

# Bank of England PRA

## Appendix 8: New draft statement of policy – Solvency II: The PRA’s approach to insurance own funds permissions

**Draft statement of policy**

April 2024

Draft for consultation



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# 1: Introduction

1.1 This statement of policy (SoP) sets out the Prudential Regulation Authority's (PRA) approach to granting the regulatory permissions set out in the Own Funds part of the PRA Rulebook (Own Funds permissions). Where relevant, this SoP also sets out the PRA's approach to variations to those permissions, and the circumstances in which the PRA may take the decision to revoke an Own Funds permission. When granting, varying or revoking Own Funds permissions, the PRA would exercise its powers under section 138BA (s138BA) of the Financial Services and Markets Act 2023 (FSMA).

1.2 This SoP is relevant to all UK Solvency II firms, and the Society of Lloyd's, referred to collectively as 'firms'.

1.3 As set out in the Own Funds Part of the PRA Rulebook, there are specific circumstances in which firms must apply to the PRA for prior permission before undertaking certain actions in relation own fund items. This SoP sets out the PRA's approach to granting:

- permission for repayment or redemption of an own fund item (Chapter 2);
- permission to allow an item of ancillary own funds (AOF) to be taken into account as part of own funds, referred to as an 'ancillary own funds permission' in the Own Funds part (Chapter 3).
- permission to include in its Tier 1 own funds, Tier 2 own funds or Tier 3 own funds (as the case may be) an own fund item that is not included in the own funds lists set out in the Own Funds part, referred to as a 'classification of own funds permission' in the Own Funds part (Chapter 4);
- permission for repayment and redemption between five and ten years for restricted Tier 1 own fund items (Chapter 5);
- permission for early repayment or redemption of an own fund items (Chapter 6); and
- permission to repay, redeem, or make distributions on own fund items while in breach of the Solvency Capital Requirement (SCR), or to avoid triggering a principal loss absorbency mechanism in own fund items while in significant non-compliance with the SCR (Chapter 7);

1.4 Within this SoP, all references to repayment or redemption include the repayment, redemption, repurchase or buyback of a basic own funds 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 paragraph 2.1(b) and (c).

1.5 The PRA encourages early engagement with firms that are considering submitting an application for an Own Funds permission, via their usual supervisory contact. The nature of this engagement will depend on the complexity and scale of the proposed application, and the firm's readiness to submit a formal application.

1.6 This SoP should be read in conjunction with the Own Funds Part of the PRA Rulebook and SS2/15, SS3/15, and SS22/15.

## 2: Prior permission for repayment or redemption of an own fund item

2.1 This chapter outlines the PRA's approach to applications for prior permission under s138BA of FSMA to:

- a) repay or redeem a Tier 1, Tier 2 or Tier 3 own fund item in accordance with Own Funds 3B.14(1), 3E.6(1), and 3G.6(1);
- b) exchange or convert a Tier 1, Tier 2 or Tier 3 own fund item into another own fund item of at least the same quality, without it being deemed as a repayment or redemption in accordance with Own Funds 3B.15(1), 3E.7(1), 3G.7(1); or
- c) repay or redeem a Tier 1, Tier 2, or Tier 3 own fund item out of the proceeds of a new basic own funds item of at least the same capital quality, without it being deemed as a repayment or redemption in accordance with Own Funds 3B.15(2), 3E.7(2), 3G.7(2).

2.2 When considering applications for prior permission under these circumstances, the PRA will base its assessment on the firm's own assessment of the repayment or redemption, which must address the following:

- a) the current and short-to-medium term impact on the firm's overall solvency position;
- b) how the action is consistent with the firm's medium-term capital management plan and Own Risk and Solvency Assessment (ORSA); and

- c) the firm'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.

2.3 Where a firm is proposing a series of repayments or redemptions over a short period of time, it should inform the PRA, which may consider the series of transactions as a whole rather than on an individual basis.

2.4 Firms should submit applications providing the information set out in paragraph 2.2, at least three months prior to the earlier of the required contractual notice to holders of the item of repayment or redemption; or the proposed repayment or redemption date. The PRA expects to determine the outcome of an application for prior permission to repay or redeem an own fund item no later than three months from the date of receipt.

2.5 After receiving prior permission from the PRA for the repayment or redemption the firm 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 on which the permission is granted, 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 firm may reinstate the item as available own funds and the permission for repayment or redemption is revoked.

## 3: Ancillary own funds permissions

### Overview

3.1 This chapter sets out the PRA's approach to applications for AOF permissions which allow a firm to take into account an item of AOF as part of its own funds in accordance with Own Funds 2.1 and 2.5 – 2.7.

