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European Insurance

Moving regulatory frameworks create risks for hybrid bondholders

European insurers have commonly issued hybrid debt instruments as a cost effective way to strengthen their regulatory solvency position. These instruments include clauses which are activated in case of breach of regulatory capital requirements, in case of regulatory intervention or in case of non eligibility of the debt as regulatory capital. Because insurance regulation is changing significantly, we think the risk for holders of these securities will increase in the medium term.

From 1 January 2016, European insurers will have to comply with the new Solvency II regime. Furthermore, ComFrame, the regulation for Internationally Active Insurance Groups (IAIGs) is scheduled to come into force in 2019, and Global Systematically Important Insurers (G-SIIs)[1] will also be subject to additional capital requirements from 2019. Although none of these new regulations are completely finalised yet, calibrations of required capital and definitions of eligible capital will differ from Solvency I, the current regulatory regime. As a result of these changes, we see three main risks for holders of existing debts issued by European insurers:

1. A breach of regulatory capital requirements triggering a coupon suspension could become more likely than under the current regime;
2. Regulatory intervention triggering a mandatory or an optional suspension of coupons could become more frequent than under the current regulatory regime, particularly for G-SIIs;
3. The possibility to unilaterally vary the terms and conditions or exchange debts in case of non eligibility to regulatory capital could, in a few instances, allow insurers to introduce loss absorption features into existing debts, especially when the debt is intended to be eligible as "Tier 1" capital.

At this stage, we do not expect that the introduction of Solvency II will lead to a significant and generalised increase in risk for noteholders notably due to the various transitional arrangements which will smooth the transition from the current regime. Additionally, we believe most outstanding hybrid instruments with mandatory coupon suspension mechanisms will be called before or when the transitional measures expire. However, if, over time, as the benefits of transitional measures diminish, insurers' Solvency II ratios drift much closer to 100% and we believe hybrid instruments with mandatory coupon suspension mechanisms will remain outstanding, negative rating actions could occur. The impact of

regulations for IAIGs and G-SIIs are more uncertain. We will evaluate the potential impacts of the new regulatory regimes on the ratings of existing debts as more details become available.

1) A breach of regulatory capital requirements triggering a coupon deferral could become more likely

What is a coupon deferral trigger based on a breach of capital requirements

Most debts issued by European insurers include a “mandatory deferral” clause based on a breach of solvency capital requirements. These clauses stipulate that the issuer must defer coupons if its regulatory solvency ratio falls below a given threshold, most of the time set at 100% (see examples in Appendix 1).

Why could future regulatory regimes present a risk for investors?

Under Solvency I, we generally consider that there is a low probability that this trigger could be breached. We qualify this trigger as “weak” or “not meaningful”.[2]

In most recent issuances, the terms and conditions explicitly state that, when Solvency II will come into force, the trigger will switch to Solvency II capital requirements (SCR).[3] Solvency II will be a more economic and more stringent regime than Solvency I and capital requirements will take into account more risks than the current regime. For most insurers, we expect that the Solvency II ratio will be lower than their correspondent Solvency I ratios. This will be exacerbated by the decline in interest rates since year-end 2013 which exerts significant negative pressures on Solvency II ratios. In addition, for insurers which intend to use internal models for the computation of Solvency II ratios, we expect that regulators will ask for some changes in calibrations or some capital add-on before they approve the models, exerting further downward pressure on Solvency II ratios.[4]

Furthermore, because Solvency II ratios will be calculated on a market-consistent basis, the volatility of Solvency II ratios is expected to be higher than under the current regime and more difficult to predict.[5] As a consequence, the probability that a solvency ratio falls below 100% is likely to be higher under Solvency II than under the current regime.

In addition, “mandatory deferral” clauses commonly refer to requirements under applicable capital or supervisory regulations, which will go beyond the mere Solvency II regime. IAIGs and G-SIIs will for example be subject to specific capital requirements. Neither the amount of capital required, nor the definition of eligible regulatory capital under these new regulatory regimes are known at this stage, but the G-SIIs capital requirements are likely to be more onerous than Solvency II.[6] However, in most insurance companies’ issuances, we understand that a coupon deferral is required only if the regulation requires such a deferral. In other words, a breach of capital requirements under the IAIGs or G-SIIs regulations would trigger a deferral of coupon only if (1) the debt would be eligible as regulatory capital under these regulations, and (2) these regulations would require a deferral of coupons for these debts to be eligible as required capital.

In most cases, a breach of regulatory capital requirements would have a limited economic impact on bondholders. Indeed, most debt only allows a deferral of coupons (as opposed to a cancellation of coupons), which means that skipped coupons would remain due at a future date. We do not consider a coupon deferral as a default, nevertheless, we consider a coupon deferral as a credit event, and we typically rate subordinated and junior subordinated debt instruments with a mandatory “strong” coupon deferral mechanism one notch lower than the same instrument with a “weak” coupon deferral mechanism.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

What is the likelihood that this risk materialises?

