

Final Report

on

Public Consultation No. 14/036 on

Guidelines on ring-fenced 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 ring-fenced funds. The Guidelines relate to Articles 99(b) and 111(1)(h) of Directive 2009/138/EC¹ (Solvency II Directive), and to Articles 80, 81, 216 and 217 of the Implementing Measures².

As a result of the above, on 2 June 2014 EIOPA launched a public consultation on draft Guidelines on ring-fenced funds. The Consultation Paper is also published on EIOPA's website³.

These Guidelines are issued to NCAs to promote effective supervisory practices and consistent application of Union law with regards to the identification and treatment of ring-fenced funds including:

- The identification of whether any own-fund items have a reduced capacity to fully absorb losses on a going-concern basis;
- The determination of what constitutes the assets and liabilities of the ring-fenced fund;
- The calculation of the notional Solvency Capital Requirement (SCR) for each ring-fenced fund;
- In the case where the SCR is calculated using an internal model, the nature of evidence undertakings should provide in order to assess the system for measuring diversification effects.

¹ OJ L 335, 17.12.2009, p. 1–155

² As published by the European Commission on 10 October 2014:

http://ec.europa.eu/internal_market/insurance/docs/solvency/solvency2/delegated/141010-delegated-act-solvency-2_en.pdf

³ <https://eiopa.europa.eu/consultations/consultation-papers/2014-closed-consultations/june-2014/public-consultation-on-the-set-1-of-the-solvency-ii-guidelines/index.html>

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 on EIOPA's website.

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.

Main comments received and EIOPA's response

This section highlights the main comments received during the public consultation and how EIOPA has responded to them, including how the proposal has been amended in the light of these comments.

1. Arrangements and products that are generally outside of the scope of ring-fenced funds

- a) The respondents to the public consultation welcomed the fact that EIOPA had sought to clarify which types of arrangements and products are generally not considered to be ring-fenced funds according to Solvency II. It was, however, advocated that a number of other arrangements should be considered as outside of the scope of ring-fenced funds, including traditional life management funds and assets pledged as collateral for reinsurance arrangements.
- b) With respect to the particular arrangements highlighted by respondents, EIOPA believes that it is not possible to generalise as to whether a ring-fenced fund would normally arise. There are certain collateral provisions for example, which take the form of a legally binding agreement, charge or trust for the benefit of specified policyholders, and therefore in that case a restriction on the assets is likely to be created. Thus, when identifying the nature of any restrictions affecting assets and own-funds within their business in accordance with the Guidelines, undertaking will need to consider the particular nature of the life management fund or collateral arrangement. As a result, EIOPA has not added to the list of arrangements in Guideline 3.

2. Time period for which restrictions on assets are specified

- a) It was asserted by a number of stakeholders that restrictions which only apply temporarily should not result in ring-fenced funds. In particular, it was argued that the provision to consider restrictions which are specified for a limited period of time was 'going beyond' the Implementing Measures. It was also noted that there was an apparent inconsistency between this and another provision, which stated that coverage assets and similar arrangements that are established for the protection of policyholders in the case of winding-up proceedings are generally outside of the scope of ring-fenced funds.

- b) Article 80 of the Implementing Measures states that undertakings need to reduce their amount of own funds where there are own-fund items which have a reduced capacity to fully absorb losses on a going-concern basis, due to their lack of transferability within the undertaking. The time period for which the restrictions apply is not specified. EIOPA does not consider this to mean that the restrictions need to apply indefinitely whilst the undertaking is a going concern. Rather, as explained in Recital 39 of the Implementing Measures, it is to contrast with arrangements that only affect loss-absorbency in the case of winding-up, which are not considered as ring-fenced funds.

In seeking to provide for a practical and appropriate application of the requirement in Article 80 of the Implementing Measures, EIOPA has specified that undertakings need to consider all restrictions on assets and own funds at the time that they calculate their SCR. Even if the restriction applies for a limited period of time, this should be reflected in the SCR calculation, as there would be a reduced ability of those own-fund items to absorb losses when needed. If the restrictions cease to apply, then it would be reflected the next time that the undertaking calculates their SCR.⁴ Consequently, EIOPA does not consider that it is appropriate to prescribe any minimum time period for which restrictions need to be in place in order to be of relevance.

Although EIOPA considered it to be clear that ring-fenced funds arise from restrictions on own-fund items on a going-concern basis, EIOPA has adjusted the wording of the Guidelines to avoid any apparent inconsistency and lack of clarity.

3. Non-material ring-fenced funds

- a) Various stakeholders argued that the proposed treatment of non-material ring-fenced funds was not proportionate. Respondents stated that the elements to be taken into account in order to determine whether or not a ring-fenced fund is material were unduly burdensome. The inclusion of the assets and liabilities of non-material ring-fenced funds within the SCR calculation was also judged to be inconsistent with Article 81(2) of the Implementing Measures and disproportionate.
- b) Following the comments made, EIOPA continues to believe that the treatment of materiality described in the Guidelines is appropriate. Regarding the first point, in order to assess the materiality of a ring-fenced fund, undertakings will need to evaluate and quantify the nature and impact of the ring-fenced fund in terms of its assets, liabilities, risks and its likely effect on the SCR calculation. EIOPA considers it important to describe the main elements of this assessment in order to support a convergent approach and does not consider these elements to be unduly burdensome. Moreover, if an undertaking has

⁴ According to Article 102 of the Solvency II Directive, undertakings are required to calculate their SCR at least annually or if their risk profile deviates significantly from the assumptions underlying the last reported SCR.

satisfactorily demonstrated that a particular ring-fenced fund is not material, where there are not substantive changes to the nature of the ring-fenced fund or undertaking, it should be possible to continue to rely on the assessment made.

