EIOPA-BoS-14/168

27 November 2014

Final Report

on

Public Consultation No. 14/036 on Guidelines on classification of own funds

Following the shortening exercise launched by EIOPA in 2026, the Guideline has been amended by EIOPA-BoS-2026-74. This final report has been therefore updated exclusively in its annex to reflect the amended Guidelines and the corresponding explanatory text.
The executive summary and the feedback statement remain unchanged and reflect the original text of the Guidelines. The feedback statement and the resolution of comments as a result of the shortening exercise are available at this link.

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1. Executive summary

Introduction

According to Article 16 of Regulation (EU) No 1094/2010 (EIOPA Regulation) EIOPA may issue guidelines addressed to National Competent Authorities (NCAs) or financial institutions.

According to Article 16 of the EIOPA Regulation, EIOPA shall, where appropriate, conduct open public consultations and analyse the potential costs and benefits. In addition, EIOPA shall request the opinion of the Insurance and Reinsurance Stakeholder Group (IRSG) referred to in Article 37 of the EIOPA Regulation.

EIOPA has developed Guidelines on the classification of own funds. These relate to Articles 93, 94 and 95 of Directive 2009/138/EC[1] (Solvency II Directive), and to Articles 69 to 73, 76, 77, 79 and 82 of the Implementing Measures[2].

As a result of the above, on 2 June 2014 EIOPA launched a Public Consultation on draft Guidelines on the classification of own funds. The Consultation Paper is also published on EIOPA's website[3].

These Guidelines are issued to NCAs to promote effective supervisory practices and consistent application of Union law with regard to:

- How the lists of own funds items and the features determining classification for each tier should be applied;
- The eligibility and limits applicable to own-fund items
- The procedures to be followed concerning the supervisory approval of the classification of own-fund items not on the lists
- The application of the transitional arrangements for existing own-fund items.

Content

This Final Report includes the feedback statement to the consultation paper (EIOPA-CP-14/036) and the Guidelines. The Impact Assessment and cost and benefit analysis, and the Resolution of comments are published separately on EIOPA's website[4].

[1] OJ L 335, 17.12.2009, p. 1–155
[2] As published by the European Commission on 10 October 2014: http://ec.europa.eu/internal_market/insurance/docs/solvency/solvency2/delegated/141010-delegated-act-solvency-2_en.pdf
[3] [4] https://eiopa.europa.eu/consultations/consultation-papers/2014-closed-consultations/june-2014/public-consultation-on-the-set-1-of-the-solvency-ii-guidelines/index.html

Next steps

In accordance with Article 16 of the EIOPA Regulation, within 2 months of the issuance of these guidelines, each competent authority shall confirm if it complies or intends to comply with these guidelines. In the event that a competent authority does not comply or does not intend to comply, it shall inform EIOPA, stating the reasons for non-compliance.

EIOPA will publish the fact that a competent authority does not comply or does not intend to comply with these guidelines. The reasons for non-compliance may also be decided on a case-by-case basis to be published by EIOPA. The competent authority will receive advanced notice of such publication.

EIOPA will, in its annual report, inform the European Parliament, the Council and the European Commission of the guidelines issued, stating which competent authority has not complied with them, and outlining how EIOPA intends to ensure that concerned competent authorities follow its guidelines in the future.

2. Feedback statement

Introduction

EIOPA would like to thank the IRSG and all the participants to the public consultation for their comments on the draft Guidelines. The responses received have provided important guidance to EIOPA in preparing a final version of these Guidelines. All of the comments made were given careful consideration by EIOPA. A summary of the main comments received and EIOPA's response to them can be found in the sections below. The full list of all the comments provided and EIOPA's responses to them is published on EIOPA's website.

General comments

This section highlights the main comments received during the public consultation and how EIOPA has responded to them, including how the proposals have been amended in the light of these comments.

1. Ability to repay or redeem own-fund items within the first five years following issuance

a) Various respondents to the public consultation, including the IRSG, raised concerns regarding the ability of undertakings to repay or redeem an own-fund item within the first five years from the date of issuance. It was argued in particular that early redemption calls before year five in the case of unforeseen events, such as tax, regulatory, accounting or rating changes, should be possible in order to allow undertakings to react to such changes by replacing own-fund items that are no longer efficient.

b) EIOPA does not agree that the Guidelines should be changed in this respect. The Guidelines are consistent with Articles 71(1)(f), 73(1)(c) and 77(1)(c) of the Implementing Measures, which provide that the first contractual opportunity to repay or redeem cannot occur before five years from the date of issuance. EIOPA clarifies in the Guidelines that for an undertaking to be able to exercise a call option predicated on unforeseen changes, such as a change in tax regulations, this would need to be stated in the contractual arrangements governing the own-fund item. Such a provision, however, would not be consistent with the requirement in the Implementing Measures stated above.

Nevertheless, it should also be mentioned that the Guideline explains that in accordance with Articles 71(2), 73(2), 77(2) of the Implementing Measures, it is possible to replace an own-fund item at any time, including within five years of issuance, subject to a number of conditions being met. These conditions are that firstly the own-fund item is either exchanged or converted into another basic own-fund item of at least the same quality, or that the repayment or redemption occurs out of the proceeds of a new basic own-fund item of the same quality, and secondly that the transaction is subject to supervisory approval. If these conditions are met, the transaction is not deemed to be a repayment or redemption, and therefore is permitted at any time following

issuance. Consequently, EIOPA considers that the Guidelines appropriately reflect the requirements in the Implementing Measures.