We believe that Solvency II ratios will in many cases be more volatile and lower than Solvency I ratios. However, the "long-term guarantee package"[7] that has been introduced in 2014 within Solvency II also shows regulators and policymakers' willingness to avoid too large a volatility of Solvency II ratios. The transitional arrangements that have been included in the Omnibus II Directive,[8] some of which will remain in place for 16 years, will also reduce the risk for insurance companies of not being able to meet the Solvency II capital requirements in the near term. For example, Storebrand Livsforsikring AS (Baa1 insurance financial strength rating, stable outlook), a Norwegian life insurer, reported at year-end 2014 an expected Solvency II ratio of 101% without transitional benefits, but of 148% including transitional benefits. As a result, the risk of coupon skip resulting from breaching the SCR under Solvency II will remain limited in most instances, at least during this transitional period. However, if, over time, as the benefits of the transitional measures diminish, insurers' Solvency II ratios drift much closer to 100% and we believe hybrid instruments with mandatory coupon deferral mechanisms will remain outstanding, negative rating actions on insurers' hybrid instruments could occur.

In any case, a low (i.e. close to 100%) Solvency II ratio without transitional measures will also reflect in many cases a relatively weak economic capitalisation, which is reflected in our assessment of insurers' financial strength, and ultimately in our assessment of the credit risk of insurers' hybrid debts.

Given the uncertainties on regulations which will apply to IAIGs and G-SIIs, it is as yet unclear as to whether triggers based on these regulations will be relevant for insurance hybrid bondholders. We believe however that there is a high likelihood that G-SIIs requirements will be more constraining than Solvency II requirements, and therefore the likelihood to breach a trigger based on G-SIIs requirements will be higher than the likelihood to breach a trigger based on Solvency II requirements. We will also monitor the definition of eligible capital under these regulations. On one hand, a restrictive list of eligible capital could create challenges to comply with the requirements and would increase the likelihood of any trigger based on these requirements to be breached, on the other hand the non eligibility of existing debts as regulatory capital would prevent the automatic activation of the coupon skip mechanism following a breach of regulatory requirements under these regulations (see above).

2) Regulatory intervention could become more frequent than under the current regulatory regime

What is regulatory intervention and why does it matter for bondholders?

Typical "mandatory deferral" clauses are activated, not only in case of a breach of capital requirements, but also in case of "regulatory intervention". In practice, this means that insurers will have to defer coupons if their supervisor asks them to do so (see examples in Appendix 1).

Regulatory intervention could also have indirect impacts for bondholders. Hence, a regulator could ask an insurance company to stop paying dividends. This would then allow the insurer to activate an "optional deferral" clause,[9] i.e. give the insurer the option to defer coupons on a discretionary basis.

In this section, we only discuss the implications of regulatory intervention on coupon deferral. Some debts may allow for equity conversion and/or capital write-down, but the number of such outstanding debts is limited to date.

Why could future regulatory regimes present a risk for investors?

Historical evidence suggests that, in contrast to what has been observed for banks, the probability that an insurance regulator intervenes before the breach of capital requirements is low. This is partly driven by the more illiquid nature of many insurance liabilities (compared to banks) which makes cash-conservation through coupon deferral less likely to help prevent an insolvency. We therefore consider triggers based on regulatory intervention to be "weak" in the insurance sector under the current Solvency I regime.

However, regulatory intervention will in the future be based on new regulatory regimes, including Solvency II, ComFrame and requirements for G-SIIs. These regimes not only include new capital requirements for insurance companies but also give new powers to supervisory authorities. Therefore, the probability of regulatory intervention may well be higher under these regimes than under Solvency I.

What is the likelihood that this risk materialises?

We believe that regulatory intervention under Solvency II will likely not arise before a breach of the SCR. Indeed, the new regime includes explicit levels of intervention for the regulators, and the first level of intervention is a breach of the SCR. Under Solvency II, insurers are temporarily allowed to hold less capital than the SCR, but, in such a scenario, they must provide a plan to their regulator showing how they will restore their capital position quickly.

However, if G-SIIs are required to hold more capital than under Solvency II, regulators could intervene when an insurer's capital is higher than the SCR (at a point between the capital requirements for G-SIIs and the capital required under Solvency II). So, even if a breach of capital requirements for G-SIIs would not trigger a mandatory deferral of coupons (for example because the debt is not eligible as capital under the G-SIIs regulation, see above), this could lead a regulator to intervene and either ask for the deferral of coupons or ask for a non-payment of dividends, which would also allow the insurer not to pay the coupon on an optional basis. In other words, for an insurer designated as G-SII, a trigger based on regulatory intervention may be stronger than for a non-systemic insurer. Nonetheless, at this stage, uncertainties on G-SIIs capital requirements are too high to assess precisely the strength of such a trigger.

3) Risk of introduction of loss absorption features in case of non eligibility as regulatory capital

When can insurers modify the terms and conditions of existing debts?

The majority of debt issued by European insurers allows the issuer to unilaterally vary the terms and conditions if the debt does not qualify as regulatory capital, or is not recognised by the regulator as a capital of sufficient quality (for example, if the debt is not recognised as at least Tier 2 capital, or if the debt is not recognised as Tier 1 capital; please refer to Appendix 2 for key features of Tier 1 and Tier 2 capital under Solvency II). This also includes situations where debts initially qualify as regulatory capital, but would not qualify anymore after a change in regulation.

