year will have a major effect on the ratio; it is typically more stable in personal lines.

38. **Commercial lines –** By opposition to personal lines, commercial lines in non-life insurance cover business interests.

39. **Comprehensive insurance** – Coverage of a number of different risks (e.g. third-party liability, fire, theft in motor insurance).

40. **Compulsory insurance** – Any type of insurance that is required by law. As an example, third-party motor insurance is usually compulsory, but not protection against theft.

41. **Consolidation ratio (Sweden)** – A ratio used by Swedish life insurance companies comparing total assets with total liabilities; it is a measure of solvency.

42. **Credit insurance** – Form of insurance covering losses suffered by the default of policyholders' customers. This is a specialised insurance business where a handful of global insurance groups have a dominant market share. Underwriting results are dependent upon macro-economic conditions and the level of insolvencies in the economy.

43. **Critical illness insurance** – Covers the risk of the insured suffering from long-term ailments. Death does not need to occur for a payout to be made by the insurance company.

44. **Current value of investments –** Refers to the market value of investments.

45. **Deductible –** Portion of the loss kept by the insured; the insurance company only covers losses in excess. A deductible contributes to lower management expenses, helps cut premiums and reduce moral hazard in insurance. Also known as excess.

46. **Deferred acquisition costs (DACs)** – Costs accounted for as an asset and amortised over time to match the emergence of a surplus on life insurance policies. They effectively match the recognition of acquisition costs as an expense on the P&L with fees/profits emerging on a life insurance policy. DACs are intangible assets and may need to be written off if the profits expected to emerge on the life insurance book of business are deemed insufficient to cover DACs.

47. **Deferred annuity** – A deferred annuity starts only after a number of years, for instance at retirement, by comparison with immediate annuities, where a regular payout starts immediately.

48. **Defined benefit pension scheme** – An occupational pension scheme where the benefits paid to the annuitant depend on the number of years in service and the salary at the time of retirement. Also known as a final salary scheme in the UK.
49. **Defined contribution pension scheme** – An occupational pension scheme where the benefits served to members depend on the final value of accumulated contributions and investment income. They differ from defined benefit schemes, where benefits depend on the number of years in employment and the salary level. Also known as a money purchase scheme in the UK.
50. **Demutualisation** – Refers to the process whereby a mutually owned financial institution, for instance an insurance company, is being converted into a stock company. Members usually receive shares in the new company, and in some cases a cash windfall, in exchange for their ownership rights.
51. **Depolarisation (UK)** – See polarisation.
52. **Deposits with ceding undertakings/deposits received from reinsurers** – Some reinsurance contracts involve a financing element, with a cash payment from the reinsurance company to the ceding company. The ceding company recognises the amount outstanding under the arrangement as a liability in the balance sheet as “deposits received from reinsurers”. The reinsurance company (or primary company which assumes reinsurance risk) establishes an asset called “deposits with ceding undertakings” to reflect expected repayments.
53. **Direct writer** – An insurance company selling insurance directly through its employees, without the use of independent intermediaries. Note the difference with the concept of primary insurance company, used in the context of reinsurance transactions.
54. **Directors & officers insurance (D&O)** – It covers the personal interests of directors and officers of companies against lawsuits claiming they committed wrongful acts.
55. **Discounting** – The reduction to present value at a given date of a future cash transaction at an assumed date, using a discount factor reflecting the time value of money. The choice of a discount rate will usually greatly influence the value of insurance provisions, and may give indications on the conservatism of provisioning methods.
56. **Dividends** – Usually dividends paid to shareholders, although in some cases, especially in the US, policyholder dividends refer to policyholder bonuses/benefits.
57. **Double leverage** – Usually refers to a situation where a holding company raises debt and downstreams it as equity capital, or subordinated debt, to an operating insurance subsidiary. The operation contributes to an increase in the solvency of the operating company but at the expense of an increase in consolidated indebtedness.
58. **DTI returns (UK)** – Former name given to regulatory returns, when the Department of Trade and Industry (DTI) regulated UK insurance companies. Now called FSA returns.

59. **Earned premiums** – Premiums covering the accounting year, by comparison with premiums written, which are simply written during the year. Earned premiums are effectively premiums attributable to the risks borne by the insurer during the accounting year. For instance, for a 12-month policy signed on 1 November 2002, the premium written in 2002 is the full premium, but only two months of the premium are earned in 2002; the rest (10 months) relate to risk coverage in 2003 and is earned in 2003.

60. **Economic loss** – In the context of a catastrophic event, in particular, the insured loss differs from the economic loss because not all losses are insured. The insured loss only reflects the portion of the losses covered by the insurance and reinsurance industry; the economic loss reflects the total loss for the economy. For catastrophic losses, the difference can be substantial in markets where the penetration of insurance is low, or when the risk that caused the damage was an uninsurable event.

61. **Embedded value** – The sum of the net asset value of a life insurance company and the discounted value of profits expected to emerge on business already written. The latter is calculated with a set of economic and operational assumptions. A deduction for the effect of holding the minimum statutory solvency margin is usually made. The embedded value excludes any value that may be attributed to future new business: this would be captured in the appraisal value.

62. **Embedded value profits/margins** – The difference in embedded value between two dates gives the embedded value profit. Embedded value margins are calculated by comparing such profits with new business premium.

63. **Employers' liability insurance** – Employers' liability insurance provides coverage to employers against claims made by employees who are injured or become ill as a result of their work.

64. **Endowment mortgages** – Mortgages where repayment is effected through an endowment policy. At maturity, the endowment policy should repay the loan; if the borrower dies before maturity, the sum assured will repay the loan. In the UK, endowment mortgages have been popular, but tax changes, lower investment returns, and the emergence of modern, flexible repayment mortgages have made them less attractive and many providers have removed them from their product offerings.

65. **Endowment policy** – A contract with a savings component involving asset accumulation, and a life insurance protection component. If death occurs before maturity, the sum assured is paid out. At maturity, the amount built-up is payable. Endowment policies can be written in a number of different forms (unit-linked, with-profits, non-profit), and are long-term contracts.