2. Foreseeable dividends

a) A number of stakeholders challenged the proposals relating to Article 70(1)(b) of the Implementing Measures on foreseeable dividends. It was argued that, to consider a dividend or distribution to be foreseeable when it is declared or approved by the administrative, management or supervisory body, or other persons who effectively run the undertaking, is inconsistent both with the Implementing Measures and Accounting Directives, and furthermore does not recognise the responsibility of the shareholders in the process of dividend approval.

b) EIOPA does not agree with these comments and has not changed the approach proposed in the Guidelines. The treatment in the Guidelines does not go beyond the Implementing Measures which do not specify when the dividend becomes foreseeable. Therefore, the Guideline is important to provide for a consistent application in practice. In general, Solvency II intends to provide for the appropriate prudential treatment that provides adequate policyholder protection; in this context EIOPA considers that the dividend should be recognised as foreseeable when payment becomes likely. It is not necessary for the Solvency II treatment to be consistent with the Accounting Directives in all cases. In addition, this treatment has no effect on the responsibility that shareholders may have to finally decide on whether to approve the dividend.

3. Implications of non-compliance with the SCR

a) Numerous comments were received pertaining to the ability for undertakings to make distributions or repay or redeem an own-fund item when there is non-compliance with the SCR, or such payments would result in non-compliance. This included concerns at the immediate cancellation of payments upon the breach of the SCR and for this to be provided for in the contractual terms of the own-fund item, as well as at the restrictions placed on the operation of any alternative coupon satisfaction mechanism (ACSM).

b) In response to these comments in general, EIOPA would highlight a number of points. To start with, although it is recognised that unforeseen circumstances arise, undertakings are responsible for monitoring their SCR position and maintaining an appropriate margin above the SCR. Secondly, it is vital for undertakings to not take steps to further weaken their solvency position where there has been or will be non-compliance with the SCR. This means that, notwithstanding the time given to undertakings to restore compliance with the SCR, there needs to be some immediate controls to restrict actions which may exacerbate the situation. It also means that any mechanisms to allow for payments to be made in these circumstances, should be exceptional and should operate under restrictive conditions. Finally, EIOPA considers that the Guidelines do not 'go beyond' the Implementing Measures as some

stakeholders asserted, but are strictly consistent with both the intention and text of that legislation.

More specifically in response to the stakeholder comments, Article 71(1)(j) of the Implementing Measures already requires that non-compliance with the SCR results in the cancellation of repayment or redemption. The Guideline provides the practical detail that this requirement means that the contract for the own-fund item should allow the undertaking to cancel the repayment or redemption whenever the SCR is breached (i.e. at any point, since SCR breach can occur at any point) and even if notice of payment has been given. A supervisory waiver can of course be applied for and a clarification has been added to Guidelines 7, 10 and 11 on this point. However, unless the waiver has been granted before the SCR is actually breached (i.e. it was applied for in anticipation of the breach) then the repayment or redemption needs to be suspended until any waiver has been granted.

With respect to ACSM, the Implementing Measures provide that any distribution where there is non-compliance with the SCR can only be in exceptional circumstances and must not further weaken the solvency position of the undertaking (Article 71(1)(m)(ii) of the Implementing Measures). As a result, EIOPA does not consider that it is possible for an undertaking to meet this requirement by using treasury or own shares to pay a distribution when there is an SCR breach.

4. Full flexibility over dividends – use of "dividend stoppers" and "dividend pushers"

a) It was asserted that dividend "pushers" and "stoppers", which require a distribution on a Tier 1 own-fund item in the event of a distribution being made on any other item issued by the undertaking, or prevent the payment of a dividend where there is non-payment of an interest payment on a hybrid instrument respectively, should be acceptable for hybrid instruments. These mechanisms were considered to be important to provide assurance to hybrid investors that they will not be treated less favourably than equity investors. It was, therefore, argued that they should be permissible provided that their exercise does not result in non-compliance with the SCR.

b) Notwithstanding the merits of the arguments put forward, the Guidelines are directly linked to Articles 71(1)(n), 71(3) and 71(4) of the Implementing Measures, which are explicit as to the requirement for undertakings to have full flexibility over distributions. The Implementing Measures also set out the meaning of full flexibility, and, amongst other aspects, provide that the undertaking should have full discretion at all times to cancel distributions, and that there can be no obligation to make a distribution in the event of a distribution on another item. The Guidelines simply clarify that this means such "dividend stoppers" and "dividend pushers" should not be included within the contractual arrangements governing the own-fund item.

5. Limited incentives to redeem

a) Most respondents to the public consultation, including the IRSG, provided comments on the categorisation of a change in the distribution structure of an own-fund item from a fixed to a floating rate combined with a call option, as an incentive to redeem that is not limited, and therefore as not permitted in any tier. Stakeholders expressed strong concerns regarding this provision including; that it would have a significant impact on the market as many instruments are currently structured in this way; that from an economic perspective such structures do not represent an incentive to redeem; and that it is not consistent with the approach taken in other regulatory frameworks, such as Basel III, and therefore does not provide a "level playing field".

b) Based on the comments received, EIOPA has reconsidered its approach and decided to delete the relevant provision on the basis that it is not clear that such fixed to floating structures do unduly incentivise the holder of the own-fund item to exercise a call option. EIOPA, therefore, judged that it is not appropriate to categorically prohibit all such structures. Instead, supervisory authorities will need to consider on a case by case basis whether a particular structure is an unlimited incentive to redeem. EIOPA will also continue to monitor developments in this area.

