

**PRA RULEBOOK: SOLVENCY II FIRMS: OWN FUNDS INSTRUMENT 2015**

**Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
  - (1) section 137G (the PRA’s general rules); and
  - (2) section 137T (general supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**PRA Rulebook: Solvency II Firms: Own Funds Instrument 2015**

- D. The PRA makes the rules in the Annex to this instrument.

**Commencement**

- E. This instrument comes into force on 1 January 2016.

**Citation**

- F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Own Funds Instrument 2015.

**By order of the Board of the Prudential Regulation Authority**

17 March 2015

## Annex

In this Annex, the text is all new and is not underlined.

### Part

# OWN FUNDS

---

### Chapter content

1. APPLICATION
2. DETERMINATION OF OWN FUNDS
3. CLASSIFICATION OF OWN FUNDS INTO TIERS
4. ELIGIBILITY AND LIMITS APPLICABLE TO TIERS
5. NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS
6. LLOYD'S

### Links

## 1 APPLICATION

---

1.1 Unless otherwise stated, this Part applies to:

- (1) a *UK Solvency II firm*; and
- (2) in accordance with Insurance General Application 3, the *Society*.

## 2 DETERMINATION OF OWN FUNDS

---

2.1 A *firm's own funds* comprise the sum of its *basic own funds* and *ancillary own funds*.

**[Note: Art. 87 of the *Solvency II Directive*]**

2.2 The *firm's basic own funds* consist of the following items:

- (1) the excess of assets over liabilities, less the amount of own *shares* held by the *firm*; and
- (2) subordinated liabilities.

**[Note: Art. 88 of the *Solvency II Directive*]**

2.3 Subject to 2.5, the *firm's ancillary own funds* consist of items (other than items of *basic own funds*) which can be called up to absorb losses, including the following (to the extent that they are not items of *basic own funds*):

- (1) unpaid share capital or initial fund that has not been called up;
- (2) letters of credit and guarantees;
- (3) any other legally binding commitments received by the *firm*; and
- (4) for a *mutual*, any future claims which it may have against its members by way of a call for supplementary contribution within the next 12 *months*.

**[Note: Art. 89(1) of the *Solvency II Directive*]**

2.4 Where an item of *ancillary own funds* becomes paid in or called up, the proceeds paid in or the amount due in respect of the call must be treated as an asset and the item must cease to be treated as an item of *ancillary own funds*.

**[Note: Art. 89(2) of the *Solvency II Directive*]**

2.5 When determining its *own funds*, a *firm* must not take into account any item of *ancillary own funds* unless, subject to 2.6, it has received the *PRA's* approval of either:

- (1) a monetary amount for the relevant item of *ancillary own funds*; or
- (2) the method by which to determine the amount of the relevant item of *ancillary own funds*, together with the amount determined in accordance with that method for a specified time period.

**[Note: Art. 90(1) and (3) of the *Solvency II Directive*]**

2.6 Where a *firm* has received approval:

- (1) under 2.5(1), it may only include in its *own funds* the item of *ancillary own funds* for an amount up to the amount approved; or
- (2) under 2.5(2), it may only include in its *own funds* the item of *ancillary own funds* up to the amount determined using the method approved, and only for the time period for which approval is granted.

**[Note: Art. 90(3) of the Solvency II Directive]**

2.7 A *firm* may only attribute an amount to an item of *ancillary own funds* to the extent that it:

- (1) reflects the loss-absorbency of the item; and
- (2) is based upon prudent and realistic assumptions.

**[Note: Art. 90(2) of the Solvency II Directive]**

### 3 CLASSIFICATION OF OWN FUNDS INTO TIERS

---

3.1 A *firm* may only include an *own funds* item in its *Tier 1 own funds* if:

- (1) it is an item of *basic own funds*; and
- (2) it substantially possesses the characteristics set out in 3.5(1) and 3.5(2), taking into consideration the features set out in 3.6.