66. **Equalisation reserve** – In non-life insurance and reinsurance mainly, a reserve set-up to cover high-severity, low frequency claims (e.g. catastrophic events). Tax regulation limits the constitution of equalisation reserves. Because it does not relate to incurred losses, it is sometimes added to solvency capital. It is built over periods when claims experience is better than average to strengthen the balance sheet.

67. **Equity-backing ratio (UK)** – The ratio of equity investments (and sometimes, property investments) as a percentage of total assets (or

sometimes, assets in the with-profits fund only). The equity-backing ratio shows the exposure of the insurance company to more volatile equity investments. Only companies with a strong capital base will typically be able to maintain a high equity-backing ratio, as they have the capital necessary to weather the volatility of equities.

68. **Excess** – See deductible.

69. **Excess of loss reinsurance** – A form of reinsurance contract where the ceding insurance company pays claims up to a certain level, and then is covered by the reinsurance company. The participation of the reinsurer in the claims effectively depends on the size of the claim. This is a form of non-proportional reinsurance.

70. **Expense ratio** – The ratio of operating expenses as a percentage of premiums gives an indication on the efficiency of the business independent of the claims experience and the performance of the investment portfolio.

71. **Facultative reinsurance** – The reinsurance company decides to cover or not individual risks presented by the ceding insurance company. Differs from treaty reinsurance.

72. **Fair value** – The market price of an instrument, either an asset (e.g. an investment) or a liability (e.g. an insurance policy). It is the price at which the instrument would be exchanged freely between two parties. A key concept under International Accounting Standards.

73. **Final salary scheme (UK)** – See defined benefit pension scheme.

74. **Financial reinsurance** – Often refers to a reinsurance operation concluded primarily to stabilise the balance sheet of the ceding insurance company and provide capital support. There is no clearly accepted definition of what financial reinsurance involves.

75. **Finite risk** – Insurance and reinsurance policies where the aggregate risk to the insurer or reinsurer is capped at a given ceiling. Finite risk contracts are usually long-term contracts, and include a profit-sharing mechanism.

76. **Fluctuation (revaluation) reserve** – Under some accounting standards, a portion of realised or unrealised gains on investments is accounted for in a fluctuation or revaluation reserve to smooth earnings. It is part of the insurance company's capital base.

77. **Form 9 (UK)** – Probably the most commonly used section of FSA returns, Form 9 gives the summary solvency position of a regulated insurance operating company.

78. **Free asset ratio (UK)** – For UK life insurance companies only, a solvency measure calculated as (available assets minus the required minimum margin of solvency)/admissible assets. Everything else being equal, the higher the free asset ratio, the higher the level of surplus capital relative to the asset base. Note that different definitions exist in the industry and that headline free asset ratios may not be directly comparable; further, in some cases future profits are included. Reported free asset ratios are dependent on assumptions made to value liabilities.

79. **Free assets (UK)** – Assets available on top of a life insurance company's liabilities and the required minimum margin of solvency. It is effectively a measure of surplus capital, and shows what is left "free" once minimum solvency requirements have been covered. The measure is sensitive to assumptions used to value liabilities, e.g. the choice of discount rates. The concept of available assets in FSA returns is close: available assets are calculated as total assets minus total liabilities, before deducting the required minimum margin of solvency. Note that in some cases the free asset ratio includes future profits, an intangible asset.

80. **Fronting** – In reinsurance, the practice of the ceding company to retain only a small portion of a risk and to cede the remainder to a reinsurance company.

81. **FSA (UK)** – The Financial Services Authority, the UK regulator for the financial services industry.

82. **FSA returns (UK)** – Regulatory returns sent annually to the Financial Services Authority and prepared for each regulated operating insurance company. FSA returns comprise detailed financial information on solvency, investments, business mix, claims and premiums, etc. and are publicly available. Note the difference with the Report & Accounts, which are prepared under a different set of accounting standards and filed with Companies House.

83. **Fund** – In life insurance, it often refers to a pool of assets managed separately for asset and liability management purposes. Funds may be legally or contractually segregated, in which case the company has limited freedom to move assets between them. As an example, the with-profits fund of a UK life insurance company is earmarked and is managed separately from the non-profit fund, which covers non-profit business; however, both may be part of the same operating company. The fact that an insurance company's balance sheet is separated into sub-funds does not mean that, in the unlikely event of liquidation, the sub-funds would be treated separately.

84. **Fund for future appropriations (FFA) (UK)** – In the Report & Accounts, the FFA includes funds not allocated between policyholders and shareholders. It is used to pay out terminal bonuses on with-profits business and to finance the new business strain. Note that regulatory solvency calculations, however, are based on FSA returns, not on the FFA. The FFA is only published in the Report & Accounts, not in the FSA returns.

85. **Future profits** – A concept used in EU regulation referring to the profits expected to emerge in a life insurance company. They are calculated retrospectively based upon the profits that emerged in the previous years, and are admissible in the regulatory solvency margin of the company, under certain conditions. They exist because of the conservative assumptions used to value liabilities under statutory accounting. The concept does not apply to non-life insurance. There is a debate on the value of this intangible asset, and the EU has announced future profits would no longer be admissible in solvency capital starting in 2009. Importantly, comparisons between companies may be biased if one company reports future profits and the other does not: reported solvency ratios for the latter will, everything else being equal, be lower.

86. **General account (US)** – In life insurance, the general account excludes separate accounts, i.e. it excludes unit-linked business where investment risk is transferred to policyholders.

87. **General insurance (UK)** – Another expression for non-life insurance.

88. **Gross** – Usually means "gross of reinsurance", i.e. before taking into account reinsurance operations (e.g. gross combined ratio, gross underwriting result, gross claims, gross premiums). In the context of investment income, it refers to a measure before deducting investment expenses (i.e. before deducting the cost of managing assets). In the context of income, it usually refers to a pre-tax measure (e.g. gross income).