6. Procedures for supervisory approval of the classification of items not on the lists

a) Stakeholders, including the IRSG, disputed the appropriateness of the proposed procedures for the supervisory approval of the classification of own-fund items, which are not included in the relevant lists in the Implementing Measures. The principal concern was the length of time for the approval, which was considered to be too long in view of the need for undertakings to respond quickly in times of distress, and a shorter period, such as two weeks or one month, was considered preferable. It was also proposed by stakeholders that there should be a "fast-track" or pre-approval process, that a request for additional information by the supervisory authority should not result in a suspension of the time period, and that a failure by the supervisory authority to respond within the prescribed time periods should result in the approval of the application.

b) EIOPA intends to take a consistent approach regarding this approval procedure and other comparable approval procedures, most importantly the procedures for the approval of an amount of ancillary own funds set out in the proposed Implementing Technical Standards (ITS) on this topic[5]. EIOPA considers that the ITS provide for an appropriate balance between, on the one hand, the need for supervisory authorities to conduct suitably thorough assessments and be satisfied as to the loss-absorbency of the own-fund item, and, on the other

[5] https://eiopa.europa.eu/consultations/consultation-papers/2014-closed-consultations/april-2014/public-consultation-on-the-set-1-of-the-solvency-ii-implementing-technical-standards-its/index.html

hand, the need for undertakings to have certainty regarding the process and be able to respond to fluctuations in their capital position or to market developments. Regarding the time period for approval specifically, EIOPA would reiterate the points that it made in the response to the public consultation on the ITS. These were principally that the Solvency II governance framework requires undertakings to review and manage both their short and medium term capital position, such that they should not ordinary need to raise capital in a matter of weeks. It was also stated that the time periods represent upper limits, which may be needed to deal with more complex items. However, supervisory authorities would be expected to respond more quickly where this is reasonable, such as where an item is more straightforward or a similar application has been submitted previously.

At the same time, a number of specific revisions have been made to the Guidelines relating to the approval of the classification of items not on the lists. First, several changes have been made to reflect amendments to the ITS following the public consultation on the ITS, for example to clarify that the request for additional information by the supervisory authority needs to be specific and justified. Second, to remove a number of provisions that were consistent with the approach taken in the ITS, but which, based on the stakeholder comments and upon review by EIOPA, were not in fact appropriate for the approval process in the Guidelines; for instance aspects relating to the valuation of the own-fund item.

7. Principal loss absorbency mechanisms – write-up

a) A number of respondents to the public consultation, including the IRSG, commented on the issue of write-down, whereby the "value" of an own-fund item is reduced when there is significant non-compliance with the SCR. In general, stakeholders sought more specific guidance on how any corresponding write-up mechanism should operate once the undertaking has restored compliance with the SCR. This included how the reference to profits in the Guidelines should be interpreted, and whether the write-up mechanism would be automatic or discretionary.

b) The Guidelines apply the elements that are prescribed in the Implementing Measures. The Implementing Measures do not directly address the issue of write-up, but it is considered important to address this issue in the Guidelines to set out which write-up features would be contrary to the Implementing Measures. The main condition is that any write-up should not undermine the purpose of the write-down, which was to address a significant breach of the SCR. The Guidelines therefore clarify that this means that there should be no direct link between the issuance of new capital and the write-up, and that write-up is only possible on the basis of profits made once SCR compliance has been restored.

Regarding the request by stakeholders for further specification, such as whether the write-up is automatic or discretionary, or whether it is pro rata or not; these elements are not specifically addressed by EIOPA and so would need to be considered in relation to the specific features of an instrument and how they met the features determining classification. EIOPA has set out an overarching principle that the nature of write-down and write-up mechanisms should not undermine the loss absorbency intended by the Implementing Measures. Thus, overall, EIOPA has not changed the approach following the comments from stakeholders.

General nature of the participants to the Public Consultation

EIOPA received comments from the Insurance and Reinsurance Stakeholder Group (IRSG) and eight responses from other stakeholders to the public consultation. All non-confidential comments received have been published on EIOPA's website.

Respondents can be classified into four main categories: European trade, insurance, or actuarial associations; national insurance or actuarial associations; (re)insurance groups or undertakings; and other parties such as consultants and lawyers.

IRSG opinion

The IRSG opinion on the draft set 1 of the Solvency II Guidelines on Pillar 1 and Internal Models, as well as the particular comments on the Guidelines at hand, can be consulted on EIOPA's website[6].

Comments on the Impact Assessment

A separate Consultation Paper was prepared covering the Impact Assessment for the Set 1 of EIOPA Solvency II Guidelines. Where the need for reviewing the Impact Assessment has arisen following comments on the guidelines, the Impact Assessment Report has been revised accordingly. The revised Impact Assessment on the Set 1 of EIOPA Solvency II Guidelines can be consulted on EIOPA's website.

[6] https://eiopa.europa.eu/about-eiopa/organisation/stakeholder-groups/sgs-opinion-feedback/index.html

Annex: Guidelines

1. 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")[7].

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")[8] as well as to Articles 69 to 73, 76, 77, 79 and 82 of the Implementing Measures.

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 the Implementing Measures, 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

[7] OJ L 331, 15.12.2010, p. 48–83
[8] OJ L 335, 17.12.2009, p. 1-155

the nominal value of the share at issuance or the value received at issuance 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 the Implementing Measures.

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 in any own-fund item, regardless of the tier, which cap or restrict the level or amount of distributions to be made on the item referred to in Article 69(a)(i) of the Implementing Measures, 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 the Implementing Measures 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. **Ancillary own funds are contingent in that they have not been paid in, and are not recognised on the balance sheet. The need for supervisory approval of such items recognises this contingent nature. If, at some undetermined point in the future, the ancillary own funds are called up, then they cease to be contingent and become basic own-fund items represented by assets on the balance sheet.**

1.18. **Article 89 of Solvency II states that ancillary own funds may comprise any legally binding commitment received by undertakings. This might encompass many arrangements that do not fall within the categories of specific ancillary own-fund items referred to in Solvency II as long as they can be called upon to absorb losses.**

1.19. **These Guidelines describe considerations relating to the supervisory authority approval process for ancillary own-fund items, classification of ancillary own fund items and ongoing satisfaction of criteria for approval.**

1.20. **The ancillary own funds approval process envisages ongoing communication between supervisory authorities and undertakings, including before an undertaking submits a formal application for approval of an ancillary own-fund item. Where the ancillary own-fund item on call would become an Item not on the lists, and therefore two supervisory approvals are needed, such communication should include the procedural approach to be followed regarding this need for two approvals.**

1.21. **Article 226 of Solvency II permits a group to apply for approval of an ancillary own-fund item in respect of an intermediate insurance holding company or an intermediate mixed financial holding company. In such cases these Guidelines apply as though the intermediate insurance**

holding company or the intermediate mixed financial holding company were an insurance or reinsurance undertaking. This also applies where a group is headed by an insurance holding company or a mixed financial holding company in accordance with Article 235 of Solvency II.