Regarding the second point; Article 81(2) of the Implementing Measures obviates the need for the undertaking to calculate a notional SCR for the ring-fenced fund, as it would otherwise have to, by providing that for non-material ring-fenced funds, undertakings may reduce their own funds by the amount of restricted own funds within the ring-fenced fund. Article 81(2) of the Implementing Measures therefore recognises that an additional SCR calculation would not be proportionate in the case of non-material ring-fenced funds. In particular, the derogation is from paragraph 1 of Article 81 of the Implementing Measures; it does not provide that the assets and liabilities in the non-material ring-fenced fund should be excluded from the scope of the SCR calculation as a whole. Consequently, from a legal perspective, EIOPA considers that the approach taken in the Guideline is strictly consistent with the Implementing Measures. From a prudential perspective, the SCR is intended to capture the risks arising from all of the assets held by the undertaking. Even if the restricted own funds are not included within the undertaking's available own funds, the ring-fenced fund may still pose risks to the undertaking as a whole, and for example require capital support. Finally, given that the ring-fenced fund is non-material, EIOPA does not agree that this is an overly burdensome approach.

4. Calculation of the SCR in the presence of ring-fenced funds using an internal model

- a) It was commented that the evidence that undertakings should provide to the supervisory authority, in order to demonstrate that an internal model adequately takes into account the effect on diversification of the presence of ring-fenced funds, appeared to be too burdensome. As an alternative, it was proposed that a proper dialogue should take place between the undertaking and supervisory authority.
- b) In response to this, first it is important to mention that the conditions in Article 234 of the Implementing Measures mean that an undertaking needs to be able to clearly and precisely evidence how they have recognised diversification effects within the internal model, based on detailed analysis and appropriate data and assumptions. Second, the nature of ring-fenced funds is such that there is a presumption of limited diversification among ring-fenced funds or between the ring-fenced funds and the remaining part of the undertaking. Thus, EIOPA considers that it is appropriate to specify the particular elements that need to be considered when measuring diversification effects in the context of ring-fenced funds. This provides a common basis for assessments by supervisory authorities and indicates to undertakings what is expected. It should also facilitate effective dialogue between undertakings and supervisory authorities on the suitability of the modelling of diversification. Consequently,

EIOPA believes that the proposed approach is appropriate and has not changed the Guideline.

5. Reporting of the SCR split by risk modules

- a) One stakeholder argued that the specification of how to meet the requirement for undertakings to report the SCR split by risk modules was 'going beyond' what was required by the Implementing Measures.
- b) EIOPA does not agree with this comment and has not changed the Guideline and associated Technical Annex. Where there are ring-fenced funds, EIOPA maintains that in order for the reporting requirements in Articles 297 and 311 of the Implementing Measures to be met, in a meaningful way, it is important for the effects of non-diversification to be identified. EIOPA recognises that this is not necessarily a straightforward task, and for this reason set out two simplification approaches in the Technical Annex, which it considers to not be unduly burdensome.

6. Assets and liabilities of a ring-fenced fund

- a) A number respondents to the public consultation commented on the Guideline relating to the assets and liabilities in a ring-fenced fund, in terms of its clarity and whether the provisions were suitable in view of the variety of ring-fenced funds in operation within the Union. One of the concerns expressed was that additional requirements were being imposed regarding the calculation of the liabilities in the ring-fenced fund. Another issue raised was that the proposals were too prescriptive, and, for instance, did reflect the fact that cash flows arising in respect of some insurance liabilities may be attributed between the ring-fenced fund and the remainder of the undertaking.
- b) In view of these comments, EIOPA has amended the Guideline, including removing some of the details, improving the clarity of the drafting and changing the structure. Regarding the latter, there are now three separate Guidelines covering the assets in the ring-fenced funds (Guideline 6), the liabilities in a ring-fenced fund (Guideline 7), and future shareholder transfers (Guideline 8). It has also been clarified that the assets in the ring-fenced fund are identified with reference to the particular restrictions in the arrangement giving rise to the ring-fenced fund, and therefore do not necessarily include all related cash flows from the assets.

Regarding the calculation of the liabilities in the ring-fenced fund, the proposed Guideline was intended to explain how this calculation may vary depending on how the restrictions giving rise to the ring-fenced fund have been defined. However, as the Guideline does not appear to have been clear, appropriate or consistent with the Implementing Measures in all cases, these paragraphs have been removed. In the revised Guidelines, only the more general point is made that the liabilities should be those which are properly attributable to the policies or risks covered by the ring-fenced fund. As a result, EIOPA considers that

these revisions address the stakeholder concerns regarding the suitability of the Guidelines for different types of ring-fencing arrangements.

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 non-confidential 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 and Internal Models, as well as the particular comments on the Guidelines at hand, can be consulted on EIOPA's website⁵.

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 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.

⁵ <https://eiopa.europa.eu/about-eiopa/organisation/stakeholder-groups/sgs-opinion-feedback/index.html>

Annex: Guideline

1. Guidelines on ring-fenced funds

Introduction

- 1.1. According to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (hereinafter "EIOPA Regulation")⁶ EIOPA is drafting Guidelines on ring-fenced funds.
- 1.2. The Guidelines relate to Articles 99(b) and 111(1)(h) of 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 (hereinafter "Solvency II")⁷ as well as to Articles 80, 81, 216 and 217 of the Implementing Measures.
- 1.3. These Guidelines are addressed to supervisory authorities under Solvency II.
- 1.4. These Guidelines are intended to promote a consistent approach by assisting undertakings and supervisory authorities in:
 - (a) the identification of whether any own-fund items have a reduced capacity to fully absorb losses on a going-concern basis due to their lack of transferability within the undertaking, having regard to the different national, legal and product frameworks in Member States which might give rise to ring-fenced funds and having regard to how these own-fund items are calculated;
 - (b) the determination of what constitutes assets and liabilities of the ring-fenced fund through identification of the assets and liabilities associated with any restricted own-fund items;
 - (c) the calculation of the notional Solvency Capital Requirement (hereinafter "SCR") for each ring-fenced fund where the SCR is calculated using the standard formula or using an internal model;
 - (d) the comparison of the amount of the restricted own-fund items within the ring-fenced fund with the notional SCR of the ring-fenced fund;
 - (e) the calculation by undertakings of the SCR where one or more ring-fenced funds exist;
 - (f) in the case where the SCR is calculated using an internal model, the nature of evidence undertakings should provide to supervisory authorities in order to assess the system for measuring diversification effects, taking account of any material restrictions on diversification which arise from the existence of ring-fenced funds.