89. **Gross premium method –** A method for placing a value on a life insurance company's liabilities that explicitly values the future office premiums payable. In addition, it usually values explicitly future discretionary benefits and future expenses. As a result, the method values explicitly liabilities in respect of future renewal expenses and (for with-profits business) future bonus additions, unlike the net premium, where allowances for these factors are implicit. Note the difference with the net premium method.

90. **Gross premiums written** – See premiums written.

91. **Group business** – Group business is written by an employer for the benefit of its employees. It differs from individual business, which is written through individual contracts.

92. **Guarantee fund** – (i) Under EU regulation, a minimum level of solvency insurance companies must cover with solvency capital. It is the very minimum level of funding required by EU legislation, below which some more severe form of regulatory intervention would happen; (ii) Also relates to market guarantee funds, where losses stemming from defaulting insurance companies are covered with a safety net.

93. **Guaranteed annuity options (GAOs) (UK)** – GAOs were attached to a number of pension products written up to the 1980s. They gave a minimum conversion rate, meaning at retirement an individual could benefit from the contractually guaranteed conversion rate. With falling interest rates, GAOs become attractive for policyholders, representing a risk of losses for insurance companies. GAOs have been fully reserved for under regulatory accounting, and some companies have taken further protection – e.g., with derivative contracts – to protect against economic losses in case of falling interest rates.

94. **Guaranteed surrender value** – In life insurance, the minimum value the policyholder is entitled to receive if he/she decides to surrender (cancel) a policy. Guaranteed surrender values are mostly relevant for accumulation-type life insurance policies, e.g. savings, and vary greatly across Europe. The asset mix of a life insurance policy will partly depend on the level of guaranteed surrender values: the higher the value, the lower investment flexibility for the insurer, meaning investments are more likely to be in fixed-income assets.

95. **Hard market –** Refers to market conditions in non-life insurance/reinsurance where premiums are increasing and terms/conditions strengthened for the benefit of the insurer. See soft market.

96. **Hidden reserves** – See unrealised capital gains. They sometimes refer to a conservative level of insurance liabilities, where some of the provisions are likely to be released over time, meaning there is "hidden value" built into the liabilities.

97. **Home service company (UK)** – An insurance company collecting premiums at policyholders' homes. This type of business has declined rapidly in the recent years.

98. **Hybrid capital** – Usually refers to subordinated securities where the deep subordination of creditors, a long maturity, and interest deferral features provide a buffer for the protection of policyholders.

99. **IBNR reserve (Incurred But Not Reported)** – Refers to a reserve made to cover claims that have already happened but have not been reported to the insurance company when the balance sheet is calculated. For instance, insurance companies prepare an IBNR for losses occurring in December but reported the year after.

100. **Immediate annuity** – The payment of an income stream starts immediately after the contract is concluded. Immediate annuities differ from deferred annuities.

101. **Impaired life** – Usually relates to policyholders with a reduced life expectancy, e.g. as a result of ill-health. There is a market for "impaired life annuities", where annuitants with ill-health may be able to find better pensions terms based on a reduced expected payout duration.

102. **Implicit items** – Implicit items are intangible assets, which under certain conditions are admissible to cover an insurance company's required minimum margin of solvency. They appear because of the conservatism built in the valuation of liabilities by insurance regulation. Future profits are implicit items.

103. **Income drawdown (UK)** – Instead of converting a lump sum into an annuity, a retiree may decide to keep money invested and draw down an income from the fund, until the age of 75. The retiree effectively keeps the fund at risk, and retains more flexibility than with an annuity.

104. **Independent financial advisors (IFAs) (UK)** – In the UK, financial advisors are either "independent" from insurance companies, in which case they must offer products from a wide array of providers, or "tied" to a specific provider.

105. **Individual Savings Account (ISA) (UK)** – A tax-exempt savings vehicle for individual investors. Individuals can invest up to £7,000 a year in specified investments, mainly investment funds. Capital gains and investment income are free of tax.

106. **Industrial branch (UK)** – Refers to life insurance business where door-to-door sales people collected premiums at the policyholder's home. The concept is somewhat dated, but is still found in FSA returns.

107. **Industrial risks** – The expression refers to the coverage of large non-life insurance business risks.

108. **In-force business** – Insurance on which the premiums are being paid or have been fully paid. In other words, the portfolio of policies active at a given

point in time. In life insurance, the "value of business in-force" is the discounted value of the profits expected to emerge on in-force business.

109. **Inherited estate (UK) –** For life insurance proprietary companies, surplus capital available on top of what is necessary to cover policyholders' reasonable expectations. An inherited (orphan) estate is effectively surplus capital on a realistic basis, built over time in the last fifty years, and not allocated to policyholders or shareholders. Some companies have tried to allocate this capital between policyholders and shareholders, but regulatory restrictions make the process relatively difficult.

110. **Insolvency** – The concept of insolvency usually refers to insolvency under insurance regulation, which tends to be more conservative than the concept of insolvency under company law. It is different from the concept of liquidation (winding-up).

111. **Insurance undertaking** – The EU terminology for an insurance company or mutual.

112. **Insured life** – The person on whose life the policy is issued.

113. **Insured loss** – See the article on economic loss.

114. **Intra-group reinsurance** – Reinsurance contracts between affiliates of the same group to help manage capital and transfer risk within the group. Intra-group reinsurance operations would typically be excluded from consolidated financial statements.

115. **Investment trust (UK)** – A listed investment company. It invests in shares of other companies, and can be geared with borrowings. Its share capital is fixed, not like an OEIC, and the stock price may not reflect the investment trust's net asset value.

116. **Inward reinsurance –** Reinsurance business accepted by an insurer or reinsurer, as opposed to that ceded to another insurer.

117. **Lapse** – Occurs when the policyholder has failed to pay the premium. Differs from surrenders, although statistics often show "lapses and surrenders" together.