1.22. **These Guidelines are amended by EIOPA-BoS-2026-74 and apply from 30 January 2027.**

1.23. For the purpose of these Guidelines, the following definition has been developed:

a) 'Capital instrument' means an instrument which if called up will generate an asset, often in the form of cash, while simultaneously creating corresponding interests in the insurance or reinsurance undertaking in the case of shares, or corresponding subordinated liabilities of the undertaking;

b) 'Item not on the lists' means an own-fund item not included in the lists set out in Articles 69, 72 and 76 of the Implementing Measures.

1.24. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.

Section 1: Tier 1 items

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

1.25. For the purposes of Article 69(a)(i) of the Implementing Measures, 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.

1.26. 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 the Implementing Measures, 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**~~

~~1.27. For the purposes of Article 70(1)(a) of the Implementing Measures, undertakings should include own shares held both directly and indirectly.~~

~~1.28. For the purposes of Article 70(1)(b) of the Implementing Measures:~~

~~(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 the Implementing Measures.~~

Guideline 3 - Tier 1 features determining classification of items referred to in Article 69(a)(i), (ii) and (iv) of the Implementing Measures

1.29. In the case of an item referred to in Article 69(a)(i), (ii) and (iv) of the Implementing Measures, 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 the Implementing Measures

1.30. In the case of an item referred to in Article 69(a)(i) and (ii) of the Implementing Measures, for the purposes of displaying the features in Article 71(3) of the Implementing Measures (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 the Implementing Measures, 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.

1.31. The undertaking should identify the legal basis for the cancellation of distributions in accordance with Article 71(1)(l)(i) of the Implementing Measures 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 the Implementing Measures

1.32. In the case of an item referred to in Article 69(a)(iii), (v) and (b) of the Implementing Measures, 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.

1.33. For the purposes of displaying the features in Article 71(1)(d) of the Implementing Measures (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.

1.34. For the purposes of displaying the features in Article 71(1)(f)(ii) of the Implementing Measures (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.

1.35. 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 the Implementing Measures.

1.36. For the purposes of displaying the features in Article 71(1)(m) of the Implementing Measures (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 the Implementing Measures on each occasion that the cancellation of the distribution is required;

(ii) do not oblige the undertaking to operate any alternative coupon satisfaction mechanism.

1.37. For the purposes of displaying the features in Article 71(4) of the Implementing Measures (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).

1.38. For the purposes of displaying the features in Article 71(1)(e), (5), (6) and (8) of the Implementing Measures (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 the Implementing Measures 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 the Implementing Measures;

(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;

1.39. 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 the Implementing Measures – immediate availability to absorb losses

1.40. In the case of an item referred to in Article 69 (a)(i), (ii), (iii), (v) and (b) of the Implementing Measures, 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 the Implementing Measures – repayment or redemption at the option of the undertaking

1.41. In the case of an item referred to in Article 69(a)(i), (ii), (iii), (v) and (b) of the Implementing Measures, for the purposes of displaying the features in Article 71(1)(h) and (i) of the Implementing Measures, 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.

1.42. 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.

1.43. In the case of an item referred to in Article 69(a)(iii), (v) and (b) of the Implementing Measures, for the purposes of displaying the features in Article 71(1)(j) of the Implementing Measures (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 16, in the event of non-compliance with the SCR or if the repayment or redemption would result in such non-compliance.

1.44. For undertakings that have suspended repayment or redemption in accordance with Article 71(1)(j) of the Implementing Measures, 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

1.45. 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 the Implementing Measures, 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.

1.46. 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

1.47. In the case of items referred to in Article 72(a)(i), (ii) and (iv) of the Implementing Measures, 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

1.48. In the case of items referred to in Article 72(a)(i) and (ii) of the Implementing Measures, for undertakings determining classification in accordance with Article 73(1)(b) of the Implementing Measures, paragraph 1.24 of Guideline 3 applies *mutatis mutandis.*

1.49. In the case of items referred to in Article 72(a)(iii), (iv) and (b) of the Implementing Measures, for undertakings determining classification in accordance with Article 73(1)(b) of the Implementing Measures, paragraph 1.27 of Guideline 5 applies *mutatis mutandis*.

1.50. For the purposes of displaying the features in Article 73(1)(c) of the Implementing Measures (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.

1.51. 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 the Implementing Measures.

1.52. For the purposes of displaying the features in Article 73(1)(e) of the Implementing Measures (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.

1.53. 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.

1.54. 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 the Implementing Measures (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 16, 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 the Implementing Measures (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.

1.55. For undertakings that have suspended repayment or redemption in accordance with Article 73(1)(f) of the Implementing Measures, 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

1.56. For undertakings determining classification in accordance with Article 77(1)(b) of the Implementing Measures, paragraph 1.27 of Guideline 5 applies *mutatis mutandis* to Tier 3 basic own-fund items.

1.57. For the purposes of displaying the features in Article 77(1)(c) of the Implementing Measures (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.

1.58. 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 the Implementing Measures.

1.59. For the purposes of displaying the features in Article 77(1)(e) of the Implementing Measures (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.

1.60. 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.

1.61. In the case of an item referred to in Article 76(a)(i), (ii) and (b) of the Implementing Measures, 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 the Implementing Measures, 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 16, 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 the Implementing Measures, 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.

1.62. For undertakings that have suspended repayment or redemption in accordance with Article 77(1)(f) of the Implementing Measures, 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~~

~~1.63. For the purposes of displaying the features in Article 71, Article 73 and Article 77 of the Implementing Measures, 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 the Implementing Measures.~~

Guideline 13 - Encumbrances

1.64. For the purposes of displaying the features in Articles 71(1)(o), 73(1)(i) and 77(1)(h) of the Implementing Measures, 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.