Why could future regulatory regimes present a risk for investors?

Under the future regulatory regimes, the list of eligible regulatory capital will differ from the current Solvency I regime. In particular, many hybrid debt instruments issued between 2010 and 2014 would theoretically not qualify as regulatory capital.[10]

We expect that, under Solvency II, most debts will initially be grandfathered and allowed to temporarily count as regulatory capital. The grandfathering rules currently refer to a transition period of up to 10 years, and make no reference to any phasing out of the grandfathered amount the nearer one approaches 10 years.

Should the debts not be called at the end of the grandfathering period, then insurers may vary the terms and conditions of the debt to make it eligible as regulatory capital. In most instances, this would not pose any risk to the noteholders, because (1) features which make the debt non-eligible as regulatory capital are minor and changing these features would not increase credit risk for noteholders[11] and (2) the ability to vary the instruments is very restricted and noteholders are, in general, well protected.

However, in rare circumstances, notably when debts allow to change terms and conditions in case of non eligibility as Tier 1 capital under Solvency II, we understand that the debt documentation may allow the issuer to introduce loss absorption features. In general, the documentation states that any change in the terms and conditions should not be prejudicial to the noteholders, but at the same time, the ability to include capital write-down or conversion into shares is explicitly mentioned. This is for example the case of some of the debts issued by some Italian insurers, such as UnipolSai Assicurazioni S.p.A.[12] (Baa2 insurance financial strength, stable outlook) or Generali Assicurazioni S.p.A.[13] (Baa1, stable outlook) (see examples in Appendix 3). These debts are rated 2 notches below the issuer's senior debt rating (please refer to Moody's press releases for more details on the rationale for these ratings).

Furthermore, the language included in debt documentation is most of the time vague enough to consider that there is a risk that variation or substitution of debt could also apply if a debt would not qualify as regulatory capital under IAIGs or G-SIIs regimes. Since definition of eligible capital under these regimes is not defined yet, we cannot fully appreciate the extent of the risks posed by these clauses at this stage. However, conditions for a debt to be eligible as regulatory capital under G-SIIs regulation will likely be tougher to meet than under Solvency II.

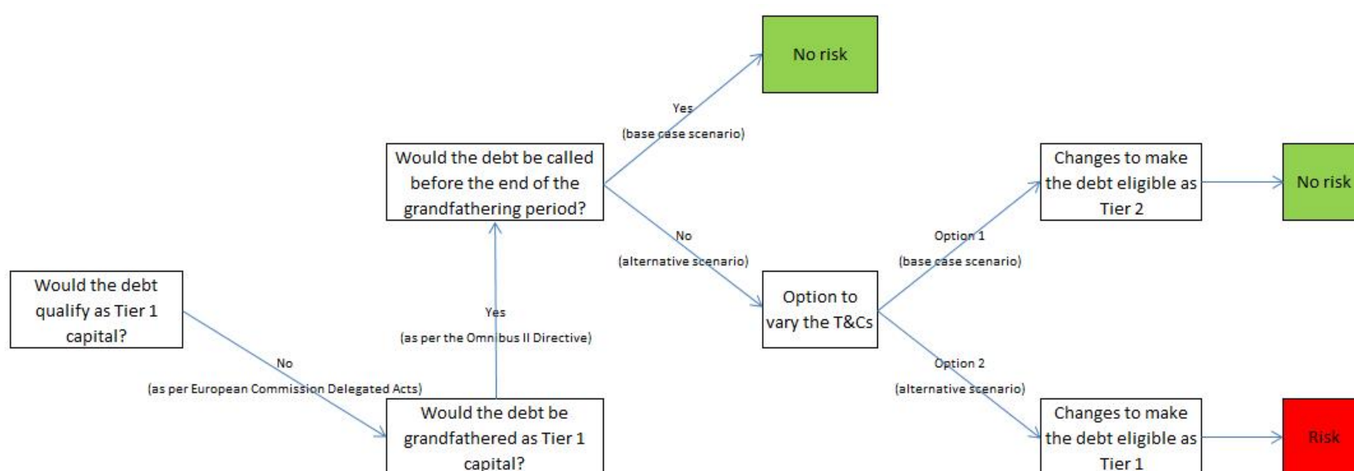
We note however that the option to amend the terms and conditions of the debt in case of non eligibility as regulatory capital is legally complex to activate. As an illustration, Lloyds Banking Group plc (Baa1 senior debt, positive outlook) issued hybrid instruments in 2009 (Enhanced Capital Notes, ECNs) that the regulator is not considering anymore as core capital in its stress testing exercise. As a result, Lloyds decided to call this security in advance, as allowed by the terms and conditions of the ECNs under certain circumstances, invoking this change in regulatory treatment. In June 2015, a court denied Lloyds' ability to exercise this option, arguing that the ECNs may still be considered as core capital in future stress tests.

What is the likelihood of this risk materialising?