118. **Life insurance provision** – The actuarial estimate of the liabilities of a life insurance company. It excludes the required minimum margin of solvency but, in the UK, it includes the resilience reserve.

119. **Linked** – Refers to a life insurance policy where benefits are expressed in a unit of account, usually an investment fund. Benefits are effectively "linked" to the value of the underlying units rather than fixed benefits set up at inception or a share of a participating fund.

120. **Long-tail liability** – With long-tail liability business, claims can be presented to the insurance company a long time after the occurrence of the trigger event. As a result, the insurer is exposed to claims for a number of years after subscription, even though the risk may no longer be covered; estimating the likely cost of such claims can be difficult. This exposes the insurer to the deterioration of its claims experience due to changes in the legal environment, for instance. Asbestos and environmental claims are typical examples of claims made under long-tail liability contracts.

121. **Long-term business (UK)** – UK regulatory expression broadly equivalent to life insurance and pensions.
122. **Long-term care** – Care provided to those who are unable to look after themselves without some kind of support. Some insurance policies pay out an income in case the policyholder needs such help.
123. **Long-term fund (UK)** – The long-term fund consists of assets that are attributed to long-term (life insurance) business. In the case of a proprietary office, the fund excludes shareholders' assets.
124. **Loss adjuster** – The loss adjuster investigates and assesses losses, and negotiates settlement with the claimant, usually on behalf of the insurance company.
125. **Loss ratio** – In non-life insurance, the ratio of claims expenses to premiums. Claims expenses include claims paid, a provision for unpaid claims and an adjustment in the outstanding claims provision; premiums are usually earned premiums. The lower the ratio, the better the underwriting performance of the insurer. The ratio can be calculated net or gross of reinsurance, i.e. after or before taking into account reinsurance receivables. The sum of the expense ratio and the loss ratio makes the combined ratio. Also called claims ratio.
126. **Loss reserve** – An estimate of the cost of claims incurred but not yet settled. The loss reserve includes IBNR, which allow for claims not reported to the insurer at the time the balance sheet is calculated.
127. **Management expenses –** See administrative expenses.
128. **Market value accounting –** Investments are valued at their current market value. This compares with historical cost accounting. Depending on accounting standards, the balance sheet of an insurance company may be reported on a market value basis, or unrealised capital gains may be reported off-balance sheet.
129. **Market value adjuster (or reduction) factor (UK)** – A penalty applied to with-profits bonds when policyholders surrender in poor market conditions. Most UK life insurance companies have applied the penalty recently to protect solvency levels and the benefits of remaining policyholders, and ensure that a fair share of the assets is paid out. In falling equity markets, the risk exists that, without such a penalty, policyholders would receive a payment in excess of the underlying asset value of their contracts (asset share). MVAs are an essential tool used by UK companies to protect their capital bases. Some contracts have no MVA provision, or are “MVA-free” at specific anniversary dates, however.
130. **Mathematical reserves** – See life insurance provision.
131. **Maturity** – Agreed date when the policy comes to an end and benefits are paid (e.g. accrued value of the policy in the case of a savings policy) or when risk coverage stops (e.g. term insurance).
132. **Modified statutory solvency basis (MSSB) (UK) –** The primary accounting standard for UK insurance companies. It builds on the statutory requirements, which demonstrate solvency. It is somewhat more conservative than the achieved profits method, in the sense that it does not relate to the future surplus on the in-force business. The total profit recognised over the lifetime

of a policy is the same as under the modified statutory basis of reporting, but the timing of recognition is different; the MSSB method defers the recognition of profit. For that reason, the MSSB method is not such a good measure to assess the value added from new business. The payment of shareholder dividends is dependent upon MSSB profits.

133. **Money purchase scheme (UK) –** UK term for a defined contribution pension scheme. Employees/employers pay contributions to a fund, on behalf of employees: investment risk is borne by employees.

134. **Moral hazard** – The attitude of a policyholder can increase the probability a loss is incurred, which represents moral hazard. For instance, an insured person may adopt a risky behaviour knowing an insurance company would cover losses ("I am insured, so I can drive fast"). Risk underwriting, the use of deductibles, and exclusions, are commonly used to reduce moral hazard.

135. **Mortality tables** – Actuarial tables displaying the frequency of death for an individual, by sex and generation. The use of mortality tables is often regulated and drives pricing and reserving in life insurance. Adjustments to life insurance provisions are sometimes made to take account of changes in life expectancy and the use of new mortality tables.

136. **Mutual fund (US) –** US form of collective investment vehicle.

137. **Mutuality** – (i) Refers to mutually owned companies, where certain categories of policyholders (members) have ownership rights; (ii) Refers to a key insurance concept where independent risks are pooled to become insurable.

138. **Net** – Usually means "net of reinsurance", i.e. after taking into account reinsurance operations (e.g. net combined ratio, net underwriting result, net claims, net premiums). In the context of investment income, it refers to a measure after deducting the cost of managing assets. In some cases, it refers to an after-tax measure (e.g. net income).

139. **Net premium method –** A method for valuing a life insurance company's liabilities that involves valuing the contractual liabilities to date allowing for mortality and interest, and deducting the value of future net premiums. The premium brought into account will exactly provide for the benefits payable under the policy excluding any additions for future profits, expenses or other charges. A variation of the net premium method involves zillmerisation. See also gross premium method.

140. **Net premiums written** – See premiums written.

141. **New business premium** – Refers to new contracts (policies) written in a given year, by comparison with premium income or premiums written, which usually include premiums collected on regular premium policies written in previous years.

142. **New business strain** – New business strain arises when the early years' premiums under a contract, less the initial expenses, are not sufficient to cover the provision and the required solvency margin that the company needs to set up. It mainly arises at inception, but it is possible to have further strains in subsequent years, usually lower. Rapidly growing insurance companies, or

companies with a thin capital base, may find it difficult to finance this new business strain. The concept is mostly used in the context of life insurance.