⁶ OJ L 331, 15.12.2010, p. 48-83

⁷ OJ L 335, 17.12.2009, p. 1-155

- 1.5. The requirement to calculate a notional SCR in respect of a ring-fenced fund does not require undertakings to maintain an amount of own funds within a ring-fenced fund equal to or greater than the notional SCR. However, where the amount of own funds within a ring-fenced fund is less than the notional SCR, the undertaking will not be in compliance with its SCR unless the total of the own funds within the ring-fenced fund and within the remaining parts of the undertaking combined are sufficient to cover that SCR, after application of the limits set out in Article 82 of the Implementing Measures.
- 1.6. These Guidelines, except for Guidelines 1 to 5, are relevant to the treatment of portfolios of assets and obligations to which a matching adjustment is applied following supervisory approval.
- 1.7. If not defined in these Guidelines the terms have the meaning defined in the legal acts referred to in the introduction.
- 1.8. The Guidelines shall apply from 1 April 2015.

Guideline 1 - Characteristics and scope of ring-fenced funds

- 1.9. Undertakings should identify ring-fenced funds by reference to the following characteristics:
 - (a) the existence of a restriction on assets in relation to certain liabilities on a going-concern basis, which would lead to restricted own funds within the business of an undertaking, is the defining characteristic of a ring-fenced fund;
 - (b) ring-fenced funds may arise where profit participation forms part of the arrangement and also in the absence of profit participation;
 - (c) while the ring-fenced assets and liabilities should form an identifiable unit, in the same manner as though the ring-fenced fund were a separate undertaking, it is not necessary that these items are managed together as a separate unit or form a separate sub-fund for a ring-fenced fund to arise;
 - (d) where proceeds of, or returns on, the assets in the ring-fenced fund are also subject to the ring-fenced fund arrangement, undertakings are able to trace them at any given time, i.e. undertakings are able to identify items as covered by, or subject to, the arrangement giving rise to the ring-fenced fund.

Guideline 2 - Arrangements and products that are generally outside the scope of ring-fenced funds

- 1.10. In the process of identifying ring-fenced funds, undertakings should consider the following arrangements and products as generally outside the scope of ring-fenced funds:
 - (a) conventional unit-linked products, as referred to in Article 132(3) of Solvency II;

- (b) conventional index-linked products, as referred to in Article 132(3) of Solvency II;
- (c) provisions, including technical provisions and equalisation provisions and reserves set up in accounts or financial statements prepared under the requirements applying in a particular jurisdiction are not ring-fenced funds solely by virtue of being set up in such financial statements;
- (d) conventional reinsurance business provided that individual contracts do not give rise to restrictions on the assets of the undertakings;
- (e) coverage assets and similar arrangements that are established for the protection of policyholders in the case of winding-up proceedings, either for the policyholders of the undertaking as a whole or for separate sections or groups of policyholders of the undertaking, including assets identified in the register in accordance with Articles 275(a) and 276 of Solvency II (the special register);
- (f) separation of life and non-life business in composite undertakings which carry out simultaneously life and non-life or health insurance activities set out in Articles 73 and 74 of Solvency II, but not disregarding the fact that a ring-fenced fund may still arise within either or both of the component parts of composite undertakings depending on the nature of the underlying business;
- (g) surplus funds are not ring-fenced solely by virtue of being surplus funds, but could be if they are generated within a ring-fenced fund;
- (h) transfer of a portfolio into an undertaking during a reorganisation of a business, where the separation of assets in respect of the existing business of the receiving undertaking from the assets of the transferred portfolio does not constitute a ring-fenced fund, if this separation has been put in place under national law to protect the existing business from the fund that is being transferred-in only on a temporary basis;
- (i) experience funds, where policyholders are entitled to a share of the experience of the fund in a manner, typically a minimum predefined percentage, set out in the policy documentation, and have no rights to any amounts not allocated in accordance with that specified profit-sharing mechanism. Amounts allocated to policyholders are included in technical provisions. Amounts not allocated to policyholders are fully transferable, can be returned to the shareholders or other providers of capital, can be used to absorb losses as and when they occur or can be, but are not required to be, used to increase benefits to policyholders and can therefore form part of own funds not subject to restriction.

Guideline 3 - Restrictions giving rise to ring-fenced funds

- 1.11. Undertakings should identify the nature of any restrictions affecting assets and own funds within their business and the associated liabilities in respect of the

contracts, policyholders or risks for which such assets and own funds can be used.

- 1.12. In order to identify any such restrictions which give rise to a ring-fenced fund undertakings should consider at least:
- (a) the contractual terms;
 - (b) any separate legal arrangement that applies in addition to the terms of a policy;
 - (c) provisions in the articles, statutes or other document giving rise to the undertaking's formation or organisation;
 - (d) national legislation or regulations in respect of product design or the conduct of the relationship between undertakings and their policyholders: ring-fenced funds would arise where, as a result of legal provisions protecting the general good in a Member State, an undertaking must apply particular assets only for the purposes of a particular part of its business;
 - (e) provisions of European Union law, whether transposed or directly applicable;
 - (f) arrangements specified by order of a court or other competent authority which require separation of or restrictions on assets or own funds in order to protect one or more groups of policyholders.
- 1.13. Undertakings should take into account all restrictions affecting assets and own funds in place at the time that the SCR is calculated, irrespective of the time period for which those restrictions apply on a going-concern basis.