The diagram below, which focuses on debts issued by UnipolSai Assicurazioni and Generali Assicurazioni mentioned above, shows that in the most likely scenarios investors will not be at risk, but also shows one potential scenario which could lead to a risk for investors:

Exhibit 1

Moody's assessment of risk for noteholders of recent debts issued by UnipolSai Assicurazioni and Generali Assicurazioni, in relation with the issuer's ability to amend terms and conditions



Source: Moody's Investors Service

As per the grandfathering rules included in the Omnibus II Directive, current outstanding hybrid debts will be grandfathered under Solvency II, which will limit a quick need to vary the terms and conditions of the notes.

Our base case scenario foresees that debts will be grandfathered for a period of 10 years, and that they will be called at the first call date, which most of the time falls before the end of the grandfathering period.

However, if the debts are not called before the end of this period (for example because the grandfathering time frame is subsequently shortened or regulators decide to amend the criteria and make them more restrictive before the end of the expected 10-year period) the debts would not be eligible as regulatory capital anymore. The terms and conditions of the notes could allow the issuer to exercise the option to vary the debt to make it eligible as Tier 1 capital. In some cases, the documentation would also make this option available if the debts are not called at the end of the grandfathering period for reasons which are intrinsic to the issuer (e.g., inability to refinance the debt and lack of liquid resources to repay the debt).[14] In this case, given that we currently do not expect the quality of capital to be a focus for European insurers and thus they are indifferent to either hold Tier 1 or Tier 2 capital, we believe that the issuer could change the terms and conditions of the debt to make it eligible as Tier 2 capital, without any material prejudice to noteholders (option 1 in the diagram above). This is our base case expectation in the case the debt is not called before the end of the grandfathering period.

However, in an alternative scenario (option 2 in the diagram above), the issuer could introduce loss absorption features in the notes. In this scenario, the credit risk would increase for noteholders. This option remains at the discretion of the issuer.

Appendix 1: Examples of mandatory coupon deferral clauses

1) DE000A13R7Z7: Allianz EUR1.5 billion subordinated bond issued in 2014 (coupon 3.375% / undated)

Terms and Conditions	Moody's Comment
(…) A "Compulsory Deferral Event" will have occurred with respect to the date on which any payment of interest and/ or Arrears of Interest on the Notes is scheduled to be paid under these Terms and Conditions if (i) such payment would cause or accelerate the occurrence of an Insolvency Event; or (ii) there is in effect on such date an order of the Competent Supervisory Authority prohibiting the Issuer in accordance with regulations applicable at such time from making payments under the Notes; or (iii) **a Solvency Capital Event** either has occurred on or prior to such date and is continuing on such date or would be caused by the payment by the Issuer of interest and/or Arrears of Interest on the Notes on the relevant date, unless (…)	Trigger based on regulatory intervention Trigger based on a breach of capital requirements
(…) A "Solvency Capital Event" will have occurred (i) prior to the Solvency II Directive becoming part of the Applicable Supervisory Regulations, if the Issuer or the Issuer's group do not have sufficient funds to cover the required minimum solvency margin (or a comparable term in case of a change in applicable rules) in accordance with Applicable Supervisory Regulations or in accordance with the regulations for financial conglomerates; and (ii) **upon the Solvency II Directive becoming part of the Applicable Supervisory Regulations, if the regulatory capital** (howsoever described in the Applicable Supervisory Regulations) *of the Issuer or the Issuer's group is not sufficient to cover the applicable solvency capital requirement* (SCR) or the applicable minimum capital requirement (MCR) **or the applicable capital adequacy requirement (in each case howsoever described in the Applicable Supervisory Regulations)**, whichever occurs earlier, pursuant to the Applicable Supervisory Regulations or pursuant to the regulation for financial conglomerates, and if a deferral of interest is required or a payment of Arrears of Interest or a repayment of principal or repurchase is prohibited, respectively, in the case of such insufficiency in order for the Notes to qualify as Tier 2 Capital of the Issuer or the Issuer's group (…)	Definition of the trigger based on a breach of capital requirements
(…) "Applicable Supervisory Regulations" means the provisions of insurance supervisory laws and any rules and regulations thereunder (including the guidelines and recommendations of the European Insurance and Occupational Pensions Authority, the administrative practice of the Competent Supervisory Authority and any applicable decision of a court) for single solvency of the Issuer and group solvency purposes of the Issuer's group (including the capital adequacy of internationally active insurance groups). (…)	Applicable regulations explicitly include regulation for IAIGs

2) XS1134541561 37-1: AXA GBP724 million deeply subordinated bond issued in 2014 (coupon 5.453% / undated)