3.2 When granting these permissions, the PRA would exercise its powers under s138BA of FSMA to grant, vary or revoke a permission, based on the criteria set out below.

### Initial application for ancillary own funds permission

3.3 A firm must submit a written application to the PRA for permission of each AOF item. This application must consist of a cover letter (paragraphs 3.4 – 3.5) and supporting evidence (paragraphs 3.6 – 3.15) and should also address paragraph 3.16 unless there are good reasons not to do so.

3.4 The cover letter should confirm all of the following:

- a) any legal or contractual terms governing the AOF item or any connected arrangement are unambiguous and clearly defined;
- b) the amount ascribed to the AOF item in the application complies with Own Funds 2.7;
- c) the economic substance of the AOF item, including how the item provides basic own funds once called up, has been fully reflected in the application;
- d) the firm considers that the AOF item complies with the criteria for the classification of own funds, taking into account likely future developments as well as the circumstances at the date of the application; and
- e) no facts have been omitted which if known by the PRA could influence:
  - i. its decision regarding whether to approve an AOF item,
  - ii. the amount for which approval of an item should be granted, or
  - iii. the time period for which approval of a calculation method should apply.

3.5 The cover letter must also list other applications to the PRA for permission submitted by the firm or currently foreseen within the next six months, together with corresponding application dates.

### Supporting evidence regarding the amount or method

3.6 The firm's application must seek approval of:

- a) a specified monetary amount for an AOF item; or
- b) a calculation method to determine the amount of an AOF item.

3.7 Where a firm seeks permission for a specified monetary amount, as referred to in paragraph 3.6(a), the application should include an explanation of the calculation of the amount, based on prudent and realistic assumptions in accordance with Own Funds 2.7.

3.8 Where a firm seeks permission for a calculation method, as referred to in paragraph 3.6(b), it must provide the following information:

- a) an explanation of the method and how it reflects the loss-absorbency of the AOF item;
- b) description of any assumptions upon which the method relies and how these assumptions are prudent and realistic;
- c) the item's expected initial amount that has been calculated in accordance with the method and a justification of that amount; and
- d) an explanation of the validation processes the firm will implement to ensure that the results of the method continue to reflect the loss-absorbing capacity of the item on an ongoing basis.

### Supporting evidence regarding the criteria for permission

3.9 Where a firm seeks permission to take into account an item of AOF as part of its own funds, the supporting evidence must contain sufficient information to allow the PRA to assess whether the application complies with the criteria determined in Own Funds 2.5 - 2.7, paragraph 3.25 and paragraphs 3.31 - 3.43 of this SoP. It must contain at least the information described in paragraphs 3.10 – 3.15, and should also address paragraph 3.16 unless there are good reasons not to do so.

#### *General Information*

3.10 The firm must provide information regarding the nature of the AOF item and the loss absorbing capacity of the basic own funds item into which the AOF item converts on being called up, including the following:

- a) the item's legal or contractual terms, together with the terms of any connected arrangement and evidence that the counterparty has entered into, or will enter into, the contract and any connected arrangement;
- b) evidence that the contract and any connected arrangements are legally binding and enforceable in all relevant jurisdictions, based on legal opinions for each relevant jurisdiction;
- c) the period during which the contract is in effect and, if different, the period during which the firm may call upon the item;



- d) confirmation that the AOF item, once that item has been called up and paid in, would display all of the features of a basic own funds item classified in Tier 1 in accordance with Own Funds 3B, or all of the features of a basic own funds item classified in Tier 2 in accordance with Own Funds 3E;
- e) confirmation that the item's contractual terms do not contain any provision which might create a disincentive for the firm to call upon the item to absorb losses or place any constraint upon its ability to be callable on demand;
- f) confirmation that the AOF item or its benefits would only be available to the firm and would not be transferrable or assignable to any other party or be able to be encumbered in any other way;
- g) any factors which restrict the conditions under which the firm might seek to call upon the item, including but not limited to conditions of stress specific to the firm or wider market stress;
- h) whether the firm has, or in the future may have, any obligation to, or any expectation or understanding that it will pay funds or provide any other benefit to the counterparty or to a third party in connection with the item, other than in the event of repayment of a basic own funds item which would satisfy the features in Own Funds 3B.1(8) and 3E.1(4); and
- i) a copy of the medium term capital management plan including how the item will contribute to the firm's existing capital structure, and how the item might enable the firm to meet its existing or future capital requirements.

