

# **Guidelines on classification of own funds**

## Introduction

- 1.1. These Guidelines are drafted according to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (hereinafter "EIOPA Regulation")<sup>1</sup>.
- 1.2. These Guidelines relate to Articles 93 to 95 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (hereinafter "Solvency II")<sup>2</sup> as well as to Articles 69 to 73, 76, 77, 79 and 82 of Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC (hereinafter "Commission Delegated Regulation 2015/35")<sup>3</sup>.
- 1.3. These Guidelines are addressed to supervisory authorities under Solvency II.
- 1.4. The purpose of these Guidelines is to provide guidance on how the lists of own-fund items and the features determining classification for each tier should be applied. The Guidelines also set out procedures relating to the classification of own funds including the prior supervisory approval of Items not on the lists of own-fund items.
- 1.5. Undertakings have different capital items in their financial statements. Most of these will correspond to the defined lists of basic own-fund items in Commission Delegated Regulation 2015/35, which do not require supervisory approval. Some, including retained earnings, will be taken into account within the reconciliation reserve, which is a single own-fund item. Other Items not on the lists will need to be approved as basic or ancillary own-funds items. All items should be assessed against the features for determining classification to judge whether they qualify as available own funds and their appropriate tier.
- 1.6. The terms of the contractual arrangement governing the own-fund item should comply with the substance not just the form specified in Solvency II and be clear and unambiguous.
- 1.7. Paid-in ordinary share capital including its related share premium account, and paid-in initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings, should form the highest quality own funds which can be relied on to absorb losses on a going-concern basis. The quality of such own funds should not be undermined.
- 1.8. The interpretation of share premium account should be based on the economic substance as different terminology may be employed in national law. Share premium account should therefore be understood as a separate account or reserve to which share premiums, the amount between the value received and the nominal value of the share at issuance or the value received at issuance

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<sup>1</sup> OJ L 331, 15.12.2010, p. 48–83

<sup>2</sup> OJ L 335, 17.12.2009, p. 1-155

<sup>3</sup> OJ L 12, 17.01.2015, p. 1-797

and the value recognised in share capital, are transferred in accordance with national law.

- 1.9. The Guidelines clarify that in order for undertakings to always retain full flexibility in raising new own-fund items, paid-in subordinated mutual member accounts, paid-in preference shares including the related share premium account, and paid-in subordinated liabilities should not, by their contractual arrangements, prevent or hinder new own funds being raised.
- 1.10. Own-fund items should have sufficient maturity, depending on the tier in which they are classified. The Guidelines set out that this requirement should not be undermined by any call options prior to five years for items of all tiers as defined in Article 94 of Solvency II, irrespective of whether they relate to changes that lie within or outside the control of the undertaking. While the repurchase or buyback of any own-fund item is permitted at the option of the undertaking on or after the first possible call date, the undertaking should not create any expectation at issuance that the item will be bought back, redeemed or cancelled before the contractual maturity of the item. Since a repayment or redemption may have a substantial impact on the solvency position of the undertaking in the short and medium term, a repayment or redemption is always subject to supervisory approval. This is without prejudice to the treatment of transactions that are not deemed to be repayment or redemption as described in Articles 71(2), 73(2) and 77(2) of Commission Delegated Regulation 2015/35.
- 1.11. In order to avoid deterioration in an undertaking's solvency position, own-fund items need to provide that undertakings will be able to maintain own funds when there is non-compliance with the Solvency Capital Requirement (hereinafter "SCR") or if repayment or redemption would result in such non-compliance. The Guidelines set out that this should be independent of any contractual obligations or any notice of repayment and redemption given.
- 1.12. Since distributions cannot be made where they further weaken the solvency position of the undertaking, the Guidelines set out that alternative coupon satisfaction mechanisms should only be permissible in a restricted manner, whereby the cancellation of distributions is not undermined and there is no decrease in own funds of the undertaking.
- 1.13. Arrangements intended to stop or require payments on other items undermine full flexibility. The Guidelines make it clear that the use of dividend stoppers, capping or restricting the level or amount of distributions to be made on the item referred to in Article 69(a)(i) of Commission Delegated Regulation 2015/35, in any own-fund item, regardless of the tier, that would prevent payment on Tier 1 items is prohibited as they could discourage new providers of own funds and thus represent a hindrance to recapitalisation.
- 1.14. In order that any principal loss absorbency mechanism can achieve its purpose at the point of the trigger, the terms of the contractual arrangement should be clearly defined and legally certain, and capable of being applied without delay. The Guidelines explain that while a future write-up is generally permitted, this mechanism should not undermine the loss absorbency and should only be

allowed on the basis of profits generated after restoring compliance with the SCR.

- 1.15. While called-up but not paid-in ordinary share capital may be classified as Tier 2 basic own funds, provided that the Tier 2 features are met, the Guidelines provide that this capital should only count as own funds for a limited time. This is to avoid the calling-up of capital solely for the purpose of satisfying the requirements of own funds classification without any intent that the item should become paid-in in due course.
- 1.16. These Guidelines also provide guidance in the event of non-compliance with the SCR. Non-compliance with the SCR arises when the value of own funds eligible to cover the SCR is less than the amount of the SCR. This should not be confused with a significant non-compliance with the SCR as defined in Article 71(8) of Commission Delegated Regulation 2015/35 specifically for the purposes of principal loss absorbency mechanisms. Non-compliance with the Minimum Capital Requirement (hereinafter "MCR") arises when the value of own funds eligible to cover the MCR is less than the amount of the MCR.
- 1.17. For the purpose of these Guidelines, the following definition has been developed:

'Item not on the lists' means an own-fund item not included in the lists set out in Articles 69, 72 and 76 of Commission Delegated Regulation 2015/35.
- 1.18. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.
- 1.19. The Guidelines shall apply from 1 April 2015.

