Article Title: ARCHIVE | Criteria | Insurance | General: Insurer Hybrid Capital Instruments With Nonviability Contingent Capital (NVCC) Features Data: (EDITOR'S NOTE: —This article has been superseded by "Hybrid Capital: Methodology And Assumptions," published July 1, 2019.) 1. S&P; Global Ratings is clarifying its methodology and assumptions for assigning equity content and an issue credit rating to an insurer's hybrid capital instrument. The clarification adds the treatment of a contingent capital feature for loss absorption via write-down or conversion into common equity upon the breach of a nonviability trigger. Such a contingent capital feature is herein referred to as nonviability contingent capital (NVCC). 2. This article supplements "Hybrid Capital Handbook: September 2008 Edition," published Sept. 15, 2008, by adding more detail for the treatment of insurers' hybrid capital instruments that contain an NVCC feature. This article is related to the "Principles Of Credit Ratings," published Feb. 16, 2011. I. SCOPE OF THE CRITERIA 3. The criteria in this article apply to our assignment of equity content and an issue credit rating to an insurer's hybrid capital instrument that has an NVCC feature. The term "nonviability contingent capital feature" in this article means a feature that upon activation of a nonviability trigger leads to loss absorption through either principal write-down--whether partial or full--or conversion to common equity. Depending on the terms of the instrument, the loss absorption can be mandatory or discretionary. (See the section III.A below for the definition of a nonviability trigger.) 4. Instruments issued to shareholders and other affiliated parties, including governments (even if not shareholders) are not in scope. Instruments issued by unregulated members of insurance groups, including unregulated holding companies, are also not in scope. II. SUMMARY OF THE CRITERIA 5. An NVCC trigger is relevant for both the equity content and the issue credit rating on a hybrid capital instrument. An NVCC feature can be either mandatory or discretionary, and upon the activation of a nonviability trigger leads to loss absorption through either principal write-down--whether partial or full--or conversion to common equity. 6. Nonviability refers to a situation whereby an insurer is in breach of, or about to breach, regulatory requirements for its license, for example, in situations whereby shareholder equity has been depleted to levels that are about to breach regulatory solvency requirements. 7. An NVCC feature, even if mandatory, does not add to a hybrid capital instrument's loss-absorbing capability before the issuer is non-viable. Thus, we assign "minimal" equity content to the instrument unless its other features are consistent with "intermediate" or "high" equity content. The criteria do not apply a conversion price floor to an NVCC conversion feature in order for the feature to be consistent with "intermediate" or "high" equity content. 8. Our issue credit rating on an instrument that has a mandatory NVCC trigger is one notch lower than that on an equivalent hybrid capital instrument that does not contain a mandatory NVCC clause. A discretionary NVCC feature does not affect the issue credit rating assigned to an instrument. 9. This paragraph has been deleted. See the "Revisions And Updates" section. III. METHODOLOGY AND ASSUMPTIONS 10. The presence of a nonviability feature is relevant to the issue credit rating on a hybrid capital instrument, but does not add to or lower the issue's equity content. A. Defining Nonviability Features 11. "Nonviability" refers to a situation whereby an insurer is in breach of, or about to breach, regulatory requirements for its license, for example, in situations whereby shareholder equity has been depleted to levels that are about to breach regulatory solvency requirements. A hybrid capital instrument with an NVCC feature typically forms part of regulatory capital and, if the feature is mandatory, would have to share the burden of a recapitalization. However, it is unlikely to absorb any losses before nonviability, other than through coupon nonpayment; that is, if the instrument has a nondeferrable coupon, it typically cannot absorb losses before nonviability, limiting the equity content attributable to this feature. B. Equity Content 12. An NVCC feature, even if mandatory, does not add to a hybrid capital instrument's loss-absorbing capability before the issuer is non-viable. Thus, whether the feature is discretionary or mandatory, we assign "minimal" equity content to the instrument, and consequently exclude it from the insurer's total adjusted capital, unless other features of the instrument provide for sufficient loss absorption before the point of nonviability. 