#### *Information on counterparties*

3.11 Except where paragraph 3.40 applies and the status of a group of counterparties may be assessed as though it were a single counterparty, the firm must provide information regarding the status of each counterparty including the following:

- a) the names and a description of each counterparty, including the nature of any relationship between the firm and the counterparty;
- b) an assessment of the risk of default of the counterparties in order to support the assessment by the PRA specified in paragraph 3.36;
- c) an assessment of the liquidity position of the counterparties in order to support the assessment by the PRA specified in paragraph 3.37;
- d) an assessment of the counterparties' willingness to pay in order to support the supervisory assessment specified in paragraph 3.38;
- e) a description of the range of circumstances in which the firm might seek to call upon the item including current expectations as to when the item might be called prior to or at the point of non-compliance with the SCR or MCR; and
- f) information on any other factors relevant to the status of the counterparties to support the assessment by the PRA specified in paragraph 3.38.

3.12 Where the counterparties are treated as a group of counterparties in accordance with paragraph 3.40, the information in points (a) to (f) of paragraph 3.11 must be provided in respect of the group of counterparties.

3.13 Where the counterparty is a member of the same group or subgroup as the firm by virtue of Groups 2.1 and 2.4 and has commitments under AOF items to different entities within the group, the information in points (b) to (f) of paragraph 3.11 must include evidence of the ability of the counterparty to satisfy multiple calls on AOF items at the same time, having regard to the circumstances and the entities of the group.

#### *Information on recoverability*

3.14 The firm must provide information regarding the recoverability of the funds, including the following:

- a) details of arrangements which might enhance the recoverability of the item including the availability of collateral;
- b) details of whether national law, in any relevant jurisdiction, prevents a call being made or satisfied, including in the event of resolution, administration or insolvency proceedings being initiated in respect of the firm; and
- c) details of arrangements or circumstances that might prevent a call being made or satisfied in deteriorating financial conditions including non-compliance with the SCR or MCR.

#### *Information on past calls*

3.15 The firm should provide information regarding past calls including the following:

- a) information on its experience of past calls or the collection of other funds due from the same or similar counterparties in the same or similar circumstances;
- b) all relevant available market data relating to past calls or the collection of other funds due from the same or similar counterparties in the same or similar circumstances; and
- c) an assessment as to the relevance and reliability of the information described in points (a) and (b) as regards the expected outcome of future calls by the firm.

#### *Information on processes to identify future changes*

3.16 Firms must provide a description of the processes it has in place to identify any future changes, as specified in paragraph 3.31(d), which may have the effect of reducing the loss-absorbency of the AOF item. The description must include the following:

- a) how it intends to identify changes to:
  - I. the structure or contractual terms of the arrangement, including the cancellation or expiry of an AOF item or the use or call up partly or wholly of an AOF item;

- II. the status of the counterparties concerned, including the default of a counterparty; and
- III. the recoverability of the AOF item, including calls on other AOF items provided by the same counterparties.

- b) how it intends to inform the PRA of changes identified, including what mechanisms it has put in place to identify when the change should be escalated to the administrative, management or supervisory body of the firm and to the PRA.

3.17 When considering whether the amount ascribed to an AOF item continues to reflect its loss-absorbency, the PRA will consider using information obtained from other sources in addition to the information received from firms in accordance with paragraph 3.31(d), including but not limited to:

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

#### *Procedural matters relating to the application*

3.18 Firms are encouraged to include documentary evidence of its internal decision-making process related to the application.

3.19 If there is a change to the details of a firm's application at any time between submission and determination by the PRA, the firm must inform the PRA of these changes. Where a firm informs the PRA of a change to its application this should be treated as a new application unless:

- a) the change is due to a request from the PRA for additional information; or
- b) the PRA is satisfied that the change does not significantly affect its assessment of the application.

3.20 A firm may withdraw an application by notification in writing at any stage prior to the decision of the PRA. If the firm subsequently resubmits the application or submits an updated application, the PRA should treat this as a new application.

3.21 Firms should discuss with the PRA 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.

### **Assessment of the application – general**

3.22 Where the PRA receives an application under for an ancillary own funds permission, and it decides to grant permission, the PRA will, depending on the application received, permit either:

- a) a monetary amount for each AOF item; or
- b) a method by which each AOF item may be determined for a specified period of time.

3.23 The PRA will not permit an unlimited amount of ancillary own funds.

3.24 Where the PRA grants permission for an amount of ancillary own funds, the decision of the PRA will specify whether the amount that has been permitted is the amount for which the firm has applied or a lower amount.