143. **Non-contributory pension scheme (UK)** – Refers to an occupational pension scheme where the employer pays all the contributions, with no compulsory contribution from employees. Employees can usually make additional contributions on a voluntary basis.

144. **Non-life insurance** – Synonyms are general insurance (UK) and property & casualty insurance (US). Payments made by insurance companies are based on the loss incurred: they are not a fixed sum like in life insurance.

145. **Non-linked assets** – Assets covering non-linked life insurance business, i.e. excluding unit-linked business. To the extent that unit-linked business transfers most investment risk if not all to policyholders, credit analysts usually focus on non-linked assets when assessing the quality and volatility of a life insurance company's investment portfolio. In non-life insurance, all assets are usually non-linked assets, meaning that investment risk is borne by the insurance company.

146. **Non-participating business/policy** – A life insurance policy where the policyholder is not entitled to a share of the company's profits and surplus, but receives certain guaranteed benefits. Also known as non-profit in the UK. Examples include pure risk policies (e.g. fixed annuities, term insurance, critical illness) and unit-linked insurance contracts.

147. **Non-proportional reinsurance** – See excess of loss reinsurance.

148. **Non-technical account** – See technical account.

149. **Occupational pension fund** – Pension fund set up by an employer for the benefit of its employees, usually within a distinct legal structure. Contributions are paid either by the employer, the employee, or both. Occupational pension funds may be run as defined benefit schemes or defined contribution schemes. By comparison, personal pension schemes are contracts set up by private individuals.

150. **Open Ended Investment Company (OEIC) (UK)** – An open-ended investment fund structured as a company. Investors buy shares, the number of which varies over time: the share price of the OEIC mirrors the value of the underlying investments.

151. **Operating company** – In insurance, it refers to a company with a licence to write insurance policies, by comparison with pure holding companies, asset management companies, etc. which do not write insurance business. Regulatory solvency is mostly assessed at the level of operating companies, with a solvency ratio calculated for each operating entity within a group. New EU regulation has introduced consolidated solvency requirements to correct for double leverage and the use of the same capital in various parts of a group.

152. **Ordinary branch (UK)** – By comparison with industrial branch business, with ordinary branch insurance the premium is paid by cheque, direct debit or other banking means and not with a cash payment. The concept is somewhat dated, but is still found in UK regulatory returns to the FSA.

153. **Orphan estate (UK)** – See inherited estate.

154. **Outward reinsurance** – Describes cessions in reinsurance, by comparison with inward reinsurance, which relates to acceptances.

155. **Participating policy** – A life insurance policy where the policyholder shares profits with the company's owners, by comparison with non-participating (non-profit) policies. In the UK, with-profits contracts are participating policies.

156. **Pay-as-you-go** – A pension arrangement under which benefits are paid out of revenue and no funding is made for future liabilities. Typical of the State pension system in many European countries, where the current generation of workers pays contributions to cover the pensions of the retired population.

157. **Pensions mis-selling (UK)** – Following regulatory changes in the UK in the mid-1980s, a number of companies promoted personal pension vehicles. The pensions mis-selling scandal emerged when it appeared some investors where being advised to leave more generous occupational pension schemes to invest in personal pension products. This led to a formal industry-wide review, and compensation by individual insurance companies.

158. **Periodic premium** – A periodic premium contract is a contract where the policyholder accepts to pay a premium on a regular basis over a number of years, say annually. Also known as a regular premium contract or an annual premium contract.

159. **Permanent health insurance (UK)** – Such a contract pays out a replacement income when the insured is unable to work. It differs form private medical insurance, which pays out medical expenses.

160. **Personal lines** – In opposition to commercial lines, personal lines cover the risks borne by individuals.

161. **Personal pension schemes** – Subscribed by individuals, not employers.

162. **Polarisation (UK)** – Under regulation currently subject to revision, financial advisors have to be either independent (and distribute products from an array of providers), or tied to one provider (and advise only on the product offering of that specific provider). With "depolarisation", financial advisors would be either independent and charge fees, or would be tied to a small number of providers.

163. **Policy** – Legal document issued to the insured setting out the terms of the contract with the insurance company.

164. **Policyholder** – The person (or persons) whose risk of financial loss from an insured peril is protected by a policy.

165. **Policyholders' reasonable expectations (PRE) (UK)** – A UK life insurance concept stating that benefits paid to policyholders must be in line with his/her "reasonable expectations". The insurer has to pay a fair level of benefits to the policyholder compared with other policyholders and the underlying performance of investment markets. PRE limit what a life office will find commercially acceptable; further, the concept has asset and liability management implications. There is no clear definition available, however, and the concept also covers product features and quality of service.

166. **Pool** – A group of insurance companies sharing premiums and expenses, usually to cover large risks (e.g. aviation risks).
167. **Premium** – Amount of money paid by the insured to the insurance company to cover the risk.
168. **Premiums ceded** – Share of the premiums transferred to a reinsurance company by an insurance company.
169. **Premiums written** – Premiums that an insurer is contractually entitled to receive from the insured in relation to insurance contracts. It is used as a measure of revenue, sometimes called premium income. Premiums written can be expressed gross or net of reinsurance.
170. **Present value of in-force business (PVIF) (UK)** – The net present value of the shareholders' interest in the expected after tax cash flows from life insurance business, on the assumption that all assets backing the business will be distributed over time to in-force policyholders and/or shareholders. The PVIF may also arise from the acquisition of a portfolio of life insurance business, and is recognised as an asset under MSSB accounting.
171. **Primary insurance company** – A primary insurance company insures individuals and companies other than insurance companies, by comparison with a reinsurance company, where primary insurers get coverage for themselves. Note that companies operating mainly as primary insurers may also have a limited reinsurance activity, for instance they may reinsure affiliates. Also sometimes called a direct insurer.
172. **Private medical insurance** – It pays out medical expenses. It differs from permanent health insurance (UK), which pays a replacement income when the policyholder is unable to work.
173. **Program business (US)** – With program business, primary insurance companies cede highly specialised risks and risks that are difficult to place in the broader insurance market, to a reinsurance company. The reinsurance company uses its scale and expertise to cover the risks, and may retrocede them to other reinsurance companies.
174. **Property & casualty insurance (US)** – Also known as non-life insurance or general insurance. Payments made by insurance companies are based on the loss incurred: they are not a fixed sum like in life insurance.
175. **Proportional reinsurance** – A portion of every risk is transferred to a reinsurance company. By comparison, see excess of loss reinsurance.
176. **Protection and indemnity clubs ('P&I clubs')** – P&I clubs are mutual associations of ship owners covering specialised marine risks.
177. **Pure premium** – The pure premium is the premium that covers the expected claim on a given risk, with a calculation based on claims frequency and the severity (cost) of claims. The pure premium excludes expenses and the insurance company's profit, the addition of which gives the commercial premium.
178. **Pyramiding** – Sometimes used to describe a situation where an insurance operating company 'A' directly owns another insurance operating company 'B'. In that context, the shares in 'B' held by 'A' are accounted for as an