Terms and Conditions	Moody's Comment
(…) **Mandatory Interest Deferral Dates** On any Mandatory Interest Deferral Date, the Issuer will be obliged, by notice to the Noteholders and the Principal Paying Agent pursuant to sub-paragraph (iv) below, to defer payment of all (butnot some only) of the interest accrued to that date, and the Issuer shall not have any obligation to make such payment, provided however that if the Relevant Supervisory Authority accepts thatinterest accrued in respect of the Notes during such Interest Period can be paid (and that such acceptance has not been withdrawn by the date of the relevant payment), the relevant Interest Payment Date will not be a Mandatory Interest Deferral Date. Any interest not paid on a Mandatory Interest Deferral Date and deferred in accordance with this paragraph shall so long as the same remains outstanding constitute Arrears of Interest and shall be payable as outlined below. (…)	
(…) **Mandatory Interest Deferral Date means each Interest Payment Date in respect of which the Noteholders** and the Principal Paying Agent have been notified by the Issuer pursuant to Condition 6(c)(iv) **that (i) a Regulatory Deficiency has occurred** and such Regulatory Deficiency is continuing on such Interest Payment Date or (ii) the payment of such interest would in itself cause a Regulatory Deficiency (…)	
(…) **Regulatory Deficiency means:** (i) before the implementation of the Solvency II Directive, the consolidated solvency margin of the Issuer and/or the Group falls below 100 per cent. of the required consolidated solvency margin or any applicable solvency margin or capital adequacy levels as applicable under Applicable Supervisory Regulations; or (ii) **following the implementation of the Solvency II Directive, the own funds regulatory capital (or, if different, whatever terminology is employed by the then Applicable Supervisory Regulations)** of the Issuer and/or the Group is not sufficient to cover its capital requirement (or, if different, whatever terminology is employed by the then Applicable Supervisory Regulations) and a deferral of interest is required under such then Applicable Supervisory Regulations; or (iii) the Relevant Supervisory Authority has notified the Issuer that it has determined, in view of the financial condition of the Issuer, **that in accordance with the then Applicable Supervisory Regulations at such time, the Issuer must take specified action in relation to payments under the Notes.** (…)	Trigger based on a breach of capital requirements Trigger based on regulatory intervention

Terms and Conditions	Moody's Comment
(…) **Applicable Supervisory Regulations means the solvency margin, capital adequacy regulations or any other regulatory capital rules** (including the guidelines and recommendations of the European Insurance and Occupational Pensions Authority, the official application or interpretation of the Relevant Supervisory Authority and any applicable decision of any court or tribunal) from time to time in effect in France (or if the Issuer becomes domiciled in a jurisdiction other than France, such other jurisdiction) and applicable to the Issuer and/or the Group, which would lay down the requirements to be fulfilled by financial instruments for inclusion in at least "tier two" own funds regulatory capital as opposed to "tier one" own funds regulatory capital or "tier three" own funds regulatory capital (or, if different, whatever terminology may be retained), including any grandfathering provision thereof, for single solvency and group solvency purposes of the Issuer. For the avoidance of doubt, Applicable Supervisory Regulations include, without limitation, any future implementing measures of the Solvency II Directive in France (or if the Issuer becomes domiciled in a jurisdiction other than France, such other jurisdiction).	Applicable regulations is explicitly not limited to Solvency II

3) XS1003373047: Prudential plc GBP700 million subordinated bond issued in 2013 (coupon 5.7% / 50 years maturity)

Terms and Conditions	Moody's Comment
(…) All payments on the Notes, their respective Coupons or under the Trust Deed relating to them or arising therefrom will be deferred if the Issuer does not satisfy the Solvency Condition and the Solvency Capital Requirement at the time of payment and immediately afterwards. (…)	
(…) For this purpose, the Issuer shall satisfy the Solvency Condition if it is able to pay its debts to all Dated Tier 2 Senior Creditors, the Holders of the Notes and the holders of any Parity Securities as they fall due and the total Assets exceed total Liabilities, other than Liabilities to persons that are neither Dated Tier 2 Senior Creditors nor the Holders of the Notes nor the holders of Parity Securities, by at least 4% or such other percentage specified by the PRA from time to time as the Regulatory Capital Requirement.(…)	Trigger based on a breach of capital requirements
"Regulatory Capital Requirement" means any minimum or notional margin of solvency or minimum regulatory capital or capital ratios required for insurance companies or insurance holding companies or financial groups by the PRA;	

Appendix 2: Summary of key eligibility features for Solvency II Tier 1 and Tier 2 instruments

	Tier 1	Tier 2
Subordination	Should rank after all other claims in a winding-up and senior to equity	Must rank after the claims of all policyholders, beneficiaries and non-subordinated creditors
Maturity / redemption	Undated / First opportunity to repay or redeem shall not be before 5 years	Undated or dated at least 10yr / First opportunity to repay or redeem does not occur before 5 years
Incentive to redeem	Not permitted	Limited incentives to redeem are not permitted before ten years from issue date. Not limited incentives include principal stock settlement, mandatory conversion and interest step-ups exceeding either 100bp or 50% of the initial credit spread), all in conjunction with a call option
Loss absorption	Principal must be converted into equity or written down in case of (1) SCR below 75% (2) breach of MCR or (3) in case of breach of SCR and compliance is not re-established within 3 months	Not required
Coupon payment	Mandatory cancellation in case of breach of SCR / Full discretion to cancel distribution, non-cum / No pusher or stopper mechanism	Mandatory cancellation in case of breach of SCR / Optional coupon deferral not required /Dividend pusher allowed for optional deferral only

Sources: European Commission Delegated Acts, October 2014; Moody's Investors Service.