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

1.66. 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 the Implementing Measures, 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 the Implementing Measures;

(b) classify an item included in the lists according to the appropriate features for determining classification in Articles 73 and 77 of the Implementing Measures;

(c) seek approval from the supervisory authority to classify any items not included in the lists in accordance with Article 79 of the Implementing Measures.

1.67. 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

1.68. 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

1.69. 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 the Implementing Measures, 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

1.70. When applying for an exceptional waiver of the cancellation or deferral of distributions according to Articles 71(1)(m) and 73(1)(h) of the Implementing Measures, undertakings should demonstrate how the distribution could be made without weakening their solvency position and how the MCR would be met.

1.71. 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**~~

~~1.72. 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

1.73. Where an undertaking seeks supervisory approval of repayment or redemption according to Articles 71(1)(h), 73(1)(d) and 77(1)(d) of the Implementing Measures or a transaction not deemed to be a repayment or redemption according to Articles 71(2), 73(2) and 77(2) of the Implementing Measures, 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.

1.74. 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.

1.75. 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.

1.76. 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.

1.77. 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

1.78. For the purposes of displaying the features in Articles 71(1)(i), 73(1)(e) and 77(1)(e) of the Implementing Measures, undertakings should consider incentives to redeem that are not limited as not permitted in any tier.

1.79. 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

1.80. For the purposes of calculating eligible own funds in accordance with Article 82 of the Implementing Measures for the SCR, undertakings should:

(a) consider all Tier 1 items set out in Article 69(a)(i),(ii,)(iv) and (vi) of the Implementing Measures as eligible to cover the SCR;

(b) consider those restricted Tier 1 items in excess of the 20% limit in Article 82(3) of the Implementing Measures as available as Tier 2 basic own funds.

1.81. For the purposes of calculating eligible own funds in accordance with Article 82 of the Implementing Measures for the MCR, undertakings should:

(a) consider all Tier 1 items set out in Article 69(a)(i),(ii,)(iv) and (vi) of the Implementing Measures 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 the Implementing Measures 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~~

~~1.82. When submitting a request for approval in accordance with Article 79 of the Implementing Measures 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

1.83. 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 the Implementing Measures;

(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.

1.84. 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.

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

Guideline 23 - Supporting evidence

1.86. 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 the Implementing Measures 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.

1.87. 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**~~

~~1.88. 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

1.89. Supervisory authorities should confirm receipt of the application.

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

1.91. 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.

1.92. 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.

1.93. 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.

1.94. 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.

1.95. The undertaking should inform the supervisory authority of any change to the details of its application.

1.96. 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.

1.97. 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**~~

~~1.98. When supervisory authorities have reached a decision on an application, they should communicate this in writing to the undertakings, on a timely basis.~~

~~1.99. 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**~~

~~1.100. Undertakings should assess all basic own-fund items issued prior to 1 January 2016 or the date of entry into force of the Implementing Measures 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 the Implementing Measures. 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.~~

~~1.101. 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 the Implementing Measures 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.~~

~~1.102. 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.~~

Section 6: Ancillary own funds

Guideline 28 - Approval of ancillary own-fund items which, once called, take the form of an Item not on the lists

1.103. **If an ancillary own-fund item once called up would take the form of an Item not on the lists, undertakings should seek approval of the classification of that item, as provided for in Article 79 of Commission Delegated Regulation 2015/35 prior to submitting an application for approval of the ancillary own-fund item.**

Guideline 29 – Callable on demand

1.104. **For the items described in points (a), (b), (c), (d), (f) and (i) of Article 74 of Commission Delegated Regulation 2015/35 to be callable on demand, undertakings should ensure that the call is not:**

(a) contingent on the occurrence of an event or criteria being met;

(b) subject to the agreement of the counterparty or any third party;

(c) subject to any agreement, arrangement or incentive that means that the undertaking is not permitted or is not likely to call up the item; or

(d) subject to any other arrangement or combination of arrangements which has the same effect as points (a) to (c).

1.105. **With regard to the assessment of future claims by a mutual or mutual-type association with variable contributions for the purposes of Article 90 of Solvency II, supervisory authorities should consider whether there are any impediments to the claims being used to cover losses when they arise, and to the amounts being recovered in a timely manner**

Guideline 30 - Classification of ancillary own-fund items

1.106. **The supervisory authority should not determine the classification of an ancillary own-fund item based only on the form in which the item is presented or described. The supervisory authority's assessment and the classification of the ancillary own-fund item should depend upon the item's economic substance and the extent to which it would satisfy the characteristics and features set out in Articles 93 to 96 of Solvency II and Articles 74, 75, and 78 of Commission Delegated Regulation 2015/35.**

1.107. **Where ancillary own-fund items become Capital instruments on call, undertakings should classify the ancillary own-fund item by assessing the features of that Capital instrument and determine to which tier the Capital instrument would belong if called up.**

1.108. **Undertakings should ensure that where an ancillary own-fund item on being called results in the receipt of cash or other assets, that basic own-fund item is only treated as a contribution where it does not give rise to a corresponding Capital instrument or liability, whether contingent or not, of the undertaking.**

1.109. **Undertakings should treat items as contributions:**

(a) when they are in the form of an unconditional gift, or donation of own funds;

(b) whether they are from a parent undertaking, or any other party, or in the form of supplementary contributions from members of mutual or mutual-type undertakings;

(c) regardless of the treatment of the item for accounting purposes, as contributing to profit or loss or contributing directly to reserves.

1.110. **Since the balance sheet treatment of contributions which satisfy the necessary features and characteristics used to classify own funds into tiers, is an increase in the undertaking's assets with a corresponding increase in the reconciliation reserve, and since the contribution does not give rise to any Capital instrument or liability or any other basic own-fund item, undertakings should classify the item as Tier 2 ancillary own funds.**

1.111. **Undertakings should classify contractual arrangements which when called up meet the undertaking's liabilities by indemnifying third-parties, in the same manner as contributions if they:**

(a) generate an asset for a third-party creditor of the undertaking;

(b) do not create corresponding liabilities for the undertaking.