## **Section 1: Tier 1 items**

### **Guideline 1 - Tier 1 paid-in ordinary share capital and preference shares**

- 1.20. For the purposes of Article 69(a)(i) of Commission Delegated Regulation 2015/35, undertakings should identify paid-in ordinary share capital by the following properties:
  - (a) the shares are issued directly by the undertaking with the prior approval of its shareholders or, where permitted under national law, its administrative, management or supervisory body (hereinafter "AMSB");
  - (b) the shares entitle the owner to a claim on the residual assets of the undertaking in the event of winding-up proceedings, which is proportionate to the amount of the items issued, and is neither fixed nor subject to a cap.
- 1.21. Where an undertaking has more than one class of shares it should:
  - (a) in accordance with Article 71(1)(a)(i) and (3)(a) of Commission Delegated Regulation 2015/35, identify the differences between classes which provide for one class to rank ahead of another or which create any

preference as to distributions, and only consider as possible Tier 1 ordinary share capital the class which ranks after all other claims and has no preferential rights;

- (b) consider any share classes ranking ahead of the most subordinated class or which have other preferential features which prevent them from being classified as Tier 1 ordinary share capital in accordance with point (a) as potentially qualifying as preference shares and classify such items in the relevant tier according to their features.

## **Guideline 2 - Reconciliation Reserve**

1.22. For the purposes of Article 70(1)(a) of Commission Delegated Regulation 2015/35, undertakings should include own shares held both directly and indirectly.

1.23. For the purposes of Article 70(1)(b) of Commission Delegated Regulation 2015/35:

- (a) undertakings should consider a dividend or distribution to be foreseeable at the latest when it is declared or approved by the AMSB, or the other persons who effectively run the undertaking, regardless of any requirement for approval at the annual general meeting;
- (b) where a participating undertaking holds a participation in another undertaking, which has a foreseeable dividend, the participating undertaking should make no reduction to its reconciliation reserve for that foreseeable dividend;
- (c) undertakings should consider the amount of foreseeable charges to be taken into account as:
  - (i) the amount of taxes which are foreseeable and are not already recognised as a liability on the Solvency II balance sheet;
  - (ii) the amount of any obligations or circumstances arising during the related reporting period which are likely to reduce the profits of the undertaking and for which the supervisory authority is not satisfied that they have been appropriately captured by the valuation of assets and liabilities in accordance with Commission Delegated Regulation 2015/35.

## **Guideline 3 - Tier 1 features determining classification of items referred to in Article 69(a)(i), (ii) and (iv) of Commission Delegated Regulation 2015/35**

1.24. In the case of an item referred to in Article 69(a)(i), (ii) and (iv) of Commission Delegated Regulation 2015/35, undertakings should consider the features which may cause the insolvency or accelerate the process of the undertaking becoming insolvent as including:

- (a) the holder of the own-fund item is in a position to petition for the winding-up of the issuer in the event of distributions not being made;

- (b) the item is treated as a liability where a determination that the liabilities of an undertaking exceed its assets constitutes a test of insolvency under the applicable national law;
- (c) the holder of the own-fund item may, as a result of a distribution being cancelled or not being made, be granted the ability to cause full or partial payment of the amount invested, or to demand penalties or any other compensation that could result in a decrease of own funds.

**Guideline 4 - Tier 1 features determining classification of items referred to in Article 69(a)(i) and (ii) of Commission Delegated Regulation 2015/35**

1.25. In the case of an item referred to in Article 69(a)(i) and (ii) of Commission Delegated Regulation 2015/35, for the purposes of displaying the features in Article 71(3) of Commission Delegated Regulation 2015/35 (full flexibility), undertakings should:

- (a) consider distributable items as comprising retained earnings, including profit for the year ended prior to the year of distribution, and distributable reserves as defined under national law or by the statutes of the undertaking, reduced by the deduction of any interim net loss for the current financial year from retained earnings;
- (b) determine the amount of distributable items on the basis of the individual accounts of the undertaking and not on the basis of consolidated accounts;
- (c) reflect in the determination of distributable items any restrictions imposed by national law with regard to consolidated accounts;
- (d) ensure that the terms of the contractual arrangements governing the own-fund item or any other own-fund item do not cap or restrict the level or amount of distribution to be made on the item referred to in Article 69(a)(i) of Commission Delegated Regulation 2015/35, including capping or restricting the distribution to zero;
- (e) ensure that the terms of the contractual arrangement governing the own-fund item do not require a distribution to be made in the event of a distribution being made on any other own-fund item issued by the undertaking.

1.26. The undertaking should identify the legal basis for the cancellation of distributions in accordance with Article 71(1)(l)(i) of Commission Delegated Regulation 2015/35 prior to classifying an item as Tier 1.

