

## **Future work**

To follow up the issues raised earlier, we are considering whether the most effective way to supervise firms' use of financial engineering is through enhanced disclosure in public and regulatory returns and we aim to consult on this approach later this year. In parallel, we are also undertaking some specific supervisory work to establish the extent to which financial engineering is used by our regulated firms.

To that end, I am writing to ask you to provide the following information -

- a) the extent to which your firm engages (or has engaged since 1 December 2001) in transactions where the economic value of the transaction (including allowance for any contingent liabilities) differs materially from the value placed on the transaction in your firm's balance sheet;
- b) indicate what systems and controls your firm has in place to subject such transactions to adequate scrutiny, in the light of the FSA's high level Principles for Businesses and other applicable regulatory requirements as set out above;
- c) confirm that you are, accordingly, satisfied that your firm does not engage in financial engineering transactions or side agreements that might obscure the firm's financial position or which could put your firm at risk of breaching any applicable regulatory requirements; and
- d) confirm that your firm's individual capital assessment (ICA) explains the extent to which financial engineering has been used, for what purpose and the impact on both assets and liabilities and that the ICA assesses the capital required (if any) to mitigate risks, including both credit and operational risks, arising from such contracts.

We are asking those general insurers and reinsurers whom we subject to risk assessment to provide this information. We recognise that some of the information on the transactions requested in (a) above may have been reported in your firm's FSA insurance return under IPRU(INS) rule 9.32 and Appendix 9.5 or may have featured in other parts of the return. We plan to use this information to inform our supervisory approach and, where appropriate, our policy on regulatory reporting requirements.

If you have any doubts about any specific transactions that are still current, or any other points in this letter, please discuss these with your supervisor in the first instance. I should be grateful if you would send your response to this letter by end April.

Yours sincerely