1.112. **Undertakings should treat contracts of indemnity, which oblige a third-party indemnifier to pay sums to the undertaking's creditor without obliging the undertaking to repay such sums to the indemnifier, as ancillary own-fund items, subject to approval by the supervisory authority.**

1.113. **Supervisory authorities should classify ancillary own-fund items which on call do not become Capital instruments, contributions or arrangements, but which meet an undertaking's liabilities, by considering the features of whatever the ancillary own-fund item delivers on call.**

Compliance and Reporting Rules

1.114. 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.

1.115. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.

1.116. 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.

1.117. 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

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

2. Explanatory text

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

For the purposes of Article 69(a)(i) of the Implementing Measures, 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.

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 the Implementing Measures, 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.

2.1 Some jurisdictions allow undertakings to issue shares with:

(i) different numbers of votes; or

(ii) restrictions on the ability to transfer the shares.

Neither of these affects the subordination, and therefore neither is relevant to the tiering decision described in this Guideline.

~~**Guideline 2 – Reconciliation Reserve**~~

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

~~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.~~

2.2 Guideline 2 is deleted because it is redundant (type 1 deletion) due to the amendments to the Delegated Regulation 2015/35, especially the introduction of Article 70a. Nevertheless, GL1.23(a) and GL1.23(c) of the Guideline are not consistent with the new Article 70a. In particular, these paragraphs do not reflect the new definition of foreseeable charges under point 67 of Article 1 and the new Article 70a of Delegated Regulation 2015/35, which establishes that the amount of foreseeable dividends and distributions shall be determined in accordance with the accrual approach.

Guideline 5 - Tier 1 features determining classification of items referred to in Article 69(a)(iii), (v) and (b) of the Implementing Measures

In the case of an item referred to in Article 69(a)(iii), (v) and (b) of the draft Implementing Measures, 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.

For the purposes of displaying the features in Article 71(1)(d) of the Implementing Measures (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 own-fund 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.

For the purposes of displaying the features in Article 71(1)(f)(ii) of the Implementing Measures (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.

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 undertakings 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 the Implementing Measures.

For the purposes of displaying the features in Article 71(1)(m) of the Implementing Measures (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 the Implementing Measures on each occasion that the cancellation of the distribution is required;

(ii) do not oblige the undertaking to operate any alternative coupon satisfaction mechanism.

For the purposes of displaying the features in Article 71(4) of the Implementing Measures (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 item issued by the undertaking;

(b) require the payment of distributions to be cancelled or prevented on any other item of the undertaking in the event that no distribution is made in respect of the item;

(c) link the payment of distributions to any other event or transaction which has the same economic effect as points (a) or (b).

For the purposes of displaying the features in Article 71(1)(e), (5), (6) and (8) of the Implementing Measures (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 the Implementing Measures 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 the Implementing Measures;

(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;

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.

2.3 Where an insurance or reinsurance undertaking issues own funds indirectly via a finance entity that has been set up solely for the purpose of raising capital, and where this insurance or reinsurance undertaking guarantees the payments of the finance entity, paragraph 1.27 applies to the insurance or reinsurance undertaking, not to the finance entity.

2.4 Referring to paragraph 1.28 point (a), it is necessary for the terms of the contractual arrangement governing the own-fund item or the terms of any connected arrangement to not include such a term, because it would maintain or improve the position of existing holders of that item and thus hinder recapitalisation.

2.5 The alternative coupon satisfaction mechanism as described in paragraph 1.31 means that holders of the own-fund item would receive shares that have already been approved or authorised as an alternative to distributions in cash.

~~**Guideline 12 – Repayment or redemption**~~

~~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.~~

2.6 Guideline 12 is deleted because it is redundant (type 1 deletion) due to the amendments to the Delegated Regulation 2015/35 especially the introduction of Article 70b. Besides, the Guideline is not fully consistent with the new Article 70b. Unlike Guideline 12, Article 70b(2) makes an exception only for share buy-backs that are bought back to exercise stock options, either immediately or within no more than one month from the date of the execution of the share buy-back programme. These cases of share buy-backs should not be treated as repayment or redemption. All other cases in article 70b(1) and (2), such as other share buy-backs and other transactions or arrangements, shall be treated as repayment or redemption, in agreement with Guideline 12. Among others, this includes a requirement for prior supervisory approval, as provided for in articles 71(1)(h), 73(1)(d) and 77(1)(d). For the other examples in Guideline 12, namely, tender operations, and repurchase plans and repayment of the principal at maturity, experience indicates a broad consensus that these have the same economic effect as repayment and redemption regarding the loss-absorbing capacity or the amount of eligible own funds. Finally, as stated in Guideline 12, Article 70b 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

For the purposes of displaying the features in Articles 71(1)(o), 73(1)(i) and 77(1)(h) of the Implementing Measures 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 items.

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

When determining the treatment of an item which is encumbered according to Article 71(1)(o), 73(1)(i) or 77(1)(h) of the Implementing Measures, 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 the Implementing Measures;

(b) classify an item included in the lists according to the appropriate features for determining classification in Articles 73 and 77 of the Implementing Measures;

(c) seek approval from the supervisory authority to classify any items not included in the lists in accordance with Article 79 of the Implementing Measures.

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.

2.7 The examples on encumbrances below are illustrative and not exhaustive. Articles 71(1)(o), 73(1)(i) and 77(1)(h) of the Implementing Measures provide that any transaction which undermines a basic own-fund item's ability to meet the criteria set out in Article 94(1) of Solvency II will be considered an encumbrance.

Example 1:

If a parent undertaking A subscribes for share capital of €100,000 in its insurance subsidiary B and subsequently B invests €100,000 in shares or any other own-fund items of A, then this is the equivalent of B holding its own shares.