**[Note: Art. 94(1) of the Solvency II Directive]**

3.2 A *firm* may only include an *own funds* item in its *Tier 2 own funds* if:

- (1) where it is an item of *basic own funds*, it substantially possesses the characteristics set out in 3.5(2), taking into consideration the features set out in 3.6; or
- (2) where it is an item of *ancillary own funds*, it substantially possesses the characteristics set out in 3.5(1) and 3.5(2), taking into consideration the features set out in 3.6.

**[Note: Art. 94(2) of the Solvency II Directive]**

3.3 A *firm* may only include in its *Tier 3 own funds* an item of:

- (1) *basic own funds* that does not fall within 3.1 or 3.2(1); and
- (2) *ancillary own funds* that does not fall within 3.2(2).

**[Note: Art. 94(3) of the Solvency II Directive]**

- 3.4 (1) In classifying its *own funds* items, a *firm* must refer to the lists of *own funds* items set out in the *Solvency II Regulations*.
- (2) A *firm* must not include an *own funds* item in its *Tier 1 own funds*, *Tier 2 own funds* or *Tier 3 own funds* if that *own funds* item is not covered by the lists referred to in (1), unless it has received the *PRA*'s approval.

- (3) When seeking approval to classify an *own funds* item referred to in (2) in its *Tier 1 own funds*, *Tier 2 own funds* or *Tier 3 own funds*, a *firm* must demonstrate that the *own funds* item satisfies the criteria laid down in 3.1 to 3.3 for that classification.

**[Note: Art. 95 of the Solvency II Directive]**

3.5 The characteristics referred to in 3.1(2) and 3.2 are:

- (1) the item is available, or can be called up on demand, to fully absorb losses on a going-concern basis as well as in the case of winding up (permanent availability); and
- (2) in the case of winding up, the total amount of the item is available to absorb losses and the repayment of the item is refused to its holder until all other obligations, including insurance and *reinsurance* obligations to *policyholders*, have been met (subordination).

**[Note: Art. 93(1) of the Solvency II Directive]**

3.6 When assessing the extent to which *own funds* items possess the characteristics set out in 3.5, currently and in the future, a *firm* must consider:

- (1) the duration of the item, in particular whether the item is dated or not and, where an *own funds* item is dated, the relative duration of the item as compared to the duration of the insurance and *reinsurance* obligations of the *firm* (sufficient duration);
- (2) whether the item is free from requirements or incentives to redeem the nominal sum (absence of incentives to redeem);
- (3) whether the item is free from mandatory fixed charges (absence of mandatory servicing costs); and
- (4) whether the item is clear of encumbrances (absence of encumbrances).

**[Note: Art. 93(2) of the Solvency II Directive]**

3.7 (1) A *firm* must not classify as *Tier 1 own funds*:

- (a) paid-in ordinary share capital and related share premium account; or
- (b) paid-in initial fund, member's contribution or the equivalent *basic own funds* for a *mutual*

unless the *firm* has the right to cancel and withhold dividends or other distributions in respect of those items at any time prior to payment (and exercises that right) in the circumstances specified in the *Solvency II Regulations*.

(2) A *firm* must not classify as *Tier 2 basic own funds*:

- (a) ordinary share capital and related share premium account; or
- (b) initial fund, member's contribution or the equivalent *basic own funds* for a *mutual*

unless the *firm* has the right to defer dividends or other distributions in respect of those items at any time prior to payment (and exercises that right) in the circumstances specified in the *Solvency II Regulations*.

**[Note: Art. 93 and Art. 94 of the Solvency II Directive]**

#### **4 ELIGIBILITY AND LIMITS APPLICABLE TO TIERS**

---

4.1 As far as compliance with its *SCR* is concerned at least the following conditions must be met:

- (1) more than one-third of the total amount of the *firm's eligible own funds* is accounted for by *Tier 1 own funds*; and
- (2) less than one-third of the *firm's eligible own funds* is accounted for by *Tier 3 own funds*.

**[Note: Art. 98(1) of the Solvency II Directive]**

4.2 As far as compliance with its *MCR* is concerned, as a minimum more than 50% of the *firm's eligible own funds* must be accounted for by *Tier 1 own funds*.