Guideline 4 - Scope of ring-fenced funds treatment

- 1.14. Undertakings identifying characteristics and restrictions giving rise to ring-fenced funds treatment should at a minimum compare arrangements within their business with the following types of ring-fenced funds:
- (a) a fund of assets and liabilities in respect of profit participation ("with profits") business that is only available to cover losses arising in respect of particular policyholders or in relation to particular risks and where the following key features exist:
 - (i) policyholders within the ring-fenced fund have distinct rights relative to other business written by the undertaking;
 - (ii) there are restrictions on the use of assets, and the return on such assets, within this fund to meet liabilities or losses arising outside the fund;
 - (iii) an excess of assets over liabilities is generally maintained within the fund and this excess is restricted own funds, since its use is subject to the restrictions referred to in point (ii);

- (iv) there is generally profit participation within the ring-fenced fund whereby policyholders receive a minimum proportion of the profits generated in the fund which are distributed through additional benefits or lower premium, and, if relevant, shareholders may then receive the balance of such profits;
- (b) a legally binding arrangement or trust created for the benefit of policyholders, where, within or separate to the policy documentation, an agreement calls for certain proceeds or assets to be placed in trust or subject to a legally binding arrangement or charge for the benefit of the specified policyholders;
- (c) ring-fenced funds, which reflect the restrictions on particular assets or own funds as specified in the articles, statutes or other document giving rise to the undertaking's formation or organisation;
- (d) ring-fenced funds that arise to reflect the effect of restrictions or arrangements specified in national law;
- (e) arrangements falling within the scope of European Union law, including Solvency II and the Implementing Measures:
 - (i) Article 304 of Solvency II, which introduces a requirement for ring-fencing regarding occupational retirement provision business and retirement benefits. As a result, this type of ring-fenced fund needs to be considered for a potential adjustment to own funds according to Articles 80 and 81 of the Implementing Measures. However, the requirement in Article 217 of the Implementing Measures to calculate the SCR as the sum of notional SCRs for the ring-fenced funds and the remaining part does not apply, as Article 304 of Solvency II permits diversification effects to be recognised provided that the interests of policyholders and beneficiaries in other Member States are safeguarded;
 - (ii) Article 4 of Directive 2003/41/EC, which provides an option for Member States to apply certain provisions of that Directive to the occupational retirement provision business of insurance undertakings, subject to a ring-fencing requirement applying to the assets and liabilities of that business. This provision may be relevant in respect of business dealt with in this manner for undertakings which have not received authorisation under Article 304 of Solvency II. In this case, the requirements of Articles 81 and 217 of the Implementing Measures apply. Until 31 December 2019, Article 308b(15) of Solvency II provides a transitional measure for this business permitting the use of the laws, regulations and administrative provisions adopted by Member States concerning the relevant articles of Directive 2002/83/EC.

1.15. Undertakings should recognise that the reduced transferability of assets and scope for diversification between the assigned portfolio of the matching

adjustment and the remainder of the undertaking means that the assessments, assumptions and calculations set out in Articles 81, 216, 217 and 234 of the Implementing Measures apply to such portfolios of the matching adjustment. Undertakings should apply Guidelines 6 to 17 where they have matching adjustment portfolios.

Guideline 5 - Materiality

- 1.16. Where a ring-fenced fund is not material, Article 81 of the Implementing Measures permits undertakings to exclude the total amount of restricted own-fund items from the amount eligible to cover the SCR and the Minimum Capital Requirement (hereinafter "MCR"). In this case, in accordance with Article 216 of the Implementing Measures, undertakings are not required to calculate a notional SCR for the ring-fenced fund. However, undertakings should include the assets and liabilities of the non-material ring-fenced fund within the remaining part of the undertaking. These assets and liabilities will form part of the undertakings' overall SCR calculation.
- 1.17. Undertakings should consider the materiality of a ring-fenced fund by assessing:
- (a) the risks arising from or covered by the ring-fenced fund;
 - (b) the assets and liabilities within the ring-fenced fund;
 - (c) the amount of restricted own funds within the ring-fenced fund, the volatility of those amounts over time and the proportion of total own funds represented by restricted own funds;
 - (d) the proportion of the undertaking's total assets and capital requirements that the ring-fenced fund represents, individually or combined with other ring-fenced funds;
 - (e) the likely impact of the ring-fenced fund on the calculation of the SCR due to the reduced scope for risk diversification.

Guideline 6 - Assets in a ring-fenced fund

- 1.18. Undertakings should identify the assets in a ring-fenced fund as comprising any specified assets or pools of assets, and any related cash flows, which are restricted by the arrangements giving rise to the ring-fenced fund as described in Guideline 3.

Guideline 7 - Liabilities in a ring-fenced fund

- 1.19. Undertakings should identify the liabilities in a ring-fenced fund as only comprising those liabilities properly attributable to the policies or risks covered by the ring-fenced fund or those for which the assets subject to restriction can be used. When determining liabilities of a ring-fenced fund in respect of profit participation business, undertakings should include within the best estimate

liabilities any future discretionary benefits which the undertaking expects to pay.

- 1.20. Undertakings should ensure that the valuation of liabilities, including where appropriate future discretionary benefits, used for the purpose of the ring-fenced fund calculations is the same as the valuation which would have been derived for those liabilities if they were not included in a ring-fenced fund.

Guideline 8 - Future shareholder transfers

- 1.21. When applying Article 80(2) of the Implementing Measures, undertakings should consider future transfers attributable to shareholders as:
 - (a) only relevant in the context of profit participation business;
 - (b) coming into existence when the corresponding future discretionary benefits are recognised in the best estimate liability;
 - (c) being part of the ring-fenced fund's excess of assets over liabilities, not as a liability of the ring-fenced fund;
 - (d) including transfers which relate to declared bonuses already included in guaranteed benefits but where the corresponding distribution to shareholders has not yet been transferred out of the ring-fenced fund.

Guideline 9 - Calculating the notional SCR of a ring-fenced fund: standard formula

- 1.22. Undertakings should perform the following steps in applying the methodology set out in Article 217 of the Implementing Measures:
 - (a) in applying the SCR calculation methodology to the assets and liabilities within a ring-fenced fund as if the ring-fenced fund were a separate undertaking, undertakings should include a capital requirement for operational risk as well as any relevant adjustments for the loss-absorbing capacity of technical provisions and deferred taxes;
 - (b) in aggregating the capital requirements under the worst case scenario for the undertaking as a whole for each sub-module and risk module using the procedure for aggregation of the standard formula prescribed by Article 104 of Solvency II, undertakings may recognise diversification of risks within the ring-fenced fund;
 - (c) the capital requirement at the level of each ring-fenced fund should be calculated net of the mitigating effect of any future discretionary benefits. Where profit participation exists, assumptions regarding the variation of future bonus rates should be realistic and have due regard to the impact of the shock at the level of the ring-fenced fund, including the impact on the value of future transfers attributable to shareholders, and to any contractual, legal or statutory requirements governing the profit participation mechanism;

- (d) if, as a result of bidirectional scenarios, the risk charge for the worst case scenario is negative, even after taking into account any potential increase of liabilities due to profit participation mechanisms, and would therefore result in an increase in basic own funds within the ring-fenced fund, then the charge should be set to zero.

