Final Report
on
Public Consultation No. 14/036 on
Guidelines on ancillary own funds
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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 ancillary own funds. These Guidelines relate to Articles 89, 90, 93 to 96, 226 and 235 of Directive 2009/138/EC\(^1\) and to Articles 62, 74, 75, 78 and 79 of the Implementing Measures\(^2\). Further relevant provisions are Articles 63 to 67 of the Implementing Measures.

As a result of the above, on 2 June 2014 EIOPA launched a Public Consultation on draft Guidelines on ancillary 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 in relation to:

- The approval of ancillary own funds by supervisory authorities;
- The ongoing satisfaction of the criteria for approval of ancillary own-fund items;
- The classification of ancillary 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.

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\(^1\) OJ L 335, 17.12.2009, p. 1–155


**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. Requirement for the separate approval of the classification and the amount of ancillary own funds

   a) A number of stakeholders, including the IRSG, commented that it is inefficient to require two separate approvals, one concerning the classification of the own-fund item if it is not included in the list of items in Article 74 of the Implementing Measures, and the other concerning the approval of the amount of ancillary own funds.

   b) EIOPA considers that the approach taken is consistent with the Solvency II Directive, which in Article 90(1) requires the supervisory approval of the amount of ancillary own-fund items to be taken into account when determining own funds, and separately in Article 95(3) the supervisory approval of the classification of items not included on the lists. The two approvals address different matters and therefore, if they were combined, there would be a risk that supervisory authorities would not have sufficient time to review all of the necessary aspects of both approvals.

Guideline 1 intends to clarify the relationship between these two approvals, in that the classification of an item would need to be approved before the supervisory authority could determine the appropriate amount of ancillary own funds to approve. The proposal presented during the public consultation also aimed to promote as efficient a process as possible by explaining that, depending on the nature of the item, supervisory authorities may in practice be able to assess the two approval applications at the same time. However, based on the comments received from stakeholders, the Guideline was not sufficiently clear.

EIOPA has decided to redraft and shorten the Guideline to address only the necessary element or ‘requirement’ that the application for classification of an
item is a pre-requisite for the other application. EIOPA still aims to facilitate efficient approval processes. However, to address this issue, EIOPA has explained in the introduction and the explanatory text that undertakings and supervisory authorities are expected to discuss how to ensure that these two approval processes are pursued in an efficient manner, as part of the ongoing supervisory review process.

2. Callable on demand

a) In the version of Implementing Technical Standards (ITS) on the procedures for approval of ancillary own-fund items presented for public consultation in April⁴, EIOPA proposed that there should be no constraints on the ability of ancillary own-fund items to be callable on demand. This included, for example, that a call shall not be contingent on the occurrence of an event, or be subject to the agreement of a counterparty. This approach was based on need for ancillary own funds to be available to absorb losses when needed, as specified in Article 89(1) of the Solvency II Directive, and further specified in Article 74 of the Implementing Measures, in relation to the list of possible ancillary own-fund items.

During the public consultation on the ITS stakeholders commented on this provision, and, for instance, it was asserted that ancillary own funds that are contingent on the solvency ratio falling below a threshold must be allowed. In the final proposal for ITS published in October⁵ EIOPA removed the list of features to be fulfilled for an item to be callable on demand, but stated that it still considered those features to be necessary. It was explained that EIOPA believed it to be more appropriate to address this issue in the Guidelines on ancillary own funds.

b) The features to be fulfilled for an item to be callable on demand are now included in Guideline 3. EIOPA has, however, added a provision to clarify the application to future claims by a mutual or mutual-type association with variable contributions, for which, given the specific nature of these items, some contingency regarding the ability to call may be permitted. Article 89 of the Solvency II Directive indicates that such future claims may be recognised as ancillary own funds even if the basis on which the claim can be made is not in place at that time, but may be within the next 12 months. One possible example of such a case is if a call for supplementary contributions is dependent on the occurrence of a loss by the undertaking, and the loss has not yet occurred. For such items, supervisory authorities will need to assess if there are any impediments to the claims being used to cover losses when they arise, and to the claims being recovered in a timely manner.