**[Note: Art. 98(2) of the Solvency II Directive]**

#### **5 NOTIFICATION OF ISSUANCE OF OWN FUNDS ITEMS**

---

5.1 5.2 to 5.6 do not apply in respect of the following:

- (1) any item which a *firm* intends to include within its *basic own funds* that is not covered by the lists of *own funds* items set out in the *Solvency II Regulations*, but which may be included in its *basic own funds* only if the *firm* has received the *PRA's* approval; and
- (2) any item which a *firm* intends to include within its *ancillary own funds*.

5.2 (1) A *firm* must notify the *PRA* in writing of its intention to issue an item which it intends to include within its *basic own funds* at least one *month* before the intended date of issue, unless there are exceptional circumstances which make it impracticable to give such a period of notice, in which event the *firm* must give as much notice as is practicable in those circumstances.

- (2) When giving notice, a *firm* must:
  - (a) provide details of the amount of *basic own funds* the *firm* is seeking to raise through the intended issue and whether the *own funds* is intended to be issued to external investors or within its *group*;
  - (b) identify the classification of *basic own funds* the item is intended to fall within;
  - (c) include confirmation from the *governing body* of the *firm* that the item complies with the rules applicable to items of *basic own funds* included in the classification of the item identified in (b); and
  - (d) provide a copy of the term sheet and details of any features of the item it intends to include within its *basic own funds* which are novel, unusual or different from an item of *basic own funds* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by the *Solvency II Firms Sector* of the *PRA Rulebook* or the *Solvency II Regulations*.

5.3 A *firm* must provide a further written notification to the *PRA* including all the information required in 5.2(2) as soon as it proposes any change to the intended date of issue, amount of

issue, type of investors, classification of a particular tier of *basic own funds* or any other feature of the item intended to be included as *basic own funds* to that previously notified to the *PRA*.

5.4 If a *firm* proposes to establish a debt securities program for the issue of an item for inclusion within its *basic own funds*, it must:

- (1) notify the *PRA* of the establishment of the program; and
- (2) provide the information required by 5.2(2)

at least one *month* before the first proposed drawdown. The *PRA* must be notified of any changes in accordance with 5.3.

5.5 The items of *basic own funds* to which 5.2 does not apply are:

- (1) ordinary *shares* which:
  - (a) meet the classification criteria for ordinary share capital in *Tier 1 own funds*; and
  - (b) are the same as ordinary *shares* previously issued by the *firm*;
- (2) debt instruments issued from a debt securities program, provided that program was notified to the *PRA* prior to its first drawdown, in accordance with 5.4; and
- (3) any item which is not materially different in terms of its characteristics and eligibility for inclusion in a particular tier of *basic own funds* to items previously issued by the *firm* and included in *basic own funds*.

5.6 A *firm* must notify the *PRA* in writing, no later than the date of issue, of its intention to issue an item listed in 5.5 which it intends to include within its *basic own funds*. When giving notice, a *firm* must:

- (1) provide the information set out at 5.2(2)(a), (b) and (c); and
- (2) confirm that the terms of the item have not changed since the previous issue by the *firm* of that type of item of *basic own funds*.

## **6 LLOYD'S**

---

6.1 This Chapter applies to the *Society*.

6.2 For the purposes of complying with the *SCR Rules*, the *Society* must categorise *own funds* at Lloyd's as between:

- (1) *own funds* attributable to the *Society*; and
- (2) *own funds* attributable to *members* which are available to support *members'* *insurance business* at Lloyd's, including *funds at Lloyd's*.

6.3 The *Society* must notify the *PRA* in writing, within 14 days, in the event the *Council* makes a determination pursuant to paragraph 8(1A) or varies a determination pursuant to paragraph 8(1B)(a) of the New Central Fund Byelaw (No 23 of 1996) as amended, that the *Central Fund* or a part of the *Central Fund* is to constitute *own funds* attributable to the *Society* for the purposes of covering the *SCR* for Lloyd's.

- 6.4 In determining *own funds* at Lloyd's in accordance with 2, the *Society* shall have regard to:
- (1) the *Society's central assets* and *central liabilities*; and
  - (2) the assets and liabilities of *members*, including assets which are available to support *members' insurance business* at Lloyd's, such assets including a *member's funds at Lloyd's*.