Comparison with Solvency I legislation

Under Solvency I, subordinated debt were largely eligible as regulatory capital:

- dated subordinated debt with a maturity of more than 5 years were eligible up to 25% of the required margin, without any required feature other than the subordination to policyholders in case of liquidation and some regulatory oversight before the debt redemption;
- undated subordinated debt were eligible up to 50% of the required margin, without any required feature other than the subordination to policyholders in case of liquidation and some regulatory oversight before the debt redemption.

Appendix 3: Examples of debt allowing for a change in terms and conditions in case of non eligibility to Tier 1 capital

1) XS1140860534: Generali Finance B.V. EUR1.5 billion subordinated bond issued in 2014 (coupon 4.596% / undated)

"Regulatory Event" means that:

(i) Assicurazioni Generali is no longer subject to the consolidated regulatory supervision of the Lead Regulator; or

(…)

(iv) under Italian Legislation on Solvency Margin following implementation of the Future Regulations, the Subordinated Notes (in whole or in part) fail to be grandfathered as Tier 1 basic own-funds,

(…)

Modification and/or Exchange following a Regulatory Event, Tax Event, Rating Event or Accounting Event

(a) Where a Regulatory Event, a Tax Event, a Rating Event or an Accounting Event stated in the relevant Final Terms as applicable, for the purposes of this Condition 18.4, to the Subordinated Notes has occurred and is continuing, then the Issuer may, without any requirement for the consent or approval of the Noteholders,

(A) (…) modify the terms of the Notes to the extent that such modification is reasonably necessary to ensure that no such Regulatory Event, Tax Event, Rating Event or, as applicable, Accounting Event, would exist after such modification;

(B) where the Final Terms state that Regulatory/Tax/Rating/Accounting Event Exchange Provisions are applicable, exchange all (but not some only) of the Notes for Qualifying Securities so that the relevant Regulatory Event, Tax Event, Rating Event or, as applicable, Accounting Event that has occurred would no longer exist in relation to the Qualifying Securities, in each case, provided that, following such modification or, as applicable, exchange:

(i) the terms and conditions of, in the case of sub-(A) above, the Notes, as so modified (the "modified Notes") or, in the case of sub-(B) above, the Qualifying Securities, are – in the Issuer's reasonable determination after having consulted an independent investment bank of international standing - no more prejudicial to Noteholders than the terms and conditions applicable to the Notes prior to such modification or exchange (the "existing Notes") provided that any modification may be made in accordance with paragraphs (ii) to (iv) below and any such modification or, as applicable, any exchange of existing Notes for securities that meet the requirements set out in paragraphs (ii) to (iv) below ("Qualifying Securities"), shall not constitute a breach of this paragraph (i); and

(ii) either the person having the obligations of the Issuer under the modified Notes or, as applicable, Qualifying Securities (x) continues to be the Issuer, or (y) is substituted in accordance with Condition 18.5 (Substitution); and

(iii) the modified Notes or, as applicable, Qualifying Securities rank at least equal to the existing Notes prior to such modification or exchange and feature the same tenor, principal amount, at least the same interest rates (including applicable margins), the same interest payment dates and first call date (if any) (except for any early redemption rights analogous to redemption rights under the existing Notes (if any) for Regulatory Event, Tax Event, Rating Event or Accounting Event), the same existing rights to any accrued interest, any arrears of interest and any other amounts payable under the modified Notes or, as applicable, the Qualifying Securities, as the existing Notes prior to such modification or exchange and, to the extent the terms and conditions of the existing Notes provide for loss absorption on principal of the Notes, do not contain any terms providing for loss absorption through principal write-down or conversion into ordinary shares unless the triggers at which the principal loss absorption should take place are objective and measurable and could not be hit before the triggers on the existing Notes; and

(iv) the modified Notes or, as applicable, Qualifying Securities continue to be listed on a regulated market (for the purposes of the Markets in Financial Instruments Directive 2004/39/EC) of an internationally recognised stock exchange as selected by the Issuer

(provided that the existing Notes were so listed prior to the occurrence of such Regulatory Event, Tax Event, Rating Event or, as applicable, Accounting Event), and provided further that:

(1) Assicurazioni Generali obtains approval of the proposed modification or exchange from the Lead Regulator (if such approval is required) or gives prior written notice (if such notice is required to be given) to the Lead Regulator and, following the expiry of all relevant statutory time limits, the Lead Regulator is no longer entitled to object or impose changes to the proposed modification or exchange;

(2) the modification or exchange does not give rise to a change in any published rating of the existing Notes in effect at such time (to the extent the existing Notes were rated prior to the occurrence of such Regulatory Event, Tax Event, Rating Event or, as applicable, Accounting Event);

(3) the modification or exchange does not give rise to any right on the part of the Issuer to exercise any option to redeem the modified Notes or the Qualifying Securities prior to their stated maturity that does not already exist prior to such modification or exchange, without prejudice to the provisions under Condition 11.3 (Redemption and purchase - Redemption at the Option of the Issuer);

(4) the Issuer has delivered to the Fiscal Agent a certificate, substantially in the form shown in the Agency Agreement, signed by a duly authorised representative of the Issuer stating that conditions (i) to (iv) and (1) to (3) above have been complied with, such certificate to be made available for inspection by Noteholders; and

(5) in the case of any proposed modifications or an exchange owing to a Tax Event, the Issuer has delivered to the Fiscal Agent an opinion of independent legal advisers of recognised standing to the effect that the Tax Event can be avoided by the proposed modifications or exchange.