Guideline 10 - Calculation of the notional SCR of a ring-fenced fund: internal model

1.23. In order to calculate the notional SCR for a ring-fenced fund in accordance with Article 81(1)(a) of the Implementing Measures, undertakings should ensure that:

- (a) the internal model is capable of performing the calculation of the notional SCR for each ring-fenced fund as if each ring-fenced fund were a separate undertaking pursuing only the business included in that ring-fenced fund;
- (b) the calculation of each notional SCR is consistent with the calculation of the SCR for the undertaking as a whole;
- (c) the risk mitigation techniques and future management actions taken into account to calculate the notional SCR of each ring-fenced fund are consistent with the risk mitigation techniques and future management actions taken into account for the ring-fenced business in the calculation of the SCR for the undertaking as a whole, and with Guideline 9;
- (d) the methodology and assumptions applied in calculating the notional SCR for the purposes of each ring-fenced fund should be consistent with those used in respect of the same types of assets, liabilities and risks in the calculation of the SCR for the undertaking as a whole;
- (e) it only uses risk mitigation techniques, future management actions, methodologies or assumptions to calculate a notional SCR that differ from those used in the calculation of the SCR for the undertaking as a whole when necessary to produce a compliant notional SCR, and the justification for any differences is documented.

Guideline 11 - Determining whether restricted own funds within a ring-fenced fund exceed the notional SCR: standard formula and internal model

1.24. Undertakings should compare the amount of the restricted own-fund items within the ring-fenced fund with the notional SCR of the ring-fenced fund calculated, as set out in Guidelines 9 or 10.

1.25. The effect of the adjustment required by Article 81(2) of the Implementing Measures is to allow only an amount of own funds equal to the notional SCR to contribute to the coverage of the SCR of the undertaking as a whole and to the coverage of the MCR.

1.26. If the amount of own funds within a ring-fenced fund is equal to or less than the notional SCR of the ring-fenced fund, undertakings should not make any

adjustment to own funds as there are no restricted own-fund items in excess of the notional SCR. In this case, all of the own funds within the ring-fenced fund are available to meet the SCR and the MCR.

Guideline 12 - Calculation of the SCR of the undertaking as a whole in the presence of ring-fenced funds: standard formula

- 1.27. In calculating a separate notional SCR for the remaining part of the undertaking, undertakings should treat the assets and liabilities of that remaining part of the undertaking as though they were a separate undertaking and apply Guideline 9.
- 1.28. Without prejudice to Article 227(2) of the Implementing Measures, in calculating the SCR as the sum of the notional SCRs for each ring-fenced fund and for the remaining part of the undertaking, undertakings should not reflect any diversification benefits among ring-fenced funds or between ring-fenced funds and the remaining part of the undertaking.
- 1.29. Undertakings should set any negative notional SCRs to zero before aggregating such amounts with any positive notional SCRs of ring-fenced funds and the remaining part of the undertaking.

Guideline 13 - Calculation of the SCR of the undertaking as a whole in the presence of ring-fenced funds: internal model

- 1.30. In accordance with Article 234(b)(ii) of the Implementing Measures undertakings using an internal model should ensure that:
 - (a) they consider the manner in which the notional SCR for each ring-fenced fund is calculated;
 - (b) they consider how the system for measuring diversification effects takes into account any restrictions on diversification which arise from the existence of ring-fenced funds; and
 - (c) they provide evidence and information to supervisory authorities in relation to the following matters:
 - (i) the nature of the insurance business within each relevant ring-fenced fund and how this is the same as, or different to, the business carried on in other ring-fenced funds and the remaining part of the undertaking;
 - (ii) the degree of correlation of the risks attaching to those lines of business;
 - (iii) historical data demonstrating the incidence of losses affecting different parts of the business;
 - (iv) the rationale for and the nature of the restrictions affecting each relevant ring-fenced fund;

- (v) an explanation of the source of diversification having regard to such restrictions and identification of key variables driving dependencies;
- (vi) an analysis of any non-linear dependence and any material lack of diversification under extreme scenarios;
- (vii) the extent to which the data provided in (i) to (vi) support the observation of diversification effects among ring-fenced funds or between ring-fenced funds and the remaining part of the undertaking.

1.31. In accordance with Article 234(b)(ii) of the Implementing Measures supervisory authorities should assess:

- (a) the manner in which the notional SCR is calculated, and diversification benefits are taken into account in the internal model;
- (b) whether the assumptions underlying the system used for measuring diversification effects are justified on an empirical basis with regard to the items listed in paragraph 1.30(c).

Guideline 14 - Application of calculation methodology to similar ring-fenced funds

1.32. Where an undertaking seeks to apply the same calculation methodology to multiple ring-fenced funds that exhibit similar characteristics, it should demonstrate to the satisfaction of the supervisory authority that the methodology produces sufficiently accurate results for each of the similar ring-fenced funds.

Guideline 15 - Ongoing assessment: actions by the undertaking using an internal model

1.33. In the event of changes to circumstances, which affect the accuracy of the evidence or information provided in accordance with Guideline 13, and which may affect the supervisory authority's assessment as to whether the reduction of diversification is appropriately reflected in the outputs of the undertaking's internal model, undertakings should determine whether a change to the internal model is needed, following the policy for changing the internal model. Undertakings should report to supervisory authorities any subsequent minor change as part of the quarterly reporting of minor changes. Undertakings should submit to supervisory authorities an application for approval of changes classified as major following the policy for changing the internal model.

Guideline 16 - Ongoing assessments: actions by supervisory authority for internal models

1.34. Supervisory authorities should establish procedures to review information received from undertakings regarding any changes to the ongoing ability of an

internal model to provide results which properly reflect the diversification between or among the relevant ring-fenced funds and remaining part of the undertaking to which it is applied.