investment by 'A' and under certain conditions are admissible to cover A's policyholder liabilities. At the same time, the shares are an element of solvency capital for 'B', meaning that there is effectively a double use of capital within the group, which is potentially negative from a credit point of view.

179. **Qualifying policy (UK)** – Refers to the tax treatment of life insurance policies. The payout at maturity on a qualifying policy will be exempt from further taxation.

180. **Quota-share reinsurance** – A proportional type of reinsurance contract, where a given percentage of premiums, claims, liabilities and expenses is transferred to a reinsurance company on a given book of insurance policies.

181. **Realistic solvency capital (UK)** – Excess capital on top of liabilities, as calculated with a set of "realistic", economic assumptions instead of more conservative regulatory assumptions. Solvency capital on a realistic basis is deemed to be higher than on a statutory basis. Some companies publish an estimate of their surplus capital on a realistic basis. For proprietary companies, the concept of excess capital on a realistic basis is close to the concept of orphan estate.

182. **Re-evaluation reserve** – See fluctuation reserve.

183. **Regular premium** – See periodic premium.

184. **Regulatory returns** – They are prepared for the regulator, essentially for supervisory purposes, and may be different from returns prepared for shareholders or internal management purposes. Regulatory returns are often prepared with conservative assumptions, and as a result may not always reflect the true economic position of an insurance company's business.

185. **Reinsurance** – The process by which an insurance company cedes some of its business to another insurance company. If the latter only writes business with insurance companies, it is a reinsurance company – but primary insurance companies can write reinsurance contracts themselves. The insurance company seeking insurance protection for itself is the ceding insurance company, and the operation is called a reinsurance cession. The expressions reinsurance inwards and reinsurance outwards are sometimes used to qualify the direction of the risk transfer: the former is the acceptance of risks, the latter the placing of risks under a reinsurance contract. A reinsurer may, in turn, seek reinsurance on a portion of the risks it has reinsured, a process known as retrocession. The reinsurance market is global by nature, and contributes to risk transfer on a worldwide basis. Reinsurance companies also help primary insurance companies by providing data and market expertise, and reinsurance is often used to transfer capital strength between insurance companies. Under EU regulation, the use of reinsurance lowers the required minimum margin of solvency and boosts solvency, with limitations.

186. **Reinsurance receivables/recoverables** – Amounts due to the insurance company and payable by reinsurance companies. There may be an element of counterparty exposure if the receivables are not collateralised.

187. **Required minimum margin of solvency (RMMS)** – The minimum level that a regulated insurance company needs to cover with solvency capital to operate under normal conditions. The regulator prescribes the definition: the RMMS is effectively a weighted average of provisions (life insurance) or premiums/claims (non-life insurance).
188. **Reserve ratio** – In non-life insurance, the ratio of reserves to premiums. It can be calculated gross or net of reinsurance, and is a measure of reserve strength. The ratio is dependent upon the line of business: for long-tail risks, the ratio would usually be higher than, say, for motor insurance.
189. **Reserves** – Usually refers to liabilities established by insurers and reinsurers to reflect the estimated cost of claims payments payable in the future. Sometimes refer to surplus capital, mainly in the US.
190. **Resilience reserve/resilience tests (UK)** – Regulatory tests imposed on UK life insurance companies to ensure that they can withstand a specific fall in equity markets without breaching solvency rules. The result is embedded in the calculation of technical provisions instead of being shown as solvency capital.
191. **Retention** – The amount of risk kept by an insurance company in its own books, in comparison with insurance risks ceded to a reinsurance company. Retention ratios can be calculated on premiums and on reserves, and express the proportion of premiums (reserves) the cedent keeps in its own books, typically calculated as net premiums (reserves)/gross premiums (reserves). The lower the retention ratio, the higher the reliance on reinsurance.
192. **Retrocession** – The process by which a reinsurance company cedes (reinsures) some of its own risks to another reinsurance company (the retrocessionaire). The ceding reinsurer usually remains liable towards its own clients even if the retrocessionaire defaults.
193. **Retrocessionaire** – A reinsurance company accepting business from another reinsurance company.
194. **Revaluation reserve** – See fluctuation reserve.
195. **Reversionary bonus (UK)** – Annual bonuses added to the sum assured of a life insurance with-profits policy. They are usually not guaranteed in advance, except sometimes for the first year, but once added cannot usually be removed. They are complemented by terminal bonuses.
196. **RfB (Germany)** – A policyholder bonus reserve used in life insurance. The free portion of the RfB is the portion of the reserve not allocated to individual life insurance policies, and available for solvency purposes.
197. **Risk-based capital ratio (RBC ratio)** – A ratio comparing an insurance company's capital base with a weighted average of amounts at risk, mainly investment and underwriting risk. S&P's capital adequacy ratio is an example of risk-based capital ratio, so is the US ratio used for regulatory purposes. In the EU, the solvency ratio currently used is a more simple measure, but a move to the Solvency II framework would effectively imply the adoption of a risk-based capital model.
198. **Run-off** – An insurance company is in run-off if it has stopped writing new business and only manages existing policyholder liabilities. A solvent run-off

is when the company, while in run-off, fulfils regulatory solvency requirements; an insolvent run-off is when the company is being run-off in breach of solvency rules. Run-offs can last for decades, especially for long-tail risks and in life insurance/pensions. They may be a source of dividends for shareholders as and when reserves are freed over time, or, on the contrary, a source of risk if the reserving of the run-off company is not sufficient. Some outsourcing companies specialise in the management of run-off companies.