**Guideline 5 - Tier 1 features determining classification of items referred to in Article 69(a)(iii), (v) and (b) of Commission Delegated Regulation 2015/35**

1.27. In the case of an item referred to in Article 69(a)(iii), (v) and (b) of Commission Delegated Regulation 2015/35, undertakings should consider features which may cause insolvency or accelerate the process of the undertaking becoming insolvent as including:

- (a) the holder of the own-fund item is in a position to petition for the winding-up of the issuer in the event of distributions not being made;
- (b) the item is treated as a liability where a determination that the liabilities of an undertaking exceed its assets constitutes a test of insolvency under applicable national law;
- (c) the terms of the contractual arrangement governing the own-fund item specify circumstances or conditions which, if met, would require the initiation of insolvency or any other procedure which would prejudice the continuance of the undertaking or its business as a going concern;
- (d) the holder of the security relating to an own-fund item may, as a result of a distribution being cancelled, be granted the ability to cause full or partial payment of the amount invested, or to demand penalties or any other compensation that could result in a decrease of own funds.

1.28. For the purposes of displaying the features in Article 71(1)(d) of Commission Delegated Regulation 2015/35 (absorbing losses once there is non-compliance with capital requirements and not hindering recapitalisation), undertakings should ensure that the terms of the contractual arrangement governing the own-fund item or the terms of any connected arrangement:

- (a) do not prevent a new or increased own-fund item issued by the undertaking from ranking ahead of, or to the same degree of subordination as, that item;
- (b) do not require that any new own-fund items raised by the undertaking are more deeply subordinated to that item in conditions of stress or other circumstances where additional own funds may be needed;
- (c) do not include terms that prevent distributions on other own-fund items;
- (d) do not require that the item is automatically converted into an item that ranks more highly in terms of subordination, in conditions of stress or other circumstances where own funds may be needed, or as a result of structural changes including a merger or acquisition.

1.29. For the purposes of displaying the features in Article 71(1)(f)(ii) of Commission Delegated Regulation 2015/35 (repayment or redemption before 5 years), undertakings should ensure that the item does not include a contractual term providing for a call option prior to 5 years from the date of issuance, including call options predicated on unforeseen changes that are outside the control of the undertaking.

1.30. Subject to the satisfaction of all relevant features for determining classification and to prior supervisory approval, supervisory authorities should consider arrangements predicated on unforeseen changes, which are outside the control of the undertaking and that would give rise to transactions or arrangements which are not deemed to be repayment or redemption, to be permitted as provided for in Article 71(2) of Commission Delegated Regulation 2015/35.

- 1.31. For the purposes of displaying the features in Article 71(1)(m) of Commission Delegated Regulation 2015/35 (waiver of cancellation of distributions), undertakings should ensure that:
- (a) any alternative coupon satisfaction mechanism is only included in the terms of the contractual arrangement governing the own-fund item where the mechanism substitutes any payment of the distribution in cash by providing for distributions to be settled through the issue of ordinary share capital;
  - (b) any alternative coupon satisfaction mechanism achieves the same degree of loss absorbency as the cancellation of the distribution, and there is no decrease in own funds;
  - (c) any distributions under an alternative coupon satisfaction mechanism occur as soon as the supervisory authority has exceptionally waived the cancellation of distributions using unissued ordinary share capital which has already been approved or authorised under national law or under the statutes of the undertaking;
  - (d) any alternative coupon satisfaction mechanism does not allow the undertaking to use own shares held as a result of repurchase;
  - (e) the terms of the contractual arrangement governing the own-fund item:
    - (i) provide for the operation of any alternative coupon satisfaction mechanism to be subject to an exceptional waiver from the supervisory authority under Article 71(1)(m) of Commission Delegated Regulation 2015/35 on each occasion that the cancellation of the distribution is required;
    - (ii) do not oblige the undertaking to operate any alternative coupon satisfaction mechanism.
- 1.32. For the purposes of displaying the features in Article 71(4) of Commission Delegated Regulation 2015/35 (full flexibility over distributions), undertakings should ensure that the terms of the contractual arrangement governing the own-fund item do not:
- (a) require distributions to be made on the item in the event of a distribution being made on any other own-fund item issued by the undertaking;
  - (b) require the payment of distributions to be cancelled or prevented on any other own-fund item of the undertaking in the event that no distribution is made in respect of that item;
  - (c) link the payment of distributions to any other event or transaction which has the same economic effect as points (a) or (b).
- 1.33. For the purposes of displaying the features in Article 71(1)(e), (5), (6) and (8) of Commission Delegated Regulation 2015/35 (principal loss absorbency mechanisms), undertakings should ensure that:

- (a) the loss absorbency mechanism, including the trigger point, is clearly defined in the terms of the contractual arrangement governing the own-fund item and legally certain;
- (b) the loss absorbency mechanism can be effective at the point of the trigger, without delay and regardless of any requirement to notify holders of the item;
- (c) any write-down mechanism that does not allow for future write-up should provide that the amounts written down in accordance with 71(5)(a) of Commission Delegated Regulation 2015/35 cannot be restored;
- (d) any write-down mechanism that allows for a future write-up of the nominal or principal amount provides that:
  - (i) write-up is permitted only after the undertaking has achieved compliance with the SCR;
  - (ii) write-up is not activated by reference to own-fund items issued or increased in order to restore compliance with the SCR;
  - (iii) write-up only occurs on the basis of profits which contribute to distributable items made subsequent to the restoration of compliance with the SCR in a manner that does not undermine the loss absorbency intended by Article 71(5) of Commission Delegated Regulation 2015/35;
- (e) any conversion mechanism provides that:
  - (i) the basis on which the security relating to an own-fund item converts into ordinary share capital on significant non-compliance with the SCR is specified clearly in the terms of the contractual arrangement governing the security;
  - (ii) the conversion terms do not fully compensate the nominal amount of a holding by allowing an uncapped conversion rate in the event of falls in the share price;
  - (iii) in specifying a range within which the instruments will convert, the maximum number of shares the holder of the security may receive is certain at the time of issuance of the security, subject only to adjustments to reflect any share splits which occur subsequent to the issuance of those instruments;
  - (iv) the conversion will result in a situation where losses are absorbed on a going-concern basis and the basic own-fund items that arise as a result of the conversion do not hinder recapitalisation;

1.34. Where undertakings have own-fund items with conversion mechanisms, they should ensure that sufficient shares have already been authorised in accordance with national law or the statutes of the undertaking, so that shares are available for issuance when needed.

**Guideline 6 - Tier 1 features determining classification of items referred to in Article 69(a)(i), (ii), (iii), (v) and (b) of Commission Delegated Regulation 2015/35 – immediate availability to absorb losses**

1.35. In the case of an item referred to in Article 69 (a)(i), (ii), (iii), (v) and (b) of Commission Delegated Regulation 2015/35, undertakings should only consider an item as immediately available to absorb losses, if the item is paid in and there are no conditions or contingences in respect of its ability to absorb losses.

**Guideline 7 - Tier 1 features determining classification of items referred to in Article 69(a)(i), (ii), (iii), (v) and (b) of Commission Delegated Regulation 2015/35 – repayment or redemption at the option of the undertaking**

1.36. In the case of an item referred to in Article 69(a)(i), (ii), (iii), (v) and (b) of Commission Delegated Regulation 2015/35, for the purposes of displaying the features in Article 71(1)(h) and (i) of Commission Delegated Regulation 2015/35, undertakings should:

- (a) ensure that the terms of the legal or contractual arrangement governing the item, or any connected arrangement, do not provide for any incentive to redeem as set out in Guideline 19;
- (b) not create any expectation at issuance that the item will be redeemed or cancelled, nor should the legal or contractual terms governing the own-fund item contain any term which might give rise to such an expectation.

1.37. Undertakings should treat the item as repaid or redeemed from the date of notice to holders of the item or, if no notice is required, the date of supervisory approval, and exclude the item from own funds from that date.

1.38. In the case of an item referred to in Article 69(a)(iii), (v) and (b) of Commission Delegated Regulation 2015/35, for the purposes of displaying the features in Article 71(1)(j) of Commission Delegated Regulation 2015/35 (suspension of repayment or redemption), undertakings should ensure that the terms of the contractual arrangement governing the own-fund item include provisions for the suspension of the repayment or redemption of the item at any point, including when notice of repayment or redemption has been given other than following an exceptional waiver as described in Guideline 15, in the event of non-compliance with the SCR or if the repayment or redemption would result in such non-compliance.

1.39. For undertakings that have suspended repayment or redemption in accordance with Article 71(1)(j) of Commission Delegated Regulation 2015/35, the undertakings' subsequent actions should form part of the recovery plan referred to in Article 138 of Solvency II.

**Guideline 8 - Contractual opportunities to redeem and appropriate margin**

1.40. In the case of a request for supervisory approval of a repayment or redemption between 5 and 10 years after the date of issuance in accordance with Article 71(1)(g) of Commission Delegated Regulation 2015/35, undertakings should

demonstrate how the SCR would be exceeded by an appropriate margin following the repayment or redemption for the period of its medium-term capital management plan or, if longer, for the period between the date of redemption or repayment and 10 years after the date of issuance.

- 1.41. In assessing whether a margin is appropriate the supervisory authority should take into account:
- (a) the current and projected solvency position of the undertaking, taking into account the proposed repayment or redemption and any other proposed redemptions and repayments or issuances;
  - (b) the undertaking's medium-term capital management plan and Own Risk and Solvency Assessment (hereinafter "ORSA");
  - (c) the volatility of the undertaking's own funds and SCR having regard to the nature, scale and complexity of the risks inherent in the business of the undertaking;
  - (d) the extent to which the undertaking has access to external sources of own funds and the impact of market conditions on the ability of undertakings to raise own funds.

## **Section 2: Tier 2 items**

### **Guideline 9 - Tier 2 list of own-fund items**

- 1.42. In the case of items referred to in Article 72(a)(i), (ii) and (iv) of Commission Delegated Regulation 2015/35, undertakings should ensure that:
- (a) the time period between calling on shareholders or members to pay and the item becoming paid in, is not longer than three months. During this time, undertakings should consider the own funds to be called up but not paid in and should classify them as Tier 2 basic own funds provided that all other relevant criteria are met;
  - (b) for items which are called up but not paid in, the shareholder or member that owns the item is still obliged to pay the outstanding amount in the event of the undertaking becoming insolvent or entering into winding-up procedures, and that the amount is available to absorb losses.