Guideline 17 - Reporting of the SCR split by risk modules for undertakings with ring-fenced funds or matching adjustment portfolios

1.35. When calculating the amount of the SCR split by risk modules for the purposes of reporting in accordance with Article 311(2)(a) of the Implementing Measures and public disclosure in accordance with Article 297(2)(b) of the Implementing Measures, undertakings using the standard formula should identify the effects of non-diversification. For this purpose, undertakings should allocate by risk modules the difference between the sum of notional SCRs calculated in accordance with Article 217 of the Implementing Measures and the SCR of the undertaking as if there was no loss of diversification. When calculating this difference, undertakings may use one of the simplifications set out in the Technical Annex. The approach used should be consistently applied over time.

Compliance and Reporting Rules

1.36. 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.

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

1.38. 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.

1.39. 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

1.40. The present Guidelines shall be subject to a review by EIOPA.

Technical Annex - Simplifications for the calculation of the SCR as if there was no loss of diversification (Guideline 17)

Simplification 1 (direct summation at sub-module level)

1.41. The SCR as if there was no loss of diversification is calculated as follows:

- (a) for each sub-module of Life underwriting, Non-Life underwriting, Health underwriting, market and counterparty default risk modules, the (gross) capital charge of the entity is calculated as the sum of the (gross) capital charges across all ring-fenced funds and the remaining part;
- (b) the capital charges of the entity for Life underwriting, Non-Life underwriting, Health underwriting, market and counterparty default risk modules are calculated by aggregating the sub-module results determined above, using the relevant correlation matrices;
- (c) the capital charge of the entity for operational risk and intangibles is calculated as the sum of the capital charges across all ring-fenced funds and the remaining part;
- (d) the adjustment for loss absorbing capacity of technical provisions and deferred taxes is calculated as the sum of those adjustments across all ring-fenced funds and the remaining part;
- (e) the SCR as if there was no loss of diversification is obtained by using the usual SCR formula (as defined by Article 103 of Solvency II), taking as inputs all the numbers calculated above.

Simplification 2 (direct summation at module level)

1.42. The SCR as if there was no loss of diversification is calculated as follows:

- (a) for each risk module (Life underwriting, Non-Life underwriting, Health underwriting, market and counterparty default), the (gross) capital charge of the entity is calculated as the sum of the (gross) capital charges across all ring-fenced funds and the remaining part;
- (b) the capital charge of the entity for operational risk and intangibles is calculated as the sum of the capital charges across all ring-fenced funds and the remaining part;
- (c) the adjustment for loss absorbing capacity of technical provisions and deferred taxes is calculated as the sum of those adjustments across all ring-fenced funds and the remaining part;
- (d) the SCR as if there was no loss of diversification is obtained by using the usual SCR formula (as defined by Article 103 of Solvency II) taking as inputs all the numbers calculated above.

2. Explanatory text

Guideline 1 - Characteristics and scope of ring-fenced funds

Undertakings should identify ring-fenced funds by reference to the following characteristics:

- (a) the existence of a restriction on assets in relation to certain liabilities on a going-concern basis, which would lead to restricted own funds within the business of an undertaking, is the defining characteristic of a ring-fenced fund;
- (b) ring-fenced funds may arise where profit participation forms part of the arrangement and also in the absence of profit participation;
- (c) while the ring-fenced assets and liabilities should form an identifiable unit, in the same manner as though the ring-fenced fund were a separate undertaking, it is not necessary that these items are managed together as a separate unit or form a separate sub-fund for a ring-fenced fund to arise;
- (d) where proceeds of, or returns on, the assets in the ring-fenced fund are also subject to the ring-fenced fund arrangement, undertakings are able to trace them at any given time, i.e. undertakings are able to identify items as covered by, or subject to, the arrangement giving rise to the ring-fenced fund.

2.1. Whilst Guideline 1 describes important generic characteristics that will commonly fit all types of ring-fenced funds, it is not a closed list of characteristics by which a ring-fenced fund can always be identified nor a cumulative list.

Guideline 2 - Arrangements and products that are generally outside the scope of ring-fenced funds

In the process of identifying ring-fenced funds, undertakings should consider the following arrangements and products as generally outside the scope of ring-fenced funds:

- (a) conventional unit-linked products, as referred to in Article 132(3) of Solvency II;
- (b) conventional index-linked products, as referred to in Article 132(3) of Solvency II;
- (c) provisions, including technical provisions and equalisation provisions, and reserves set up in accounts or financial statements prepared under the requirements applying in a particular jurisdiction are not ring-fenced funds solely by virtue of being set up in such financial statements;
- (d) conventional reinsurance business provided that individual contracts do

not give rise to restrictions on the assets of the undertakings;

- (e) coverage assets and similar arrangements that are established for the protection of policyholders in the case of winding-up proceedings, either for the policyholders of the undertakings as a whole or for separate sections or groups of policyholders of the undertakings, including assets identified in the register in accordance with Articles 275(a) and 276 of Solvency II (the special register);
- (f) separation of life and non-life business in composite undertakings which carry out simultaneously life and non-life and/or health insurance activities set out in Articles 73 and 74 of Solvency II, but not disregarding the fact that a ring-fenced fund may still arise within either or both of the component parts of composite undertakings;
- (g) surplus funds are not ring-fenced solely by virtue of being surplus funds, but could be if they are generated within a ring-fenced fund;
- (h) transfer of a portfolio into an undertaking during a reorganisation of a business, where the separation of assets in respect of the existing business of the receiving undertaking from the assets of the transferred portfolio does not constitute a ring-fenced fund, if this separation has been put in place under national law to protect the existing business from the fund that is being transferred-in only on a temporary basis;
- (i) experience funds, where policyholders are entitled to a share of the experience of the fund in a manner, typically a minimum predefined percentage, set out in the policy documentation, and have no rights to any amounts not allocated in accordance with that specified profit-sharing mechanism. Amounts allocated to policyholders are included in technical provisions. Amounts not allocated to policyholders are fully transferable, can be returned to the shareholders or other providers of capital, can be used to absorb losses as and when they occur or can be, but are not required to be, used to increase benefits to policyholders and can therefore form part of own funds not subject to restriction.