13. If an instrument's other features are consistent with "intermediate" or "high" equity content, the NVCC feature does not lower the equity content. The criteria do not apply a conversion price floor to an NVCC conversion feature. This is because we believe that the regulator would not allow an insurer that has recently come close to nonviability to buy back the shares following conversion. If the NVCC instrument also features a mandatory conversion into common equity triggered by factors other than a regulatory NVCC ruling (such as on a pre-specified date), then to assign "intermediate" or "high" equity content in order to reflect the potential for the buyback of the shares following conversion, we continue to apply floors on the conversion price, as per the section '"High" equity content due to mandatory convertibility' in the "Hybrid Capital Handbook" article and in the article "Intermediate Equity Content For Certain Mandatory Convertible Preferred Stock Hybrids," published Nov. 26, 2008. C. Issue Credit Rating 14. Activation of an NVCC feature may impact the instrument's issue credit rating. This is because, as per "Methodology: Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments," published Oct. 24, 2013, a write-down of principal, even if in accordance with the terms of a hybrid capital instrument, results in a 'D' rating if it causes a permanent diminished payment. Also, the conversion of a debt instrument into common equity due to a credit-related trigger, even if in accordance with the terms of the instrument, results in a 'D' rating unless the current market value of the shares received upon conversion equals or exceeds the original principal amount plus any accrued coupon amounts. 1. Rating an insurance hybrid capital instrument with a mandatory NVCC feature 15. We define a mandatory NVCC trigger as one that is mandated either explicitly in the instrument's terms and conditions or by the legal and regulatory framework that governs the instrument. If the write-down or conversion into common equity is discretionary, then the NVCC feature is not mandatory. 16. Consistent with our treatment of such features for regulated bank issuers, unless the next paragraph applies--or "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," published Oct. 1, 2012, applies--our issue credit rating on an instrument that has a mandatory NVCC trigger is one notch lower than that on an equivalent hybrid capital instrument that does not contain a mandatory NVCC clause. (See "Hybrid Capital Handbook" for more details of our criteria for assigning such issue credit ratings to instruments issued by insurers.) The deduction of this additional notch reflects the likelihood of loss absorption via principal write-down, conversion into common equity, or distressed exchange of the hybrid capital instrument. 17. If the principal write-down or conversion into common equity can only occur after the insurer's share capital has been depleted to zero, when we expect the entity to have defaulted on other obligations, then the additional notch in the previous paragraph does not apply. 2. Rating an insurance hybrid capital instrument with a discretionary NVCC feature 18. We define a discretionary NVCC feature as one that allows an optional write-down or conversion into common equity in the instrument's terms and conditions or by the legal and regulatory framework that governs the instrument. Until activated, a discretionary NVCC feature does not affect the issue credit rating assigned to the instrument. IV. REVISIONS AND UPDATES This article was originally published on July 24, 2014. The criteria described in this article became effective immediately upon publication. Changes introduced after original publication: Following our periodic review completed on June 23, 2016, we updated the contact information, updated criteria references, and deleted paragraph 9, which was related to the initial publication of our criteria and no longer relevant. On March 6, 2019, we republished this criteria article to make nonmaterial changes to the contact information. V. RELATED CRITERIA AND RESEARCH Related Criteria Methodology: Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments, Oct. 24, 2013 Assumptions: Application Of Hybrid Capital Criteria Methodologies To Japanese Insurers, Aug. 6, 2013 Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012 Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012 Principles Of Credit Ratings, Feb. 16, 2011 Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010 Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010 Intermediate Equity Content For Certain Mandatory Convertible Preferred Stock Hybrids, Nov. 26, 2008 Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008 Bank Hybrid Capital and Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015 Related Research Credit FAQ: Applying "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings" To Subordinated And Hybrid Capital Instruments, July 16, 2014 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.