BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Reporting the reduction in loss-absorbing capacity of own fund instruments that are taxed on write down

This note sets out how firms should reflect the following items in Solvency II reporting:

a) equity accounted restricted tier 1 (rT1) which are either internally issued or which convert on trigger – ie equity accounted rT1 instruments not within the scope of PRA Policy Statement (PS) 4/19;[1] and

b) equity accounted rT1 instruments within the scope of PS4/19, for which an adjustment is expected to reflect the reduction in the loss absorbency arising where own fund instruments are taxed on write down.

This note is relevant to all firms in scope of Solvency II[2] and the Society of Lloyd's, and relates to the Implementing Technical Standards (ITS) on Supervisory Reporting.[3] The clarification applies to both the S.23.01.01 solo and S.23.01.04 group version of the S.23.01 Own funds template, hereafter referred to as 'S.23.01'.

This note should be read alongside PS4/19 and Supervisory Statement 3/15[4] which sets out the PRA's expectation that firms will deduct the maximum tax charge generated on write-down, when including externally issued rT1 capital instruments which write down on trigger in their own funds.

Under the accounting standard IAS 32 Financial Instruments: Presentation, rT1 instruments can be classified as either financial liabilities or equity instruments. All UK rT1 instruments issued as at the date of this publication are classified as equity under IAS 32.

Equity accounted rT1 instruments which are either internally issued or which convert on trigger - instruments not within the scope of PS4/19.

The PRA expects that firms will report an amount equal to the gross value of the rT1 in row 90 'Preference shares' on the S.23.01 Own funds template.

Although the Solvency II compliant rT1 instruments issued to date are not preference shares, the more appropriately named 'Subordinated liabilities' in row 140 of the S.23.01 template cannot be used for equity accounted rT1 instruments. This is because row 140 of template S.23.01 has a validation check to row 870 of the S.02.01 balance sheet template. Therefore it can only be used to report instruments classified as a financial liabilities on the Solvency II balance sheet.

1 'Solvency II: Adjusting for the reduction of loss absorbency where own fund instruments are taxed on write down', January 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/solvency-ii-adjusting-for-reduction-loss-absorbency-where-own-fund-instruments-taxed-on-write-down.

2 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast).

3 Commission Implementing Regulation 2015/2450 laying down Implementing Technical Standards (ITS) with regard to the templates for the submission of information to the supervisory authorities.

4 'Solvency II: the quality of capital instruments', January 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-the-quality-of-capital-instruments-ss.

Externally issued, equity accounted rT1 instruments which write down on trigger and are within scope of PS4/19

Reporting template S.23.01

When reporting rT1 instruments that are classified as equity under International Financial Reporting Standards (IFRS), and externally issued and write down on trigger, the PRA expects that firms will:

- report an amount equal to the gross rT1 instrument in row 90 'Preference shares' on the S.23.01 Own Funds template; and

- report the amount which equals the adjustment for reduced loss absorbency, in row 220 'Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds' on the S.23.01 Own Funds template.

Although the Solvency II compliant rT1 instruments issued to date are not preference shares, the more appropriately named 'Subordinated liabilities' in row 140 of the S.23.01 template cannot be used for equity accounted rT1 instruments. This is because row 140 of template S.23.01 has a validation check to row 870 of the S.02.01 balance sheet template. Therefore it can only be used to report instruments classified as a financial liabilities on the Solvency II balance sheet.

Row 220 in S.23.01 is reported as a total amount adjusting basic own funds. As the columns relating to the specific own funds tiers for this row are crossed, the validation in row 290 'Total basic own funds after deductions - Tier 1 – unrestricted' deducts the total amount reporting in row 220 of S.23.01 from Tier 1 – unrestricted own funds. That being the case, the use of row 220 will result in:

- a reduction in row 290 of 'Total basic own funds after deductions - Tier 1 – unrestricted' by the value of the amount reported in row 220; and
- an amount gross of the adjustment reported in row 290 for 'Total basic own funds after deductions - Tier 1 – restricted'.

This is not correct, since the adjustment should be to Tier 1 restricted. However this cannot be achieved directly using the reporting template, because of the current validations. To address this:

- PRA supervisors will adjust the figures for supervisory purposes following submission of the S23.01 template; and
- the PRA expects that firms will adjust the total amounts reported in row 290 of the S.23.01 template when producing the Solvency and Financial Condition Report to ensure that the adjustment is correctly reflected as being applied to rT1 and not unrestricted Tier 1.

Other Solvency II templates which report rT1 instruments
When reporting rT1 instruments that are classified as equity under IFRS, and externally issued and write down on trigger in other Solvency II templates, the PRA expects that firms will:

- report an amount equal to the gross rT1 instrument in the S.23.02.01 and S.23.02.04 ‘Detailed information by tiers on own funds’ templates and the 23.04.01 and S.23.04.04 ‘List of items on own funds’ templates because these are linked via validation to row 90 of S.23.01;
- report an amount equal to the gross rT1 instrument in the S.29.01 ‘Excess of Assets over Liabilities’ template; and
- reflect the annual impact of the adjustment for loss absorbency of the rT1 instrument, as well as an amount equal to the rT1 instrument net of the adjustment for the reduction in loss absorbency in the S.23.03.01 and S.23.03.04 ‘Annual movements on own funds’ templates.

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