199. **Section 2C transfer (UK)** – A section 2C transfer refers to a merger of two insurance companies, and is used to restructure insurance groups.

200. **Self-insurance** – Refers to a situation where no external coverage is used: risk is kept and losses covered directly without seeking external insurance. Risk management policies usually include an element of self-insurance, especially in large, diversified groups. External insurance is then used for compulsory insurance, and to cover low probability, high severity events.

201. **Shareholders' fund** – (i) In most cases, it refers to shareholders' equity and reserves; (ii) In the UK, the shareholders' fund is also the fund in the life insurance operating company that represents shareholders' interests in the company. Transfers from the long-term fund to the shareholders' fund are strictly limited. Shareholder dividends are paid out of the shareholders' fund.

202. **Short-tail insurance** – Claims are reported when the policy is still in force or shortly after the policy expires (e.g., motor insurance). This compares with long-tail insurance.

203. **Short-term fluctuation in investment return** – Under embedded value accounting, the operating profit is calculated using long-term economic and operational assumptions. The short-term fluctuation in investment returns then corrects for investment assumptions to calculate the profit for the year.

204. **Single passport** – EU terminology related to the authorisation for an insurance company to sell insurance throughout the EU and EEA on the basis of authorisation in its home country. Under the single passport regulation, the insurance company can operate from its home country without the use of a local insurance subsidiary.

205. **Single premium** – A single premium contract involves the payment of one premium at inception with no obligation for the policyholder to make subsequent, additional payments. It compares with regular/annual/periodic premium contracts, where the policyholder accepts at inception to make a regular payment. Some flexible products offer the option for the policyholder to make voluntary top-up payments later in the future.

206. **Soft market** – Term used to qualify a non-life insurance/reinsurance market where premiums are inexpensive, usually as a result of competition and abundant supply of insurance.

207. **Solvency I, Solvency II** – Under EU regulation, Solvency I refers to the existing solvency framework with three main directives. Solvency II refers to an ongoing review of solvency regulation, which could lead to the implementation of a risk-based capital model in the next few years.

208. **Solvency ratio** – Usually refers to the solvency ratio under EU regulation. It is calculated at the level of each operating company. Broadly speaking, in life

insurance it is calculated as admissible solvency capital as a percentage of provisions weighted by investment risk. In non-life insurance, admissible solvency capital is compared with claims and premiums; a frequently calculated measure is also the ratio of shareholders' funds to net premiums written. Note that new EU regulation introduced consolidated solvency requirements to correct for double leverage and pyramiding in the industry; this is calculated at group level.

209. **Stakeholder pensions (UK) –** Form of pension products with low expenses, targeted at the mass market and introduced in 2001. There are restrictions on the management expenses the provider can charge, and the annual contribution is capped at £3,600.

210. **Statutory reporting** – As complying with the main legal reporting method, usually for the regulator. Statutory earnings are usually calculated under conservative assumptions driven by solvency principles; they may not give an adequate picture of the economic value created by the company, however. Embedded value accounting often supplements this reporting method.

211. **Stop loss reinsurance** – The reinsurer provides coverage for losses arising between two loss ratios, or between two amounts of losses. A stop loss provision for an insurance company effectively guarantees a maximum loss ratio. Used mainly in classes of business whose results tend to fluctuate strongly over time (e.g. windstorm, earthquakes).

212. **Sub-fund –** See fund.

213. **Subordinated liabilities** – Mostly subordinated debt taking the form of loans or traded securities. Under EU insurance regulation, subordinated debt is not treated as a liability and counts towards the coverage of the required minimum margin of solvency, with limitations.

214. **Sum assured** – Minimum guaranteed benefit level under a life insurance policy. The sum assured may increase over time with the payment of bonuses.

215. **Superannuation business (Australia)** – Broadly equivalent to pensions business.

216. **Surety insurance –** Sureties and guarantees issued to third parties for the fulfilment of contractual liabilities.

217. **Surplus capital** – Sometimes used as a synonym for "solvency capital", i.e. assets available on top of an insurance company's liabilities.

218. **Surplus notes (US)** – Subordinated notes issued by US insurance companies.

219. **Surplus reinsurance –** Form of proportional reinsurance in which risks are reinsured above a specified amount.

220. **Surrender penalty** – The difference between the underlying value of a life insurance contract and the payment made to the policyholder, if the contract is terminated (surrendered) before maturity. Surrender penalties help the company recoup its initial expenses when the policyholder cancels the contract in the first few years.

221. **Surrender value –** The amount received by a policyholder if he/she decided to cancel the policy before maturity. Surrender values vary greatly, and may be poor in the first years before the insurance company has recouped its

acquisition costs from the policy. Contracts without a savings component (e.g. term insurance) rarely have a surrender value. Products with no guaranteed surrender values give more flexibility to the insurance company for asset and liability management purposes, but in some markets consumer pressure has led to a removal of surrender penalties.

222. **Survival ratio –** A measure used in non-life insurance, which estimates how many years it would take for asbestos and environmental claims to exhaust the current level of loss reserves. It is calculated on the level of claims payments, for instance averaged over the last three years ("three-year survival ratio"). A three-year survival ratio of 10 indicates that it would take 10 years to exhaust reserves if annual claims payments remained the same as the average in the last three years. Everything else being equal, the higher the ratio, the lower the risk that further reserve strengthening on A&E business is needed.