### **Guideline 10 - Tier 2 features for determining classification**

- 1.43. In the case of items referred to in Article 72(a)(i) and (ii) of Commission Delegated Regulation 2015/35, for undertakings determining classification in accordance with Article 73(1)(b) of Commission Delegated Regulation 2015/35, paragraph 1.24 of Guideline 3 applies *mutatis mutandis*.
- 1.44. In the case of items referred to in Article 72(a)(iii), (iv) and (b) of Commission Delegated Regulation 2015/35, for undertakings determining classification in accordance with Article 73(1)(b) of Commission Delegated Regulation 2015/35, paragraph 1.27 of Guideline 5 applies *mutatis mutandis*.

- 1.45. For the purposes of displaying the features in Article 73(1)(c) of Commission Delegated Regulation 2015/35 (repayment or redemption before five years), undertakings should ensure that the contractual arrangement governing the own-fund item does not include a contractual term providing for a call option prior to five years from the date of issuance, including call options predicated on unforeseen changes that are outside the control of the undertaking.
- 1.46. Subject to the satisfaction of all relevant features for determining classification and to prior supervisory approval, supervisory authorities should consider arrangements predicated on unforeseen changes which are outside the control of the undertaking and that would give rise to transactions or arrangements which are not deemed to be repayment or redemption, to be permitted as provided for in Article 73(2) of Commission Delegated Regulation 2015/35.
- 1.47. For the purposes of displaying the features in Article 73(1)(e) of Commission Delegated Regulation 2015/35 (limited incentives to redeem), undertakings should only include in the contractual terms of the arrangement governing the own-fund item or any connected arrangement, limited incentives to redeem as set out in Guideline 19.
- 1.48. Undertakings should treat Tier 2 basic own-fund items as repaid or redeemed from the date of notice to holders of the item or, if no notice is required, the date of supervisory approval, and exclude the item from own funds from that date.
- 1.49. Undertakings should ensure that the terms of the contractual arrangement governing the own-fund item:
  - (a) for the purposes of displaying the features in Article 73(1)(f) of Commission Delegated Regulation 2015/35 (suspension of repayment or redemption), include provisions for the suspension of the repayment or redemption of the item at any point, including when notice of repayment or redemption has been given or at the final maturity date of the instrument other than following an exceptional waiver as described in Guideline 15, in the event of non-compliance with the SCR or if the repayment or redemption would result in such non-compliance;
  - (b) for the purposes of displaying the features in Article 73(1)(g) of Commission Delegated Regulation 2015/35 (deferral of distributions), include provisions for the deferral of distributions at any point in the event of non-compliance with the SCR or if the distribution would result in such non-compliance.
- 1.50. For undertakings that have suspended repayment or redemption in accordance with Article 73(1)(f) of Commission Delegated Regulation 2015/35, the undertakings' subsequent actions should form part of the recovery plan referred to in Article 138 of Solvency II.

## Section 3: Tier 3 items

### Guideline 11 - Tier 3 features for determining classification

- 1.51. For undertakings determining classification in accordance with Article 77(1)(b) of Commission Delegated Regulation 2015/35, paragraph 1.27 of Guideline 5 applies *mutatis mutandis* to Tier 3 basic own-fund items.
- 1.52. For the purposes of displaying the features in Article 77(1)(c) of Commission Delegated Regulation 2015/35 (repayment or redemption before five years), undertakings should ensure that the contractual arrangement governing the item does not include a term providing for a call option prior to the intended maturity date, including call options predicated on unforeseen changes that are outside the control of the undertaking.
- 1.53. Subject to the satisfaction of all relevant features for determining classification and to prior supervisory approval, supervisory authorities should consider arrangements predicated on unforeseen changes which are outside the control of the undertaking and that would give rise to transactions or arrangements which are not deemed to be repayment or redemption to be permitted, as provided for in Article 77(2) of Commission Delegated Regulation 2015/35.
- 1.54. For the purposes of displaying the features in Article 77(1)(e) of Commission Delegated Regulation 2015/35 (limited incentives to redeem), undertakings should only include in the contractual terms of the arrangement governing the own-fund item or any connected arrangement limited incentives to redeem as set out in Guideline 19.
- 1.55. Undertakings should treat Tier 3 basic own-fund items as repaid or redeemed from the date of notice to holders of the item or if no notice is required the date of supervisory approval, and exclude the item from own funds from that date.
- 1.56. In the case of an item referred to in Article 76(a)(i), (ii) and (b) of Commission Delegated Regulation 2015/35, undertakings should ensure that the terms of the contractual arrangement governing the own-fund item:
  - (a) for the purposes of displaying the features in Article 77(1)(f) of Commission Delegated Regulation 2015/35, include provisions for the suspension of the repayment or redemption of the item at any point, including when notice of repayment or redemption has been given or at the final maturity date of the instrument other than following an exceptional waiver as described in Guideline 15, in the event of non-compliance with the SCR or if the repayment or redemption would result in such non-compliance.
  - (b) for the purposes of displaying the features in Article 77(1)(g) of Commission Delegated Regulation 2015/35, include provisions for the deferral of distributions at any point in the event of non-compliance with the SCR or if the distribution would result in such non-compliance.
- 1.57. For undertakings that have suspended repayment or redemption in accordance with Article 77(1)(f) of Commission Delegated Regulation 2015/35, the

undertakings' subsequent actions should form part of the recovery plan referred to in Article 138 of Solvency II.