#### *Factors the PRA will consider*

3.25 The PRA will base its approval or variation of approval on an assessment of the information provided, specifically:

- a) the status of the counterparties concerned, in relation to their ability and willingness to pay;
- b) the recoverability of the funds, taking account of the legal form of the ancillary own-fund item and any conditions which would prevent the item from being successfully paid in or called up; and
- c) any information on the outcome of past calls which firms and third-country insurance undertakings have made for AOF items they have paid in or called up, to the extent that such information can be reliably used to assess the expected outcome of future calls.

#### *Application timelines*

3.26 The PRA will confirm receipt of the application of the firm.

3.27 The PRA expects to 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. An application will be considered complete by the PRA if the application covers all the matters set out in paragraphs 3.3 – 3.15. Paragraph 3.16 should also be covered unless there are good reasons not to do so.

3.28 The PRA expects to determine the outcome of a complete application for a classification of own funds permission within three months from the receipt of the application, unless there are exceptional circumstances which are communicated in writing to the firm on a timely basis.

3.29 Where there are exceptional circumstances, the PRA expects to determine the outcome of a complete application within six months from the receipt of the application.

3.30 Where PRA has considered an application to be complete, this will not prevent the PRA from requesting additional information necessary for carrying out its assessment. The request should specify the additional information required and the reasons for the request. The days between the date the PRA requests such information and the date the PRA receives such information should not be included within the periods of time stated in paragraphs 3.28 and 3.29.

3.31 The PRA will take all of the following into account for the purposes of the assessment referred to in paragraph 3.25.

- (a) the legal effectiveness and enforceability of the terms of the commitment in all relevant jurisdictions;
- (b) the contractual terms of the arrangement that the firm has entered into, or will enter into, with the counterparties to provide funds;
- (c) where relevant, the firm's memorandum and articles of association or statutes; and
- (d) whether the firm has processes in place to inform the PRA of any future changes, which may have the effect of reducing the loss-absorbency of the AOF item, to any of the following:
  - i. the structure or contractual terms of the arrangement;
  - ii. the status of the counterparties concerned; or
  - iii. the recoverability of the AOF item.

3.32 The PRA will also assess whether Own funds 2.5 - 2.7 and paragraph 3.25 are complied with taking into account the range of circumstances under which the item can be called up to absorb losses.

3.33 Where the firm is seeking permission of a method by which to determine the amount of each AOF item, the PRA will assess whether the firm's process for regularly validating the method is appropriate to ensure that the results of the method reflect the loss-absorbency of the item on an ongoing basis.

3.34 In addition to the requirements set out in 3.31 – 3.33, the PRA will assess the application for permission of AOF on the basis of the criteria set out in paragraphs 3.35 – 3.43.

## Assessment of the status of the counterparties

3.35 The PRA will take all of the following into account for the purposes of the assessment of the counterparties' ability to pay referred to in paragraph 3.25.

- (a) the risk of default of the counterparties; and
- (b) the risk that default arises from a delay in the counterparties satisfying their commitments under the AOF item.

3.36 In relation to paragraph 3.35(a), the PRA will assess the risk of default of the counterparties by examining the probability of default of the counterparties and the loss given default, taking into account all of the following criteria:

- (a) the credit standing of the counterparties, provided that this appropriately reflects the counterparties' ability to satisfy their commitments under the AOF item;
- (b) whether there are any current or foreseeable practical or legal impediments to the counterparties' satisfaction of their commitments under the AOF item;
- (c) whether the counterparties are subject to legal or regulatory requirements that reduce the counterparties' ability to satisfy their commitments under the AOF item;
- (d) whether the legal form of the counterparties prejudice the counterparties' satisfaction of their commitments under the AOF item;
- (e) whether the counterparties are subject to other exposures which reduce the counterparties' ability to satisfy their commitments under the AOF item; and
- (f) whether, in relation to their commitment under the AOF item, the contractual terms of the arrangement under any applicable law are such that the counterparties have rights to set-off amounts they owe against any amounts owed to them by the firm.

3.37 In relation to paragraph 3.35(b), the PRA will assess the liquidity position of the counterparties, taking into account all of the following:

- (a) whether there are any current or foreseeable practical or legal impediments to the counterparties' ability to promptly satisfy their commitments under the AOF item;
- (b) whether the counterparties are subject to legal or regulatory requirements that may reduce the counterparties' ability to promptly satisfy their commitments under the AOF item; and
- (c) whether the legal form of the counterparties prejudices the counterparties' prompt satisfaction of their commitments under the AOF item.