3. Homogenous group of counterparties

a) Stakeholders commented on the Guideline relating to the circumstances in which a group of counterparties could be assessed as though they were a single counterparty. EIOPA proposed that the provision in the Implementing Measures is particularly relevant where a mutual or mutual-type undertaking has a large number of homogeneous non-corporate members, from whom it can make a call for supplementary contributions. It was stated by one stakeholder that the Implementing Measures apply equally in all relevant circumstances and therefore that the Guideline should be deleted.

b) In response to these comments, EIOPA agrees that the Implementing Measures apply in all cases, but Article 63(6) requires certain conditions to be satisfied. The purpose of the proposed Guideline was to indicate one circumstance in which the conditions set out in Article 63(6) may be met, without prejudicing its application in other circumstances. However, as this is more of an explanatory point, EIOPA has decided to remove this Guideline, and instead moved it to recital 5 of its proposal for ITS on ancillary own funds6.

4. Timing of the conclusion of the contractual arrangements

a) Following the comments received during the public consultation on the ITS on the approval of ancillary own funds, EIOPA acknowledged that it may not be practicable for an undertaking to formally enter into an arrangement before knowing if they will obtain supervisory approval for the item to qualify as ancillary own funds. In the final report following the public consultation on the ITS, EIOPA stated that:

EIOPA has, therefore, added a provision to Article 7 of the ITS to state that where the supervisory approval has been granted on the condition that the contract is entered into, the undertaking shall, without delay, enter into the contract, on the terms on which the approval was based, and provide a copy of the signed contract to the supervisory authority.

EIOPA also stated that, ‘Any substantive delay by the undertaking to enter into the arrangement would invalidate the approval by the supervisory authority and require a new application.’

b) In view of this, EIOPA decided that it is important to clarify in the Guidelines how the term, ‘without delay’, used in the ITS should be interpreted in practical terms. EIOPA believes that 3 weeks or 15 working days are a sufficient amount of time for undertakings to formally conclude the contractual arrangements once the approval has been granted. However, should this not be possible, undertakings will be able to ask the relevant supervisory authority if a longer

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period of time is reasonable. This provision is included as a new Guideline 2, and will be updated as necessary once the ITS has been endorsed.

5. Ongoing satisfaction of the criteria for approval

a) One stakeholder argued that the provision in Guideline 4 that undertakings should discuss possible material changes to the loss-absorbency of an ancillary own-fund item with the supervisory authority, ‘goes beyond’ the Implementing Measures and that no renewed approval process should result from such a discussion.

b) By way of response to this comment, EIOPA would maintain that the provision supplements Article 62(1)(d) of the Implementing Measures, which already requires the undertaking to have processes in place to identify and inform the supervisory authority of changes which may affect the loss-absorbency of the ancillary own-fund item. This is necessary to ensure that the amount ascribed to the ancillary own-fund item continues to reflect the item's loss absorbency on an ongoing basis.

In addition, the Guideline does not stipulate that a renewed approval application would be needed. The actions to follow from such a notification by an undertaking would depend on the circumstances of the case and the nature of the change in the loss absorbency of the item. In addition, as proposed in the ITS on the procedures for ancillary own funds approval, should the supervisory authority decide to revise the amount approved or to withdraw its approval of a method, it will need to notify the undertaking stating the reasons for this decision.

General nature of the participants to the Public Consultation

EIOPA received comments from the IRSG and six responses from other stakeholders to the public consultation. All the comments received have been published on EIOPA’s website.

Respondents can be classified into three main categories: European trade, insurance, or actuarial associations; national insurance or actuarial associations; 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, as well as the particular comments on the Guidelines at hand, can be consulted on EIOPA’s website.

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

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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.
Annex: Guideline

1. Guidelines on ancillary own funds

Introduction


1.3. These Guidelines are addressed to supervisory authorities under Solvency II.

1.4. 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.

1.5. 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.

1.6. 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.

1.7. 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.

1.8. 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

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8 OJ L 331, 15.12.2010, p. 48–83
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.

1.9. For the purpose of these Guidelines, the following definitions have 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.

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

1.11. The Guidelines shall apply from 1 April 2015.

**Guideline 1** - Approval of ancillary own-fund items which, once called, take the form of an Item not on the lists

1.12. 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 the Implementing Measures prior to submitting an application for approval of the ancillary own-fund item.