## **Section 4: All basic own-fund items**

### **Guideline 12 - Repayment or redemption**

1.58. For the purposes of displaying the features in Article 71, Article 73 and Article 77 of Commission Delegated Regulation 2015/35, undertakings should consider repayment or redemption to include the repayment, redemption, repurchase or buyback of any own-fund item or any other arrangement that has the same economic effect. This includes share buybacks, tender operations, repurchase plans and repayment of the principal at maturity for dated items as well as repayment or redemption following the exercise of an issuer call option. This is without prejudice to the treatment of transactions that are not deemed to be repayment or redemption as described in Articles 71(2), 73(2) and 77(2) of Commission Delegated Regulation 2015/35.

### **Guideline 13 - Encumbrances**

1.59. For the purposes of displaying the features in Articles 71(1)(o), 73(1)(i) and 77(1)(h) of Commission Delegated Regulation 2015/35, undertakings should:

- (a) assess whether an own-fund item is encumbered on the basis of the economic effect of the encumbrance and the nature of the item, applying the principle of substance over form;
- (b) consider encumbrances as including, but not limited to:
  - (i) rights of set off;
  - (ii) restrictions;
  - (iii) charges or guarantees;
  - (iv) holding of own-fund items of the undertaking;
  - (v) the effect of a transaction or a group of connected transactions which have the same effect as any of points (i) to (iv);
  - (vi) the effect of a transaction or a group of connected transactions which otherwise undermine an item's ability to meet the features determining classification as an own-fund item;
- (c) consider an encumbrance arising from a transaction or group of transactions which is equivalent to the holding of own shares as including the case where the undertaking holds its own Tier 1, Tier 2 or Tier 3 own-fund items.

1.60. Where the encumbrance is equivalent to the holding of own shares, undertakings should reduce the reconciliation reserve by the amount of the encumbered item.

- 1.61. When determining the treatment of an own-fund item which is encumbered according to Article 71(1)(o), 73(1)(i) or 77(1)(h) of Commission Delegated Regulation 2015/35, but the item together with the encumbrance displays the features required for a lower tier, undertakings should:
- (a) identify whether the encumbered item is included in the lists of own-fund items for the lower tier in Articles 72 and 76 of Commission Delegated Regulation 2015/35;
  - (b) classify an item included in the lists according to the appropriate features for determining classification in Articles 73 and 77 of Commission Delegated Regulation 2015/35;
  - (c) seek approval from the supervisory authority to classify any items not included in the lists in accordance with Article 79 of Commission Delegated Regulation 2015/35.
- 1.62. If an item is encumbered to the extent that it no longer displays the features determining classification, undertakings should not classify the item as own funds.

#### **Guideline 14 - Call options predicated on unforeseen changes**

- 1.63. Undertakings should consider unforeseen changes that are outside their control, referred to in paragraphs 1.29, 1.30, 1.45, 1.46, 1.52 and 1.53, as including:
- (a) a change in law or regulation relevant to the undertaking's own-fund item in any jurisdiction or the interpretation of such law or regulation by any court or authority entitled to do so;
  - (b) a change in the applicable tax treatment, regulatory classification or treatment by rating agencies of the own-fund item concerned.

#### **Guideline 15 - Exceptional waiver of suspension of repayment or redemption**

- 1.64. When applying for an exceptional waiver of the suspension of repayment or redemption according to Articles 71(1)(k)(i), 73(1)(k)(i), and 77(1)(i)(i) of Commission Delegated Regulation 2015/35, undertakings should:
- (a) describe the proposed exchange or conversion and its effect on basic own funds, including how the exchange or conversion is provided for in the terms of the contractual arrangement governing the own-fund item;
  - (b) demonstrate how the proposed exchange or conversion is or would be consistent with the recovery plan required by Article 138 of Solvency II;
  - (c) seek prior supervisory approval of the transaction in accordance with Guideline 18.

#### **Guideline 16 - Exceptional waiver of cancellation or deferral of distributions**

- 1.65. When applying for an exceptional waiver of the cancellation or deferral of distributions according to Articles 71(1)(m) and 73(1)(h) of Commission Delegated Regulation 2015/35, undertakings should demonstrate how the

distribution could be made without weakening their solvency position and how the MCR would be met.

- 1.66. An undertaking seeking an exceptional waiver in respect of settlement via an alternative coupon satisfaction mechanism should take into account the amount of ordinary share capital that would need to be issued, the extent to which restoring compliance with the SCR would require the raising of new own funds, and the likely impact of the share issuance for the purposes of the alternative coupon satisfaction mechanism on the undertaking's ability to raise those own funds, and should provide such information and analysis to the supervisory authority.

#### **Guideline 17 - Principal loss absorbency: conversion**

- 1.67. In the application of a principal loss absorbency mechanism in the form of a conversion feature according to Article 71(1)(e)(ii) of Commission Delegated Regulation 2015/35, the AMSB of the undertaking and other persons who effectively run the undertaking should be aware of the impact that a potential conversion of an instrument could have on the capital structure and ownership of the undertaking and should monitor this impact as part of the undertaking's system of governance.