3.38 The PRA will take all of the following into account for the purposes of the assessment of the counterparties' willingness to pay referred to in paragraph 3.25(a):

- (a) the range of circumstances under which the AOF item can be called up to absorb losses;

- (b) whether incentives or disincentives exist which may affect the counterparties' willingness to satisfy their commitments under the AOF item; and
- (c) whether previous transactions between the counterparties and the firm, including the counterparties' previous satisfaction of their commitments under AOF items, give an indication as to the counterparties' willingness to satisfy their current commitments under the AOF item.

3.39 The PRA will, in assessing the counterparties' ability and willingness to pay, consider any other factors relevant to the status of the counterparties including, where relevant, the firm's business model.

3.40 Where an ancillary own-fund item concerns a group of counterparties, the PRA and firm may assess the status of the group of counterparties as though it were a single counterparty provided that all of the following conditions are fulfilled:

- (a) the counterparties are individually non-material;
- (b) the counterparties included in that group are sufficiently homogeneous; and
- (c) the assessment of a group of counterparties does not overestimate the ability and willingness to pay of the counterparties included in that group.

3.41 A counterparty shall be considered as material where the status of that single counterparty is likely to have a significant effect on the assessment of the group of counterparties' ability and willingness to pay.

### **Assessment of the recoverability of the funds**

3.42 The PRA will take all of the following into account for the purposes of the assessment of the recoverability of the funds referred to in paragraph 3.25(b):

- (a) whether the recoverability of the funds is increased as a result of the availability of collateral or an analogous arrangement that complies with 3G2 - 3G8 of the Solvency Capital Requirement - Standard Formula Part of the Rulebook;
- (b) whether there is any current or foreseeable practical or legal impediment to the recoverability of the funds;
- (c) whether the recoverability of the funds is subject to legal or regulatory requirements; and
- (d) the ability of the firm to take action to enforce the counterparties' satisfaction of their commitments under the AOF item.

### **Information on the outcome of past calls**

3.43 The PRA will take all of the following into account for the purposes of the assessment of the information on the outcome of past calls referred to in paragraph 3.25(c):

- (a) whether the firm has made past calls from the same or similar counterparties under the same or similar circumstances; and
- (b) whether that information is relevant and reliable as regards the expected outcome of future calls.

## Specification of amount and timing relating to the approval of a method

3.44 Where the PRA approves a method to determine the amount of each ancillary own fund item, the PRA' decision will set out all of the following:

- (a) the initial amount of the AOF item that has been calculated using that method at the date the approval is granted;
- (b) the minimum frequency of recalculation of the amount of AOF item using that method where it is more frequent than annual, and the reasons for that frequency; and
- (c) the time period for which the calculation of the AOF item using that method is granted.

## Decision on the application

3.45 When the PRA authority has reached a decision on an application, it will communicate this in writing to the firm.

3.46 Where the PRA approves a lower amount than applied for by the firm or rejects an application for permission, it will state the reasons on which the decision is based.

3.47 Where the PRA permission has been granted, on the condition that the contract is entered into, the firm should, 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 PRA.

3.48 The firm should not consider the AOF item or method admissible until the contract has been entered into.

## Revision of the approved amount or withdrawal of the approval of the method

3.49 Where an AOF item no longer fulfils the conditions under which the permission of an amount or calculation method was granted, the PRA will decide on either of the following actions:

- a) to reduce the amount of an AOF item to a lower amount or to nil; or
- b) to withdraw its approval of a calculation method.

3.50 The PRA will notify the firm, immediately, stating the reasons, where it has decided in accordance with paragraph 3.49.



## 4: Classification of own funds permissions

4.1. This chapter sets out the PRA's approach to applications for classification of own funds permissions in respect of own fund items not covered by the own funds lists (sometimes referred to 'Items not on the lists', or INOLs) as set out in Own Funds 3.4(2).

4.2. When granting these permissions, the PRA would exercise its powers under s138BA of FSMA to grant, vary or revoke a permission, based on the criteria set out below.

### Application for classification of own funds permissions

4.3 When applying to the PRA for a classification of own funds permission, a firm should submit a written application in the form of a cover letter and supporting evidence, for each own fund item, and should approve the application at its governing body.

4.4 The firm should ensure that the cover letter is signed-off by persons authorised to sign on behalf of the AMSB. The covering letter should confirm that:

- a) the firm 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 firm considers that the basic own-fund item will comply, in terms of both legal form and economic substance, with the criteria in Own Funds 3 and the features determining classification set out in Own Funds 3B, 3E and 3G (as applicable); and
- c) no facts have been omitted which if known by the PRA could influence its decision regarding whether to grant a classification of own funds permission for the own-fund item.

4.5 The firm should also list in the cover letter other applications to the PRA for permission submitted by the firm or currently foreseen within the next six months, together with corresponding application dates.