**Guideline 2** - Entering into the contract for an ancillary own-fund item

1.13. Where supervisory approval has been granted on the condition that the contract is entered into, in accordance with Article 7(3) of the EIOPA Draft Implementing Technical Standard with regard to the procedures to be used for granting supervisory approval for the use of ancillary own-fund items, the undertaking should formally conclude the contract no later than 15 working days after the approval has been granted, unless the undertaking has agreed a longer time period in advance in writing with the supervisory authority.

**Guideline 3** - Callable on demand

1.14. For the items described in points (a), (b), (c), (d), (f) and (i) of Article 74 of the Implementing Measures 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;

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(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).

1.15. 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 4 - Classification of ancillary own-fund items**

1.16. 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 the Implementing Measures.

1.17. 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.

1.18. 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.

1.19. 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.

1.20. 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.
1.21. 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.

1.22. 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.

1.23. 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.

Guideline 5 - Ongoing satisfaction of the criteria

1.24. Undertakings should discuss with the supervisory authority as early as possible, if they have reason to believe that a material change in the loss-absorbency of an ancillary own-fund item is imminent or likely.

Guideline 6 - Assessment of the ongoing satisfaction of the criteria

1.25. When considering whether the amount ascribed to an ancillary own-fund item continues to reflect its loss-absorbency, supervisory authorities should consider using information obtained from other sources in addition to the information received from undertakings in accordance with Article 62(1)(d) of the Implementing Measures, including but not limited to:

   (a) information obtained through on-site inspections;
   (b) ad-hoc information received or obtained as part of the supervisory review process;
   (c) information provided by other supervisory authorities within the college of supervisors, where applicable.

Compliance and Reporting Rules

1.26. 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.

1.27. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
1.28. 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.

1.29. 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**

1.30. The present Guidelines shall be subject to a review by EIOPA.
1. Explanatory text

Guideline 1 - 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 the Implementing Measures prior to submitting an application for approval of the ancillary own-fund item.

1.1. 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 4 - 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 the Implementing Measures.

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
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:

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

1.2. 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.

Guideline 5 - Ongoing satisfaction of the criteria

Undertakings should discuss with the supervisory authority as early as possible, if they have reason to believe that a material change in the loss-absorbency of an ancillary own-fund item is imminent or likely.

1.3. The assessment of ongoing satisfaction may be illustrated by the following example:

An undertaking applied for approval of an ancillary own-fund item which could provide funds of up to €150m. The supervisory authority approved €100m of the €150m as a prudent and realistic amount. The approved amount of €100m was treated as Tier 2 ancillary own funds.

Later the undertaking calls €20m of the ancillary own-fund item and the counterparty honours the call; the undertaking’s Tier 1 own funds increase by €20m, i.e. the amount of the cash contribution it receives from the counterparty.
The supervisory authority will then review its assessment of the amount of the ancillary own-fund item, having regard to the impact of the call on the application of the criteria for approval. This impact will be case specific; the way a call affects the compliance of the uncalled amount of ancillary own funds with the criteria might be totally different in one case from that in another.

Taking this example, after its review the supervisory authority may decide that the approved amount should remain unchanged at €100m.

This might reflect the view that the counterparty’s €20m cash contribution came from the €50m of potential ancillary own-funds not previously recognised by the supervisory authority. The supervisory authority might view the call’s “success” (i.e. the undertaking’s receipt of the funds called) as supporting the approved amount. In such circumstances, after the call, the undertaking would still have €100m of Tier 2 ancillary own funds.

Alternatively, the way the criteria are affected may be such that the supervisory authority may decide that the ancillary own-fund item’s amount has to be reduced to €80m.

This might reflect the view that the counterparty’s €20m cash contribution came from the €100m originally approved by the supervisory authority. In such circumstances, after the call, the undertaking would have €80m of Tier 2 ancillary own funds.

However, the supervisory authority is not limited to the above actions and may adjust the ancillary own-fund item in some other way based on the facts and circumstances of the case and how these affect the satisfaction of the criteria. A supervisory conclusion in one situation creates no precedent or presumption that the call of a similar ancillary own-fund item will affect the approval criteria in the same manner on a future occasion. Each situation must be considered on a case by case basis.