(b) In connection with any modification or exchange as indicated in this Condition 18.4, the Issuer shall comply with the rules of any stock exchange or other relevant authority on which the Notes are then listed or admitted to trading.

2) XS1078235733: UnipolSai Assicurazioni S.p.A. EUR750 million subordinated bond issued in 2014 (coupon 5.75% / undated)

Regulatory Event means that:

(i) UnipolSai is no longer subject to the consolidated regulatory supervision of the Lead Regulator;

or

(…)

(iv) under Italian Legislation on Solvency Margin following implementation of the Future Regulations, the Notes (in whole or in part) fail to be grandfathered as Tier 1 basic own-funds or after having initially been grandfathered, subsequently cease to benefit from the grandfathering provisions other than as a result of the lapse of the grandfathering period, except where, in each case (ii), (iii) or (iv) this is merely the result of exceeding any then applicable limits on the inclusion of the Notes as own funds to meet up to 50 per cent. of the Solvency Margin or as Tier 1 basic own-funds, as the case may be;

Modification and/or Exchange following a Regulatory Event, Tax Event or Rating Event

(b) Where a Regulatory Event, a Tax Event or a Rating Event stated in the relevant Final Terms as applicable, for the purposes of this Condition 16.4, to the Notes has occurred and is continuing, then the Issuer may, without any requirement for the consent or approval of the Noteholders:

(A) where the Final Terms state that Modification Provisions are applicable, modify the terms of the Notes to the extent that such modification is reasonably necessary to ensure that no such Regulatory Event, Tax Event or, as applicable, Rating Event would exist after such modification,

(B) where the Final Terms state that Exchange Provisions are applicable, exchange all (but not some only) of the Notes for Qualifying Securities so that (x) where the relevant event that has occurred is a Regulatory Event, the aggregate nominal amount of the Qualifying Securities is treated under Italian Legislation on Solvency Margin as, prior to the implementation of Future Regulations, own funds available to meet up to 50 per cent. of solvency margin and following implementation of Future Regulations, as at least Tier 2 Own Funds; or (y) where the relevant event that has occurred is a Tax Event or Rating Event, such event no longer applies in relation to the Qualifying Securities, in each case, provided that, following such modification or, as applicable, exchange:

(i) the terms and conditions of, in the case of sub-(A) above, the Notes, as so modified (the modified Notes) or, in the case of sub-(B) above, the Qualifying Securities, are – in the Issuer's reasonable determination after having consulted an independent investment bank of international standing - no more prejudicial to Noteholders than the terms and conditions applicable to the Notes prior to such modification or exchange (the existing Notes) provided that any modification may be made in accordance with paragraphs (ii) to (iv) below and any such modification or, as applicable, any exchange of existing Notes for securities that meet the requirements set out in paragraphs (ii) to (iv) below (Qualifying Securities), shall not constitute a breach of this paragraph (i); and

(ii) either the person having the obligations of the Issuer under the modified Notes or, as applicable, Qualifying Securities (x) continues to be the Issuer, or (y) is substituted in accordance with Condition 18 (Substitution); and

(iii) the modified Notes or, as applicable, Qualifying Securities rank at least equal to the existing Notes prior to such modification or exchange and feature the same tenor, principal amount, at least the same interest rates (including applicable margins), the same interest payment dates and first call date (if any) (except for any early redemption rights analogous to redemption rights under the existing Notes (if any) for Regulatory Event, Tax Event or Rating Event), the same existing rights to any accrued interest, any arrears of interest and any other amounts payable under the Notes as the existing Notes prior to such modification or exchange and either do not contain any term which provides for, requires or entitles the Issuer to effect any loss absorption through a write-down of the nominal amount of the Qualifying Securities or conversion of the Qualifying Securities into ordinary shares or, to the extent the terms and conditions of the existing Notes provide for loss absorption, do not contain any terms providing for loss absorption through principal write-down or conversion into ordinary shares unless the triggers are objective and measurable; and

(iv) the modified Notes or, as applicable, Qualifying Securities continue to be listed on a regulated market (for the purposes of the Markets in Financial Instruments Directive 2004/39/EC) of an internationally recognised stock exchange as selected by the Issuer (provided that the existing Notes were so listed prior to the occurrence of such Regulatory Event, Tax Event or, as applicable, Rating Event), and provided further that:

1. UnipolSai obtains approval of the proposed modification or exchange from the Lead Regulator (if such approval is required) or gives prior written notice (if such notice is required to be given) to the Lead Regulator and, following the expiry of all relevant statutory time limits, the Lead Regulator is no longer entitled to object or impose changes to the proposed modification or exchange;

2. the modification or exchange does not give rise to a change in any published rating of the existing Notes in effect at such time (to the extent the existing Notes were rated prior to the occurrence of such Regulatory Event, Tax Event or, as applicable, Rating Event);

3. the modification or exchange does not give rise to any right on the part of the Issuer to exercise any option to redeem the modified Notes or the Qualifying Securities that does not already exist prior to such modification or exchange, without prejudice to the provisions under Condition 8.3 (Redemption at the option of the Issuer (Issuer Call));

4. the Issuer has delivered to the Agent a certificate, substantially in the form shown in the Agency Agreement, signed by a duly authorised representative of the Issuer stating that conditions (i) to (iv) and (1) to (3) above have been complied with, such certificate to be made available for inspection by Noteholders; and (5) in the case of any proposed modifications or an exchange owing to a Tax Event, the Issuer has delivered to the Fiscal Agent an opinion of independent legal advisers of recognised standing to the effect that the Tax Event can be avoided by the proposed modifications or exchange.