4.6 Within the supporting evidence, the firm should provide:

- a) a description of how the criteria in Own Funds 3 and the features determining classification set out in Own Funds 3B, 3E and 3G have been satisfied (as applicable), including how the item will contribute to the firm's existing capital structure, and how the item may enable the firm to meet its existing or future capital requirements; and

- b) a description of the basic own-fund item, sufficient to allow the PRA to conclude on the loss absorbing capacity of the item. This should include the contractual terms of the arrangement governing the own fund item. It should also include 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.

4.7 The firm should inform the PRA of any change to the details of its application during the application assessment period.

4.8 Where a firm informs the PRA of a change to its application during the application assessment period, the PRA will treat it as a new application unless:

- a) the change is due to a request from the PRA for further information referred to in 4.13; or
- b) the PRA is satisfied that the change does not significantly affect its assessment of the application.

4.9 Firms may withdraw an application by notification in writing at any stage prior to the decision of the PRA. If the firm subsequently resubmits the application or submits an updated application, the PRA will treat this as a new application.

### **Assessment of a classification of own funds permissions**

4.10 The PRA will confirm receipt of the application to the firm, and expects to 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. The PRA will consider an application complete and sufficient to commence their assessment if the application covers all the matters set out in paragraphs 4.3 - 4.6.

4.11 The PRA expects to determine the outcome of a complete application for a classification of own funds permission within three months from the receipt of the application, unless there are exceptional circumstances which are communicated in writing to the firm on a timely basis.

4.12 Where there are exceptional circumstances, the PRA expects to determine the outcome of a complete application within six months from the receipt of the application.

4.13 Notwithstanding a notification considering the application complete in paragraph 4.10, the PRA may request further information from the firm where it is necessary to its assessment of the own fund item. When requesting further information, the PRA will specify the additional information needed and the rationale for the request. The days between the date the PRA

requests additional information and the date the PRA receives such information will not count towards the periods of time stated in paragraphs 4.11 and 4.12.

4.14 The PRA will assess the following, on the basis of documents submitted by the firm, when granting a classification of own fund permission for an own fund item not covered by the own funds lists, as set out in Own Funds 3.4(2):

- a) in relation to each own fund item, the legal enforceability of the contractual terms of the own fund item in all relevant jurisdictions;
- b) in relation to each own fund item whether the own-fund item has been fully paid-in.
- c) where the firm is applying for permission to classify the item as Tier 1 own funds, whether the basic own funds item substantially possesses the characteristics set out in Own Funds 3.5, taking into consideration the features set out in Own Funds 3.6;
- d) where the firm is applying to classify the item as Tier 2 basic own funds, whether the basic own-fund item substantially possesses the characteristics set out in Own Funds 3.5(2), taking into consideration the features set out in Own Funds 3.6;
- e) where the firm is applying to classify the item as Tier 2 ancillary own funds, whether the AOF item substantially possesses the characteristics set out in Own Funds 3.5, taking into consideration the features set out in Own Funds 3.6; and
- f) where the firm is applying to classify the item as Tier 3 basic own funds, whether the basic own funds item possesses the characteristics set out in Own Funds 3.5(2), taking into consideration the features set out in Own Funds 3.6.

## Decision on the application

4.15 When the PRA has reached a decision on an application for a classification of own funds permission, it expects to communicate this in writing to the firm, on a timely basis and within the timelines set out in paragraph 4.10 and 4.11.

4.16 Where the PRA rejects the application, it will state the reasons on which the decision was based.

## 5: Prior permissions for repayment and redemption between five and ten years for restricted Tier 1 own fund items

5.1 This chapter outlines the PRA's approach to applications for prior permission under s138BA for the repayment or redemption of Tier 1 own fund items that display the features that are relevant for restricted Tier 1 own fund items (as defined in the Own Funds Part) between five and ten years after the date of issuance.

5.2 When considering applications for prior permission under these circumstances in accordance with Own Funds 3B.14(1), the PRA will base its assessment on the firm's own assessment of the repayment or redemption, which must address the following:

- a) the current and short-to-medium term impact on the firm's overall solvency position;
- b) how the action is consistent with the firm's medium-term capital management plan and Own Risk and Solvency Assessment (ORSA);
- c) the firm'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; and
- d) 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 ten years after the date of issuance.

5.3 When assessing whether a margin is appropriate, the PRA will take into account:

- a) the current and projected solvency position of the firm, considering the proposed repayment or redemption and any other proposed redemptions and repayments or issuances;
- b) the firm's medium term capital management plan and ORSA;
- c) the volatility of the firm's own funds and SCR, having regard to the nature, scale and complexity of the risks inherent in the business of the firm; and
- d) the extent to which the firm has access to external sources of own funds and the impact of market conditions on the ability of firms to raise own funds.