An adjustment of €100,000 should be made to the reconciliation reserve of B.

Example 2:

If insurer A subscribes for share capital, or any other own-fund items, of €100,000 in unrelated undertaking B and B invests reciprocally in €100,000 in shares or any other own-fund items of A, and this has been designed to inflate artificially the own funds of A, then this is the equivalent of A holding its own shares.

An adjustment of €100,000 should be made to the reconciliation reserve of A.

Example 3:

Same as Example 2, but B invests only €80,000 reciprocally in shares of A.

An adjustment of €80,000 should be made to the reconciliation reserve of A.

Example 4:

Bank A provides a subordinated loan of €200,000 to a life subsidiary L and one of €100,000 to a non-life subsidiary N of insurance undertaking B. At the same time, C, the insurance holding company of B provides a subordinated loan of €300,000 to Bank A.

These transactions are connected but they do not encumber the own funds of L and N. The provision of own funds has moved through third party A rather than down the group from C to B for L and N. This does not affect the individual entity treatment in L and N provided the subordinated loans meet the relevant criteria.

From a group perspective the connected transactions need to be considered together and eliminated to avoid the artificial creation of group own funds.

Example 5:

Bank A receives a subordinated loan of €200,000 from a life subsidiary L and one of €100,000 from a non-life subsidiary N of insurance undertaking B. At the same time, C, the insurance holding company of B receives a subordinated loan of €300,000 from Bank A.

These transactions involve a third party but they are connected. In substance, the economic effect of the transactions is equivalent to the holding of own shares by L and N.

An adjustment of €200,000 and €100,000 should be made to the reconciliation reserves of L and N respectively.

Example 6:

Parent A issues €100,000 subordinated debt (Tier 2 compliant) to the market, which is guaranteed on a subordinated basis by its insurance subsidiary B. A then invests the €100,000 proceeds into ordinary shares of B.

The share capital issued to A is encumbered by the guarantee of the debt issue used by A to fund the investment in the share capital of B.

The share capital that was in effect funded by A’s issuance of Tier 2 subordinated debt to the market should be classified as Tier 2.

Example 7:

An insurer A owns a finance subsidiary B. B issues €100,000 of Tier 2 bonds to the market and provides an intercompany loan to A for €100,000 on the same

terms. A guarantees B's payment obligations under the terms of the bonds on a subordinated basis.

A's own funds are not encumbered, because both the intercompany loan and the guarantee are provided on the basis that they meet the Tier 2 criteria, particularly with regard to subordination.

From a group perspective, the own funds will only meet the criteria for group own funds if both the bonds and guarantee are subordinated to the claims of all policy holders and beneficiaries, and non-subordinated creditors.

Guideline 15 - Exceptional waiver of suspension of repayment or redemption

When applying for an exceptional waiver of the suspension of repayment or redemption according to Article 71(1)(k)(i), Article 73(1)(k)(i), and Article 77(1)(i)(i) of the Implementing Measures, 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.

2.8 In assessing an undertaking's application for an exceptional waiver for the suspension of repayment or redemption, the supervisory authority should take into account information submitted by the undertaking and any additional analysis or projections it considers necessary for the undertaking to provide. Where the supervisory authority is not satisfied with the justification of the exceptional nature of a waiver and the analysis provided, it will not be in a position to grant approval.

Guideline 16 - Exceptional waiver of cancellation or deferral of distributions

When applying for an exceptional waiver of the cancellation or deferral of distributions according to Articles 71(1)(m) and 73(1)(h) of the Implementing Measures, undertakings should demonstrate how the distribution could be made without weakening their solvency position and how the MCR would be met.

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.

2.9 In assessing an application for an exceptional waiver of cancellation or deferral of distributions, the supervisory authority will need to take into account

information submitted by the undertaking and any additional analysis or projections it considers necessary for the undertaking to provide. Where the supervisory authority is not satisfied with the justification of the exceptional nature of a waiver and the analysis provided, it will not be in a position to grant approval.

~~**Guideline 17 – Principal loss absorbency: conversion**~~

~~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.~~

2.10 Guideline 17 is deleted because it is deemed redundant (type 1 deletion) as it requires that the AMSB of the undertaking and other persons who effectively run the undertaking are aware of the impact of potential conversion of an instrument. This aspect is embedded in the Fit and Proper requirements and principle that the AMSB is ultimate responsible for running the undertaking.

Guideline 18 - Supervisory approval of repayment and redemption

Where an undertaking seeks supervisory approval of repayment or redemption according to Articles 71(1)(h), 73(1)(d) and 77(1)(d) of the Implementing Measures or a transaction not deemed to be a repayment or redemption according to Articles 71(2), 73(2) and 77(2) of the Implementing Measures 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.

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 repayment transactions as a whole rather than on an individual basis.

An undertaking should submit the request for supervisory approval 3 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.

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.

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 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.

2.11 Undertakings may enter into arrangements that do not constitute a repayment or redemption of a basic own-fund item at any date following the date of issuance, subject to all relevant criteria being met and to prior supervisory approval as set out in Guideline 18.

2.12 In assessing an application for approval of repayment and redemption, the supervisory authority will need to take into account the information submitted by undertakings and any additional analysis or projections it considers necessary for the undertaking to provide. Where the supervisory authority is not satisfied with the justification and the analysis provided, it will not be in a position to grant approval.

~~**Guideline 21 – General features of the application**~~

~~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.~~

2.13 Guideline 21 is deleted because it is deemed redundant (type 1 deletion) as it refers to practices that are well integrated in the supervision of NCAs, and do not have added-value content compared to the Solvency II Directive and the Delegated Regulation 2015/35.

Guideline 22 - Cover letter

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 the Implementing Measures;

(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.

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.

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

2.14 The concept of economic substance as referred to in the Guideline requires undertakings to reflect how the basic own-fund item is designed to absorb losses in practice. In this respect it is important for the legal terms to be unambiguous and definite, and to consider the principle that substance prevails over form.