2.2. Conventional unit-linked products, as referred to in point (a) of the Guideline describe the situation where all of the benefits provided by a contract are directly linked to the value of units in an Undertaking for Collective Investments in Transferable Securities (UCITS) or to the value of assets contained in an internal fund held by the insurance undertakings, usually divided into units. The cash value of a policy varies according to the net asset value of the underlying investment assets and the technical provisions in respect of the benefits provided by the contract are represented as closely as possible by those units (or in the case where units are not established, by those assets).

2.3. Conventional index-linked products, as referred to in point (b) of the Guideline mean that all of the benefits provided by a contract are based on a share index

or some other reference value. The technical provisions in respect of the benefits are represented as closely as possible either by the units deemed to represent the reference value or in the case where units are not established, by assets of appropriate security and marketability which correspond as closely as possible with those on which the particular reference value is based.

Guideline 3 - Restrictions giving rise to ring-fenced funds

Undertakings should identify the nature of any restrictions affecting assets and own funds within their business and the associated liabilities in respect of the contracts, policyholders or risks for which such assets and own funds can be used.

In order to identify any such restrictions which give rise to a ring-fenced fund undertakings should consider at least:

- (a) the contractual terms;
- (b) any separate legal arrangement that applies in addition to the terms of a policy;
- (c) provisions in the articles, statutes or other document giving rise to the undertaking's formation or organisation;
- (d) national legislation or regulations in respect of product design or the conduct of the relationship between undertakings and their policyholders: ring-fenced funds would arise where, as a result of legal provisions protecting the general good in a Member State, an undertaking must apply particular assets only for the purposes of a particular part of its business;
- (e) provisions of European Union law, whether transposed or directly applicable;
- (f) arrangements specified by order of a court or other competent authority which require separation of or restrictions on assets or own funds in order to protect one or more groups of policyholders.

Undertakings should take into account all restrictions affecting assets and own funds in place at the time that the SCR is calculated, irrespective of the time period for which those restrictions apply on a going-concern basis.

2.4. Referring to point (d) of the Guideline, criteria laid down in one Member State in respect of certain business arrangements are that:

- (a) assets are separately identified within the coverage assets (for the case of insolvency);
- (b) it has been contractually agreed between the undertaking and the policyholders of the fund (in most cases employees of a particular company) that only the profit of particular assets results in a profit for these policyholders;
- (c) this profit may not be reduced because of a loss occurring outside the ring-fenced fund.

- 2.5. It should be noted that it is the effect of points (b) and (c) of the preceding paragraph which gives rise to a ring-fenced fund because they are relevant in a going concern while point (a) is not.
- 2.6. Referring to point (d) of the Guideline, legislation in some Member States creates companies which comprise individual cells (protected cell companies). Although together they comprise a single legal entity, the cells operate as distinct units on both a going and gone-concern basis. One cell cannot be called upon to support the liabilities of another, or of the undertaking as a whole. The assets of the general account or core are not normally available to meet liabilities of individual cells. However, the general account may in some cases be relied on to support an individual cell provided that the assets attributable to the relevant cell have been exhausted.

Guideline 9 - Calculating the notional SCR of a ring-fenced fund – Standard formula

Undertakings should perform the following steps in applying the methodology set out in Article 217 of the Implementing Measures:

- (a) in applying the SCR calculation methodology to the assets and liabilities within a ring-fenced fund as if the ring-fenced fund were a separate undertaking, undertakings should include a capital requirement for operational risk as well as any relevant adjustments for the loss-absorbing capacity of technical provisions and deferred taxes;
- (b) in aggregating the capital requirements under the worst case scenario for the undertaking as a whole for each sub-module and risk module using the procedure for aggregation of the standard formula prescribed by Article 104 of Solvency II, undertakings may recognise diversification of risks within the ring-fenced fund;
- (c) the capital requirement at the level of each ring-fenced fund should be calculated net of the mitigating effect of future discretionary benefits. Where profit participation exists, assumptions regarding the variation of future bonus rates should be realistic and have due regard to the impact of the shock at the level of the ring-fenced fund, including the impact on the value of future transfers attributable to shareholders, and to any contractual, legal or statutory requirements governing the profit participation mechanism;
- (d) if, as a result of bidirectional scenarios, the risk charge for the worst case scenario is negative, even after taking into account any potential increase of liabilities due to profit participation mechanisms, and would therefore result in an increase in basic own funds within the ring-fenced fund, then the charge should be set to zero.

2.7. In accordance with Article 83(5) of the Implementing Measures, in the case of bidirectional scenarios, as referred to in point (d) of the Guideline, the worst case scenario may produce a negative result for a particular capital charge.

Appendix

Technical illustration of the calculation of the SCR in the presence of ring-fenced funds using the standard formula

- 2.8. Assume an undertaking has two profit participation mechanisms that benefit different groups of policyholders (A) and (B). Those mechanisms are such that, by contractual laws, 80% of any future emerging profit (irrespective of the source, i.e. underwriting or financial) has to be allocated to the respective group of policyholders and technical provisions increase by the value of the 80% emerging profit. Only the remaining 20% can be released to shareholders.
- 2.9. The blocks of business (A) and (B) constitute two ring-fenced funds. Within each ring-fenced fund, the expected value of future profit participation form part of the value of technical provisions (following Solvency II valuation rules). The amount of future discretionary benefits for groups (A) and (B) is 100 and 300 respectively.
- 2.10. Additionally, the undertaking writes a block of non-participating business (C). This business does not constitute a ring-fenced fund.
- 2.11. The undertaking needs to calculate the SCR on the basis of the methodology set out in these Guidelines and summarised in the next paragraph.
- 2.12. General procedure to calculate the SCR:
- (a) when performing the calculation of each individual capital charge, the corresponding impact at the level of sub-modules of assets and liabilities (those relevant to capture the effect of each ring-fenced fund) would need to be computed;
 - (b) where positive effects are observed at the level of a ring-fenced fund, the gross capital charge at this level would need to take into account any potential increase of liabilities (e.g. additional distribution of profits to policyholders), even though the overall impact of the shock on the undertaking is negative. In practice, this can only happen in those cases of bidirectional scenarios (interest rate risk, currency risk, lapse risk) where positive effects calculated at the level of a ring-fenced fund can be observed;
 - (c) in parallel the capital charges at the level of each ring-fenced fund would need to be calculated net of the mitigating effect of future discretionary benefits. Where the ring-fenced fund relates to the existence of profit sharing mechanisms, the assumptions on the variation of future bonus rates would need to be realistic, with due regard to the impact of the shock at the level of the ring-fenced fund and to any contractual, legal or statutory clauses of the profit sharing mechanism. The relevant (downward) adjustment for the loss absorbing capacity of technical provisions cannot exceed, in relation to a particular ring-fenced fund, the amount of future discretionary benefits within the ring-fenced fund;