5.4 Where a firm is proposing a series of repayments or redemptions over a short period of time, it should inform the PRA, which may consider the series of transactions as a whole rather than on an individual basis.

5.5 Firms should submit applications providing the information set out in paragraph 5.3, at least three months prior to the earlier of the required contractual notice to holders of the item of repayment or redemption; or the proposed repayment or redemption date. The PRA expects to determine the outcome of an application for prior permission to repay or redeem an own fund item under these circumstances no later than three months from the date of receipt.

5.6 After receiving prior permission from the PRA for the repayment or redemption the firm 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 on which the permission is granted, 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 firm may reinstate the item as available own funds and the permission for repayment or redemption is revoked.

## 6: Prior permissions for early repayment or redemption

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6.1 This chapter outlines the PRA's approach to applications for prior permission under s138BA for the early repayment or redemption of Tier 1, Tier 2 or Tier 3 own fund items

where there has been either a change in regulatory classification or the applicable tax treatment of the basic own funds item.

6.2 In accordance with Own Funds 3B.1(6)(b), 3E.1(3) and 3G.1(3), Tier 1, Tier 2 or Tier 3 own fund items generally must not contain contractual opportunities to be repaid or redeemed before five years from the date of issuance. These own fund items may include provisions that allow early repayment or redemption to proceed only where certain criteria are met, and the firm has received prior permission from the PRA.

6.3 When considering applications for prior permission under these circumstances in accordance with Own Funds 3B.14(4), 3E.6(4), and 3G.6(3), the PRA will base its assessment on the firm's own assessment of the repayment or redemption, which must address the following:

- a) the current and short-to-medium term impact on the firm's overall solvency position;
- b) how the action is consistent with the firm's medium-term capital management plan and Own Risk and Solvency Assessment (ORSA); and
- c) the firm'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;
- d) how the SCR, after the repayment or redemption, will be exceeded by an appropriate margin taking into account the solvency position of the firm, including the firm's medium-term capital management plan; and
- e) either;
  - i) details of the change in the regulatory classification of the basic own funds item which would likely result in its exclusion from own funds or reclassification as lower tier of own funds, and how this change is both sufficiently certain, and was not reasonably foreseeable at the time of issuance; or
  - ii) details of the change in the applicable tax treatment of the basic own funds item, and how this is material, and was not reasonably foreseeable at the time of issuance.

6.4 When assessing whether a margin is appropriate, the PRA will take into account:

- a) the current and projected solvency position of the firm, considering the proposed repayment or redemption and any other proposed redemptions and repayments or issuances;

- b) the firm's medium term capital management plan and ORSA;
- c) the volatility of the firm's own funds and SCR, having regard to the nature, scale and complexity of the risks inherent in the business of the firm; and
- d) the extent to which the firm has access to external sources of own funds and the impact of market conditions on the ability of firms to raise own funds.

6.5 Where a firm is proposing a series of repayments or redemptions over a short period of time, it should inform the PRA, which may consider the series of transactions as a whole rather than on an individual basis.

6.6 Firms should submit applications providing the information set out in paragraph 6.3, at least three months prior to the earlier of the required contractual notice to holders of the item of repayment or redemption; or the proposed repayment or redemption date. The PRA expects to determine the outcome of an application for prior permission to repay or redeem an own fund item under these circumstances no later than three months from the date of receipt.

6.7 After receiving prior permission from the PRA for the repayment or redemption the firm 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 on which the permission is granted, 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 firm may reinstate the item as available own funds and the permission for repayment or redemption is revoked.

## 7: Own funds permissions when not in compliance with the SCR

7.1 This chapter outlines the PRA's approach to applications for the Own Funds permissions relevant where a firm is not in compliance with its SCR. These permissions, which the PRA may grant under s138BA of FSMA, relate to specific provisions that may be included within the terms and conditions of own fund items classified as Tier 1, Tier 2 or Tier 3 basic own funds.

7.2 Where own fund items have previously been issued with terms and conditions containing references to exceptional waivers from the PRA, applications for such exceptional waivers will now be treated as requiring a permission under s138BA of FSMA, and will be assessed as set out below.

### Prior permission to waive suspension of repayment or redemption when not in compliance with the SCR

7.3 In accordance with Own Funds 3B.1(10), 3E.1(6) and 3G.1(6), Tier 1, Tier 2 or Tier 3 own fund items firms must generally provide for repayment or redemption to be suspended when the firm does not comply with the SCR, or when the repayment or redemption of the item would lead to non-compliance with the SCR. These own fund items may include provisions that allow repayment or redemption to proceed under these circumstances only where certain criteria are met, and the firm has received prior permission from the PRA.