#### **Guideline 18 - Supervisory approval of repayment and redemption**

- 1.68. Where an undertaking seeks supervisory approval of repayment or redemption according to Articles 71(1)(h), 73(1)(d) and 77(1)(d) of Commission Delegated Regulation 2015/35 or a transaction not deemed to be a repayment or redemption according to Articles 71(2), 73(2) and 77(2) of Commission Delegated Regulation 2015/35, it should provide the supervisory authority with an assessment of the repayment or redemption taking into account:
- (a) both the current and short-to-medium term impact on the undertaking's overall solvency position and how the action is consistent with the undertaking's medium-term capital management plan and its ORSA;
  - (b) the undertaking's capacity to raise additional own funds if needed, having regard to the wider economic conditions and its access to capital markets and other sources of additional own funds.
- 1.69. Where an undertaking is proposing a series of repayments or redemptions over a short period of time, it should inform the supervisory authority, which may consider the series of transactions as a whole rather than on an individual basis.
- 1.70. An undertaking should submit the request for supervisory approval three months prior to the earlier of:
- (a) the required contractual notice to holders of the item of repayment or redemption;
  - (b) the proposed repayment or redemption date.

- 1.71. Supervisory authorities should ensure that the period of time within which it decides on the request for repayment or redemption does not exceed three months from the receipt of the request.
- 1.72. After receiving supervisory approval of the repayment or redemption the undertaking should:
- (a) consider that it is allowed, but not obliged, to exercise any call or other optional repayment or redemption under the terms of the contractual arrangement governing the own-fund item;
  - (b) when excluding an item treated as repaid or redeemed with effect from the date of notice to holders of the item or if no notice is required the date of supervisory approval, reduce the relevant category of own funds and make no adjustment to or re-calculation of the reconciliation reserve;
  - (c) continue to monitor its solvency position for any non-compliance or potential non-compliance with the SCR, which would trigger the suspension of repayment or redemption during the period leading up to the date of repayment or redemption;
  - (d) not proceed with the repayment or redemption if it would lead to non-compliance with the SCR even if notice of repayment or redemption has been given to the holders of the items. Where repayment or redemption is suspended in these circumstances the undertaking may reinstate the item as available own funds and the supervisory approval for repayment or redemption is withdrawn.

#### **Guideline 19 - Incentives to redeem**

- 1.73. For the purposes of displaying the features in Articles 71(1)(i), 73(1)(e) and 77(1)(e) of Commission Delegated Regulation 2015/35, undertakings should consider incentives to redeem that are not limited as not permitted in any tier.
- 1.74. Undertakings should consider incentives to redeem that are not limited as including:
- (a) principal stock settlement combined with a call option, where principal stock settlement is a term in the contractual arrangements governing an own-fund item that requires the holder of the own-fund item to receive ordinary shares in the event that a call is not exercised;
  - (b) mandatory conversion combined with a call option;
  - (c) an increase in the principal amount which is applicable subsequent to the call date, combined with a call option;
  - (d) any other provision or arrangement which might reasonably be regarded as providing an economic basis for the likely redemption of the item.

## **Guideline 20 - Eligibility and limits applicable to Tiers 1, 2 and 3**

- 1.75. For the purposes of calculating eligible own funds in accordance with Article 82 of Commission Delegated Regulation 2015/35 for the SCR, undertakings should:
- (a) consider all Tier 1 items set out in Article 69(a)(i),(ii),(iv) and (vi) of Commission Delegated Regulation 2015/35 as eligible to cover the SCR;
  - (b) consider those restricted Tier 1 items in excess of the 20% limit in Article 82(3) of Commission Delegated Regulation 2015/35 as available as Tier 2 basic own funds.
- 1.76. For the purposes of calculating eligible own funds in accordance with Article 82 of Commission Delegated Regulation 2015/35 for the MCR, undertakings should:
- (a) consider all Tier 1 items set out in Article 69(a)(i),(ii),(iv) and (vi) of Commission Delegated Regulation 2015/35 as eligible to cover the MCR;
  - (b) consider those restricted Tier 1 items in excess of the 20% limit in Article 82(3) as available as Tier 2 basic own funds;
  - (c) consider that the effect of Article 82(2) of Commission Delegated Regulation 2015/35 is that Tier 2 basic own-funds items are eligible as long as they are less than 20% of the MCR.

## **Section 5: Approval of the assessment and classification of Items not on the lists**

### **Guideline 21 - General features of the application**

- 1.77. When submitting a request for approval in accordance with Article 79 of Commission Delegated Regulation 2015/35 the undertaking should:
- (a) submit a written application for approval of each own-fund item;
  - (b) submit the application in one of the official languages of the Member State in which the undertaking has its head office, or in a language that has been agreed with the supervisory authority;
  - (c) approve the application at the AMSB, and submit documentary evidence of that approval;
  - (d) provide an application in the form of a cover letter and supporting evidence.

### **Guideline 22 - Cover letter**

- 1.78. The undertaking should submit a cover letter confirming that:
- (a) the undertaking believes any legal or contractual terms governing the own-fund item or any connected arrangement are unambiguous and clearly defined;

- (b) taking into account likely future developments as well as circumstances applying as at the date of the application, the undertaking considers that the basic own-fund item will comply, in terms of both legal form and economic substance, with the criteria in Articles 93 and 94 of Solvency II and the features determining classification set out in Articles 71, 73 and 77 of Commission Delegated Regulation 2015/35;
- (c) no facts have been omitted which if known by the supervisory authority could influence its decision regarding whether to approve the assessment and classification of the own-fund item.

