

Q&A

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Guidelines on classification of own funds

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Question

The Solvency II regulation talks about repayment or redemption of basic own-fund items which are subject to prior supervisory approval. In the guidelines it is further specified that repayment and redemption include, among other things, share buybacks.

Is supervisory approval required for all share buybacks and what is the legal basis for this?

EIOPA answer

The use of the phrase "repayment and redemption" is intended to capture all cases where the insurer pays back a basic own-fund item (including at any maturity date) and which therefore reduces the funds available to the insurer to absorb losses.

The provisions in Articles 71(1)(h), 73(d) and 77(d) of the delegated regulation apply to share capital as well as to subordinated liabilities, and irrespective of whether the own-fund item is undated or has a fixed maturity. The only cases

where it does not apply are those items for which the provision is not relevant because it is not possible for the insurer to repay or redeem the item, for example surplus funds (Art. 69(a)(iv)).

EIOPA's guidelines on the classification of own funds clarify the scope of these provisions based on the principle of substance over form. It is stated that any transaction or arrangement that has the same economic effect of a repayment or redemption is captured. This applies irrespective of how the transaction is commonly referred to, e.g. buyback, repurchase, tender, etc.

In the case of an insurer repurchasing or buying back its shares it would be necessary to consider the nature of the transaction. Where the buyback decreases the number of shares it is subject to prior supervisory approval because it permanently reduces loss absorbency.

However, where the share buyback is for another purposes which does not affect the loss absorbency of the insurer's share capital, for example to immediately be used to fulfil stock options, then prior supervisory approval would not be necessary since the economic effect is not the same as a repayment or redemption.

Similarly if the shares are bought back and held (on a temporary basis) by the insurer this would not require approval under Article 71(1)(h), 73(d) or 77(d) as the number of shares has not decreased. However, in this case, the shares would not be eligible own-fund items because of the deduction in accordance with Article 70(1)(a) of the delegated regulation.