7.4 When considering applications for prior permission under these circumstances in accordance with Own Funds 3B.14(2), 3E.6(2), and 3G.6(2), the PRA will base its assessment on the firm's own assessment of the repayment or redemption, which must address the following:

- a) the current and short-to-medium term impact on the firm's overall solvency position;
- b) how the action is consistent with the firm's medium-term capital management plan and Own Risk and Solvency Assessment (ORSA);
- c) the firm'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;



- d) the proposed exchange or conversion mentioned in paragraph 7.6(a) 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; and
- e) how the proposed exchange or conversion is, or would be, consistent with the recovery plan required by Undertakings in Difficulty 3.1(2).

7.5 Where a firm is proposing a series of repayments or redemptions over a short period of time, it should inform the PRA, which may consider the series of transactions as a whole rather than on an individual basis.

7.6 The PRA will grant this permission only where it is satisfied with the firm's justification and analysis described in paragraph 7.4, and where it is satisfied that the following criteria are met:

- a) the own fund item will be exchanged for or converted into an item of at least the same quality; and
- b) the firm complies with the Minimum Capital Requirement (MCR) after the repayment or redemption.

7.7 Firms must submit applications providing the information set out in paragraph 7.4, at least three months prior to the earlier of the required contractual notice of repayment or redemption to holders of the item, or the proposed repayment or redemption date. The PRA expects to determine the outcome of an application for prior permission to repay or redeem an own fund item under these circumstances no later than three months from the date of receipt.

7.8 After receiving prior permission from the PRA for the repayment or redemption the firm 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 on which the permission is granted, 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 firm may reinstate the item as available own funds and the permission for repayment or redemption is revoked.

## **Prior permission to waive cancellation or deferral of distributions when not in compliance with the SCR**

7.9 In accordance with Own Funds 3B.1(12) and 3E.1(8), Tier 1 and Tier 2 own fund items must generally provide for distributions to be cancelled or deferred where there is non-compliance with the SCR, or when the distribution would result in non-compliance with the SCR. These own fund items may include provisions that allow distributions to be made under these circumstances only where certain criteria are met, and the firm has received prior permission from the PRA in accordance with Own Funds 3B.14(3) and 3E.6(3).

7.10 The PRA will grant this permission only where it is satisfied that the following criteria are met:

- a) the distribution will not further weaken the solvency position of the firm; and
- b) the MCR will be complied with after the distribution is made.

7.11 When considering applications for prior permission under these circumstances, the PRA will base its assessment on the firm's demonstration of how the distribution could be made without weakening their solvency position, and how the MCR would be met. In addition, where a firm is applying for prior permission in respect of settlement through an alternative coupon satisfaction mechanism, the PRA will also base its assessment on the firm's assessment of the following:

- a) the amount of ordinary share capital that would need to be issued;
- b) the extent to which restoring compliance with the SCR would require the raising of new own funds; and
- c) the likely impact of the share issuance for the purposes of the alternative coupon satisfaction mechanism on the firm's ability to raise those own funds.

## Permission to waive the triggering of a principal loss absorbency mechanism

7.12 In accordance with Own Funds 3B.1(5), restricted Tier 1 own fund items must possess a principal loss absorbency mechanism that is triggered at specific trigger events representing significant non-compliance with the SCR. These own fund items may include provisions that allow the principal loss absorbency mechanism not to trigger on the occurrence of a trigger event only where certain criteria are met, and the firm has received prior permission from the PRA in accordance with Own Funds 3B.16.

7.13 When considering applications for prior permission under these circumstances, the PRA will base its assessment on the following pieces of information provided by firms:

- a) projections submitted with the recovery plan required by Group Supervision 4.4(2) and Undertakings in Difficulty 3.1(2) that demonstrate that triggering the principal loss absorbency mechanism would be very likely to give rise to a tax liability that would have a significant adverse effect on the firm's solvency position; and
- b) a certificate issued by the firm's statutory auditors certifying that all of the assumptions used in the projections are realistic.

7.14 The PRA will grant this permission only where it is satisfied with the firm's analysis and documentation described in paragraph 7.13, and where it is satisfied that the following criteria are met:

- a) the trigger event occurs in the circumstances described in Own Funds 3B.10(3); and
- b) there have been no previous trigger events in the circumstances described in Own Funds 3B.10(1) or 3B.10(2).