

Q&A

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Question

If an insurance company issues subordinated debt as tier 2 regulatory capital, and they use this capital as a loan back to their parent company - will it still be eligible as regulatory capital under solvency II?

EIOPA answer

It is not clear whether the issuance of subordinated debt in this question is from the subsidiary to the parent or to an external debt-holder. The answer is different in the two cases.

If the issuance is to external debt-holders then the eligibility of the capital will not be affected by the loan. However, the extent to which the subsidiary can reflect the loan as an asset on its Solvency II balance sheet will depend upon a realistic assessment of whether it will provide future value, or whether it is in reality unlikely to be recovered.

Alternatively if the subordinated debt is issued to the parent, its eligibility for regulatory capital purposes would depend on the nature of the loan arrangement

with the parent company and whether this undermined the extent to which the item satisfied the features required of Tier 2 own-fund items set out in Article 73 of Commission Delegated Regulation 2015/35, in particular the requirement to be free from encumbrances.

EIOPA's Guidelines on the classification of own funds set out the elements to consider regarding encumbrances. EIOPA also developed a series of examples on cases of encumbrances in the explanatory texts to the Guidelines, which can be found in the document Final Report on Public Consultation No. 14/036 on Guidelines on classification of own funds.