223. **Tail** – Indicates how much time elapses between the moment a loss is incurred (say, an accident), and the settlement of losses by the insurer. See short-tail and long-tail business.

224. **Technical account –** According to EU directives, the profit and loss account has to be separated between a non-life insurance technical account, a life insurance technical account, and a non-technical account. Insurance revenues and expenses are accounted for in the relevant technical account, the result of which flows into the non-technical account to calculate the profit for shareholders (or retained profit for a mutual). The non-technical account also includes non-insurance earnings and expenses, as well as earnings on shareholders' funds not attributable to insurance operations.

225. **Technical provisions** – EU expression broadly equivalent to insurance liabilities, i.e. the value set aside to cover expected losses arising on a book of insurance policies.

226. **Technical result** – The balance of either the life or non-life technical account. See technical account.

227. **Term insurance** – Type of life insurance protection policy with no build-up of a cash value: the insurer only pays out in case of death within a specific period of time. A typical example is a policy guaranteeing the payment of a lump sum in case of death, with no benefit payable if the policyholder is alive at maturity.

228. **Terminal bonus (UK)** – In a life insurance with-profits policy, a benefit added to the sum assured at maturity. It is not guaranteed before maturity, but can make a large portion of the total payout to the policyholder.

229. **Third-party liability insurance (TPL)** – It guarantees damages caused to others. In some cases, it may be compulsory, e.g. TPL motor insurance.

230. **Tied agent** – Person or company selling products from one insurance company. By comparison with a broker, the tied agent is linked to a specific provider.

231. **Total adjusted capital (TAC)** – Commonly refers to an insurance company's capital base under Standard & Poor's capital adequacy model. It

includes shareholders' funds and adjustments on equity, asset values and reserves.

232. **Treaty reinsurance** – With treaty reinsurance, specific categories of risks are transferred to a reinsurance company. The reinsurance company accepts taking on all the risks falling within the terms of the agreement.

233. **Triangle (loss triangle)** – It shows the development of loss reserves by line of business and year of occurrence. It shows how claims are paid out/reserved for from the time they are filed and the time they are settled, and is a tool used to measure the conservatism of an insurance company's provisions. The method used to determine claims provisions with loss triangles is called triangulation.

234. **Underwriting** – The process of evaluating and pricing risks in insurance.

235. **Underwriting cycle** – The non-life insurance and reinsurance markets have usually displayed signs of an underwriting cycle. In years of good investment returns, capital is abundant and excess supply drives premiums down (soft market). This ultimately leads to underwriting losses and forces insurance companies to increase premiums to improve their results and replenish their capital bases (hard market).

236. **Underwriting result** – Earned premiums minus the cost of claims and operating expenses. It indicates whether premiums cover claims and expenses or not; it excludes the investment return, meaning that the insurance company could still book a bottom line profit even with an underwriting loss.

237. **Unearned premium reserve** – A reserve made to cover premiums written but yet to be earned (unearned premiums).

238. **Unearned premiums** – Unearned premiums arise because, for instance, the premium on a 12-month non-life insurance policy written on 1 November covers only two months in the calendar year. 10/12 of the premium will be deemed unearned and reserved for at year-end.

239. **Unitised with-profits business (UK)** – Policyholders are allocated units in the with-profits fund, and units are priced depending on annual reversionary bonuses. This is effectively mixing the "with-profits" concept with the management structure of a unit-linked policy. A terminal bonus is also usually added at maturity. In the UK, with-profits business is now mostly written on a unitised basis.

240. **Unit-linked life insurance** – Policyholder benefits under such a contract are expressed in units of an underlying investment vehicle, e.g. an investment fund, instead of being expressed in currency terms. As a result, they fluctuate with the value of the units and investment risk is transferred to the policyholder. Solvency requirements under EU regulation are much lower than for non-linked insurance business. The insurer is compensated with explicit management charges. "Separate account" and "variable annuity" are broadly equivalent expressions used in the US.

241. **Unit trust (UK)** – A form of unlisted, open-ended investment fund; investors buy units in the fund from the asset management organisation.

242. **Universal life insurance** – A life insurance product where there is flexibility in the payment of premiums and the level of death coverage, and where

charges are disclosed. Mainly used for asset accumulation policies, where there is a savings component.

243. **Unrealised capital gains** – Sometimes referred to as “hidden reserves”, they arise when the value of investments reported on the balance sheet is inferior to the market value. Unrealised capital gains would then be reported off-balance sheet. The concept is not relevant where the full balance sheet is on a market value basis, e.g. in the UK.

244. **Variable annuities (US) –** US expression for unit-linked business.

245. **Whole life policy** – A type of life insurance policy that provides lifetime protection; premiums must usually be paid for life. The sum assured is paid out whenever death occurs. Commonly used for estate planning purposes.

246. **Winding-up** – The EU term for the liquidation of an insurance company – a rare event in insurance, and a very rare event in life insurance. See the difference with insolvency.

247. **With-profits annuity (UK)** – An annuity contract where benefits are linked to the performance of a life insurance office’s with-profits fund.

248. **With-profits bond (UK)** – A life insurance savings policy, whereby a lump-sum payment is invested in the insurer’s with-profits fund. Annual (reversionary) bonuses are added, and a terminal bonus is paid out at maturity.

249. **With-profits fund (UK)** – A fund invested in a mix of equities, property assets and bonds used to back with-profits policies. It is effectively a form of participating fund. With-profits funds have historically been invested mostly in equities to benefit from the long-term performance of this asset class. Benefits allocated to policyholders are smoothed over time so as to remove part of the volatility of equities.

250. **Zillmerisation** – A method of calculating reserves in life insurance that allows for the acquisition costs incurred when a contract is written. Zillmerised reserves are lower than reserves that are not zillmerised. The method applies to regular premium business. It is effectively a variation of the net premium method, which increases the future premiums valued to take account of acquisition costs incurred.

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