In connection with any modification or exchange as indicated in this Condition 16.4, the Issuer shall comply with the rules of any stock exchange or other relevant authority on which the Notes are then listed or admitted to trading.

Moody's Related Research

Rating Methodologies:

» Global Property and Casualty Insurers, August 2014

» Global Life Insurers, August 2014

Industry Research:

» Solvency II Latest Developments: Equivalence, Internal Model Inconsistency and Matching Adjustments, July 2015

» European Insurance: Pressures on Solvency II Ratios Will Drive Cautious Capital Management, May 2015

» European Insurers: Solvency II: Answers to Frequently Asked Questions, March 2015

» Tier 2 Capital Criteria Changes Under Solvency II, but Ability to "Grandfather" Negates Any Immediate Refinancing Need, July 2014

» Solvency II: Volatility of Regulatory Ratios Could Have Broad Implications For European Insurers, May 2013

» Regulators Take Step Toward Global Capital Requirements for Insurers, July 2014

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Five European insurance groups have been designated as G-SIIs: Allianz SE, Aviva plc, AXA, Generali Assucurazioni S.p.A. and Prudential plc. Four non-European groups have also been designated as G-SIIs (MetLife Inc., Prudential Financial Inc., American International Group Inc. and Ping An Insurance (Group) Co of China Ltd).

2 Please refer to "Global P&C Insurers" and "Global Life Insurers", Moody's Rating Methodologies, August 2014.

3 The Solvency II regime defines two types of capital requirements: the Minimum Capital Requirement (MCR) and the Solvency Capital Requirement (SCR). The SCR is higher than the MCR. However, the MCR is only defined at an operating entity level. Since most « mandatory deferral » clauses reference consolidated solvency capital requirements, in practice, the SCR will be used to determine a breach of the trigger.

4 Please refer to "Pressures on Solvency II Ratios Will Drive Cautious Capital Management", Moody's Sector Comment, May 2015.

5 Please refer to "Solvency II: Volatility of Regulatory Ratios Could Have Broad Implications For European Insurers", Moody's Special Comment, May 2013.

6 One of the key principles introduced by the International Association of Insurance Supervisors is that G-SIIs should be required by their group-wide supervisors to hold higher levels of regulatory capital than would be the case if they were not designated as G-SIIs.

7 Please refer to « Solvency II: Answers to Frequently Asked Questions», Moody's Sector In-Depth, March 2015.

8 For certain long-term guarantees underwritten under Solvency I conditions, transitional measures allow for a gradual implementation of the change in liability values over 16 years. Specifically, with regard to the valuation of technical provisions, there will be: 1) a linear transition from the Solvency I interest rate to the Solvency II risk-free interest rates, or 2) a linear transition from technical provisions based on Solvency I to technical provisions based on Solvency II. Only one of these transition measures can be used.

9 Typical « optional deferral » clauses allow the issuer to defer coupons at any time, provided that no dividend has been paid in the previous six months.

10 For example, because most debts allow for a call in the first five years under certain circumstances (e.g., changes in regulation, changes in taxation), which is prohibited for a debt to be eligible as regulatory capital under Solvency II.

11 For example, under Solvency II, debts cannot be called in the first five years to be eligible as regulatory capital. In most debts issued in the last five years, the issuer has the ability to call the debt in case of a change in regulation or in taxation rules. Removing this clause would not increase credit risk.

12 XS1078235733 : UnipolSai Assicurazioni S.p.A. EUR750 millionsuboridnated bond issued in 2014 (coupon 5.75% / undated). Please refer to "Moody's rates UnipolSai Assicurazioni's undated subordinated bonds Ba2(hyb)", Moody's Press Release, June 2014, for more details.

13 XS1140860534: Generali Finance B.V. EUR1.5 billion subordinated bond issued in 2014 (coupon 4.596% / undated). Please refer to "Moody's rates Generali Finance B.V.'s undated subordinated bonds Ba1(hyb)", Moody's Press Release, November 2014, for more details.

14 In the notes issued by Unipol (XS1078235733), the option can be exercised only if the debt is not grandfathered as Tier 1 or if the debt ceased to benefit from the grandfathering provisions other than as a result of the lapse of the grandfathering period. In the notes issued by Generali (XS1140860534), the reference to « other than as a result of the lapse of the grandfathering period » is not included, which may give more flexibility to the issuer to exercise this option (see Appendix 3).

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