1.79. The undertaking should also list in the cover letter other applications submitted by the undertaking or currently foreseen within the next six months for approval of any items listed in Article 308a(1) of Solvency II together with corresponding application dates.

1.80. The undertaking should ensure that the cover letter is signed by persons authorised to sign on behalf of the AMSB.

### **Guideline 23 - Supporting evidence**

1.81. The undertaking should provide a description of how the criteria in Articles 93 and 94 of Solvency II and the features determining classification set out in Articles 71, 73 and 77 of Commission Delegated Regulation 2015/35 have been satisfied including how the item will contribute to the undertaking's existing capital structure, and how the item may enable the undertaking to meet its existing or future capital requirements.

1.82. The undertaking should provide a description of the basic own-fund item, sufficient to allow the supervisory authority to conclude on the loss absorbing capacity of the item including the contractual terms of the arrangement governing the own-fund item and the terms of any connected arrangement together with evidence that any counterparty, where relevant, has entered into the contract and any connected arrangement and evidence that the contract and any connected arrangement are legally binding and enforceable in all relevant jurisdictions.

### **Guideline 24 - Procedures for supervisory authorities**

1.83. Supervisory authorities should establish procedures for the receipt and consideration of the applications and information provided by undertakings in accordance with Guidelines 21 to 23.

### **Guideline 25 - Assessment of the application**

1.84. Supervisory authorities should confirm receipt of the application.

1.85. Supervisory authorities should consider an application complete if the application covers all the matters set out in Guidelines 21 to 23.

- 1.86. Supervisory authorities should confirm if the application is considered complete or not on a timely basis, and at least within 30 days of the date of receipt of the application.
- 1.87. Supervisory authorities should ensure that the period of time within which it decides on an application:
  - (a) is reasonable;
  - (b) does not exceed three months from the receipt of a complete application, unless there are exceptional circumstances which are communicated in writing to the undertakings on a timely basis.
- 1.88. Where there are exceptional circumstances, supervisory authorities should not take longer than six months from the receipt of a complete application to decide on an application.
- 1.89. If necessary to its assessment of the own-fund item, supervisory authorities should request further information from the undertakings, after they have considered an application to be complete. The supervisory authority should specify the additional information needed and the rationale for the request. The days between the date the supervisory authority requests such information and the date the supervisory authority receives such information should not be included within the periods of time stated in paragraphs 1.87 and 1.88.
- 1.90. The undertaking should inform the supervisory authority of any change to the details of its application.
- 1.91. Where an undertaking informs the supervisory authority of a change to its application, the supervisory authority should treat it as a new application unless:
  - (a) the change is due to a request from the supervisory authority for further information; or
  - (b) the supervisory authority is satisfied that the change does not significantly affect its assessment of the application.
- 1.92. Undertakings should be able to withdraw an application by notification in writing at any stage prior to the decision of the supervisory authority. If the undertaking subsequently resubmits the application or submits an updated application, the supervisory authority should treat this as a new application.

#### **Guideline 26 - Communication of the supervisory authorities' decision**

- 1.93. When supervisory authorities have reached a decision on an application, they should communicate this in writing to the undertakings, on a timely basis.
- 1.94. Where the supervisory authority rejects the application, it should state the reasons on which the decision is based.

## **Section 6: Transitional arrangements**

### **Guideline 27 - Transitional arrangements**

- 1.95. Undertakings should assess all basic own-fund items issued prior to 1 January 2016 or the date of entry into force of Commission Delegated Regulation 2015/35 referred to in Article 97 of Solvency II, whichever is earliest to determine whether they display the features determining classification under Articles 71 and 73 of Commission Delegated Regulation 2015/35. Where such items display the features determining classification as Tier 1 or Tier 2, undertakings should classify the item in that tier, even if the item cannot be used to meet the available solvency margin according to the laws, regulations and administrative provisions which are adopted pursuant to Directive 73/239/EEC, Directive 2002/13/EC, Directive 2002/83/EC and Directive 2005/68/EC.
- 1.96. Where items that are available as basic own funds in accordance with Article 308b(9) or (10) of Solvency II are exchanged or converted into another basic own-fund item after 1 January 2016 or the date of entry into force of Commission Delegated Regulation 2015/35 referred to in Article 97, whichever is earliest, undertakings should consider the item into which it is converted, or for which it is exchanged, as a new item which does not satisfy Article 308b(9)(a) or (10)(a) of Solvency II.
- 1.97. Supervisory authorities should consider items which are only ineligible due to the application of limits according to the laws, regulations and administrative provisions which are adopted pursuant to Directive 73/239/EEC, Directive 2002/13/EC, Directive 2002/83/EC and Directive 2005/68/EC, as satisfying the requirements in Article 308b(9)(b) and (10)(b) of Solvency II.

### **Compliance and Reporting Rules**

- 1.98. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, Competent Authorities and financial institutions shall make every effort to comply with guidelines and recommendations.
- 1.99. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.100. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.
- 1.101. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

### **Final Provision on Reviews**

- 1.102. The present Guidelines shall be subject to a review by EIOPA.