- (d) for each of gross/net, the total capital charge for the individual risk is given by the sum of the capital charges calculated at the level of each ring-fenced fund and at the level of the remaining sub-portfolio of business;
- (e) for each of gross/net, the total capital charges for each individual risk are then aggregated using the usual procedure of the standard formula to derive the total SCR.

2.13. For example, the calculation of the interest rate risk charge (Step (a) of the preceding paragraph) would require the computation of the impact of both the upward and downward scenarios at the level of each ring-fenced fund (A) and (B) and at the level of the remaining business (C).

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)
ΔNAV before any adjustment (per relevant segment)			
Upward shock	250	-100	-400
Downward shock	-80	200	500

2.14. Step (b) of paragraph 2.12 requires the reduction of positive ΔNAV partial results due to profit participation at the level of the ring-fenced fund. In the current example, where positive, the ΔNAV results are reduced by 80% (such amount is retained in the ring-fenced fund and used to increase the benefits of the corresponding groups of policyholders).

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)
After increase of liabilities within the ring-fenced fund			
Upward shock	50	-100	-400
Downward shock	-80	40	500

2.15. Step (c) of paragraph 2.12 is concerned with the calculation of the net capital charges, and the assessment of the extent to which the management is able to reduce future discretionary bonuses at the level of each ring-fenced fund. In this example, it is assumed that the 1/3 of the negative ΔNAV results is mitigated by the reduction in future discretionary bonuses (note that on the block of business (C) this is not applicable, because it is non-participating business).

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)
Net charges - after adjustment for loss absorbency of technical provisions			
Upward shock	50	-67	-400
Downward shock	-53	40	500

2.16. Based on these results, the upward shock scenario is chosen to compute the notional SCR, as it corresponds to the worst case scenario at the level of the undertaking.

2.17. Within each ring-fenced fund, the risk modules and sub-modules are aggregated to reflect diversification that exists within the ring-fenced fund. The

example below assumes that the interest rate risk is the only risk in the market module and there is one further individual risk, mortality risk. A correlation of 50% between interest rate risk and mortality risk is assumed, for the purposes of this example.

- 2.18. The notional SCR for each of the ring-fenced funds and the remaining part of the undertaking are then summed to give an overall SCR. The table below shows the breakdown of the SCR into the different components.

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)	Entity
Interest Rate Risk Shock	-50 (set to 0)	67	400	467
Mortality risk shock	10	125	200	335
Calculation of SCR	10	169	529	708

- 2.19. The above example shows the effects of diversification within each ring-fenced fund and diversification within the remaining part of the undertaking. There is no diversification between the ring-fenced funds and between the remaining part of the undertaking.

Calculation of total eligible own funds in the presence of ring-fenced funds

Case 1: Ring-fenced fund in surplus after deducting the notional SCR

- 2.20. Where there are sufficient own funds within each ring-fenced fund to cover the respective notional SCR, the own funds in excess of the notional SCR must be excluded from the own funds of the undertaking as a whole.
- 2.21. If this is the case, any amount representing the value of future shareholder transfers is not restricted and therefore forms part of the own funds available to meet the SCR for the undertaking as a whole – see ring-fenced fund (B) in the table below.

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)	Entity
Own funds	200	400	1400	2000
SCR	10	169	529	708
Shareholder Value in ring-fenced fund	0	30	0	30
Own funds available to cover SCR of the undertaking as a whole	10	199	1400	1609
Own funds unavailable to cover SCR of the undertaking as a whole	190	201	0	391

Case 2: Ring-fenced fund in deficit after deducting the notional SCR

- 2.22. Where there are insufficient own funds within a ring-fenced fund to cover the notional SCR for that ring-fenced fund (ring-fenced fund (A) in this example):

- (a) there is no restriction on the amount of own funds in that ring-fenced fund;
- (b) the deficit in that ring-fenced fund is met by own funds outside the ring-fencing arrangements, i.e. arising in non-participating business (C) in this example.

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)	Entity
Own Funds	5	400	1400	1805
SCR	10	169	529	708
Shareholder Value in ring-fenced fund	0	30	0	30
Own funds available to cover SCR	5	199	1400	1604
Own funds unavailable to cover SCR	0	201	0	201

Case 3: Ring-fenced fund adjustment when a non-material ring-fenced fund is present

2.23. Where the entity contains a ring-fenced fund that is non-material, undertakings may exclude the total amount of restricted own-fund items from the amount eligible to cover the SCR and the MCR (in the case of ring-fenced fund D below, 8 is excluded). Where a ring-fenced fund is non-material, it is treated as part of the remaining part of the undertaking.

Before non-material treatment

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)	Ring-fenced fund (D) non-material	Entity
Own funds	50	400	1400	8	1858
SCR	100	169	529	5	803
Shareholder value in ring-fenced fund	0	30	0	0	30
Own funds available to cover SCR	50	199	1400	5	1654
Own funds unavailable to cover SCR	0	201	0	3	204

After non-material treatment

	Ring-fenced fund (A)	Ring-fenced fund (B)	Remainder (C)	Ring-fenced fund (D) non-material	Entity
Own funds	50	400	1408	8	1858
SCR	100	169	532 ⁸	0	801
Shareholder value in ring-fenced fund	0	30	0	0	30
Own funds available to cover SCR	50	199	1408	0	1657
Own funds unavailable to cover SCR	0	201	0	8	209

⁸ Less than 5 of D's SCR is added to C. This takes account of diversification between D and the rest of C.