~~**Guideline 24 – Procedures for supervisory authorities**~~

~~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.~~

2.15 Guideline 24 is deleted because it is deemed redundant (type 1 deletion) as it refers to practices that are well integrated in the supervision of NCAs, and do not have added-value content compared to the Solvency II Directive and the Delegated Regulation 2015/35.

~~**Guideline 24 – Procedures for supervisory authorities**~~

~~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.~~

2.16 Guideline 24 is deleted because it is deemed redundant (type 1 deletion) as it refers to practices that are well integrated in the supervision of NCAs, and do not have added-value content compared to the Solvency II Directive and the Delegated Regulation 2015/35.

~~**Guideline 26 – Communication of the supervisory authorities' decision**~~

~~When supervisory authorities have reached a decision on an application, they should communicate this in writing to the undertakings, on a timely basis.~~

~~Where the supervisory authority rejects the application, it should state the reasons on which the decision is based.~~

2.17 Guideline 26 is deleted because it is deemed redundant (type 1 deletion) as it refers to practices that are well integrated in the supervision of NCAs, and does not have added-value content compared to the Solvency II Directive and the Delegated Regulation 2015/35.

~~**Guideline 27 – Transitional arrangements**~~

~~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.~~

~~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.~~

~~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.~~

2.18 Guideline 27 is deleted because it is deemed not necessary (type 2 deletion). The transitional OF items are no longer eligible as the transitional period was 10 years, expiring on 1 January 2026.

Guideline 28 - Approval of ancillary own-fund items which, once called, take the form of an Item not on the lists

If an ancillary own-fund item once called up would take the form of an Item not on the lists, undertakings should seek approval of the classification of that item, as provided for in Article 79 of Commission Delegated Regulation 2015/35 prior to submitting an application for approval of the ancillary own-fund item.

2.19 Guideline merged from Guidelines on Ancillary Own Funds.

2.20 The approval of the classification of an Item not on the lists requires a separate approval process. While this approval is a pre-requisite for the approval of the ancillary own-fund item, supervisory authorities may choose for efficiency reasons to assess the two applications concurrently and grant both approvals at the same time, depending on the nature and the structure of the item

Guideline 29 - Callable on demand

For the items described in points (a), (b), (c), (d), (f) and (i) of Article 74 of Commission Delegated Regulation 2015/35 to be callable on demand, undertakings should ensure that the call is not:

a) contingent on the occurrence of an event or criteria being met;

b) subject to the agreement of the counterparty or any third party;

c) subject to any agreement, arrangement or incentive that means that the undertaking is not permitted or is not likely to call up the item; or

d) subject to any other arrangement or combination of arrangements which has the same effect as points (a) to (c).

With regard to the assessment of future claims by a mutual or mutual-type association with variable contributions for the purposes of Article 90 of Solvency II, supervisory authorities should consider whether there are any impediments to the claims being used to cover losses when they arise, and to the amounts being recovered in a timely manner.

2.21 Guideline merged from Guidelines on Ancillary Own Funds.

Guideline 30 - Classification of ancillary own-fund items

The supervisory authority should not determine the classification of an ancillary own-fund item based only on the form in which the item is presented or described. The supervisory authority’s assessment and the classification of the ancillary own-fund item should depend upon the item’s economic substance and the extent to which it would satisfy the characteristics and features set out in Articles 93 to 96 of Solvency II

and Articles 74, 75, and 78 of Commission Delegated Regulation 2015/35.

Where ancillary own-fund items become Capital instruments on call, undertakings should classify the ancillary own-fund item by assessing the features of that Capital instrument and determine to which tier the Capital instrument would belong if called up.

Undertakings should ensure that where an ancillary own-fund item on being called results in the receipt of cash or other assets, that basic own-fund item is only treated as a contribution where it does not give rise to a corresponding Capital instrument or liability, whether contingent or not, of the undertaking.

Undertakings should treat items as contributions:

a) when they are in the form of an unconditional gift, or donation of own funds;

b) whether they are from a parent undertaking, or any other party, or in the form of supplementary contributions from members of mutual or mutual-type undertakings;

c) regardless of the treatment of the item for accounting purposes, as contributing to profit or loss or contributing directly to reserves.

Since the balance sheet treatment of contributions which satisfy the necessary features and characteristics used to classify own funds into tiers, is an increase in the undertaking's assets with a corresponding increase in the reconciliation reserve, and since the contribution does not give rise to any Capital instrument or liability or any other basic own-fund item, undertakings should classify the item as Tier 2 ancillary own funds.

Undertakings should classify contractual arrangements which when called up meet the undertaking's liabilities by indemnifying third-parties, in the same manner as contributions if they:

a) generate an asset for a third-party creditor of the undertaking;

b) do not create corresponding liabilities for the undertaking.

Undertakings should treat contracts of indemnity, which oblige a third-party indemnifier to pay sums to the undertaking's creditor without obliging the undertaking to repay such sums to the indemnifier, as ancillary own-fund items, subject to approval by the supervisory authority.

Supervisory authorities should classify ancillary own-fund items which on call do not become Capital instruments, contributions or arrangements, but which meet an undertaking's liabilities, by considering the features of whatever the ancillary own-fund item delivers on call.

2.22 Guideline merged from Guidelines on Ancillary Own Funds.

2.23 Arrangements which write off or convert an undertaking's liabilities, whether that conversion is on demand or not, only create an ancillary own-fund item if they are approved by the supervisory authority. This is regardless of whether the counterparty (which may be a group company or third-party) has converted a liability in the past. Paid-in ordinary share capital or other own-fund

items which comply with the features described in Article 71 of the Implementing Measures are classified as Tier 1, so undertakings should classify the issued but uncalled form of such capital as Tier 2. Subordinated liabilities or other own-fund items which are fully paid-in, but do not possess the features for Tier 1 classification may be classified as Tier 2, if they possess the features necessary for that tier, and therefore undertakings should classify their ancillary form as Tier 3.