



**RESERVE
BANK**

O F N E W Z E A L A N D
T E P Ū T E A M A T U A

**Application for capital recognition or
repayment: material to be provided
to the Reserve Bank.**

Prudential Supervision Department

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Part 1 – Introduction

1. Locally incorporated registered banks must receive a notice of non-objection from the Reserve Bank before including any Additional Tier 1 or Tier 2 capital instrument within regulatory capital and must receive approval for certain repayments of instruments. These requirements are set in subpart 2H of the Reserve Bank documents “Capital Adequacy Framework (Standardised Approach) (BS2A)” and “Capital Adequacy Framework (Internal Models Based Approach) (BS2B)”.
2. This document provides details of the material to be provided to the Reserve Bank as follows:

Part 2: Application for notice of non-objection to treat instruments as regulatory capital.

Part 3: Application for approval to repay capital instruments.

Part 2 - Application for notice of non-objection to treat instruments as regulatory capital

Introduction

3. Directors of banks registered by the Reserve Bank are responsible for ensuring their bank's capital instruments comply with the Reserve Bank's capital adequacy framework. However locally-incorporated registered banks are required to have received a notice of non-objection from the Reserve Bank before including any Additional Tier 1 or Tier 2 instrument in regulatory capital.
4. The non-objection requirement is designed to provide comfort to the Reserve Bank that on the basis of the information it receives from the issuing bank, there is no reason to object to the instrument being recognised as regulatory capital in accordance with the Reserve Bank's capital adequacy framework. A notice of non-objection does not guarantee that the instrument complies with the Reserve Bank's capital adequacy standards.

Information to be provided to the Reserve Bank

5. The following information is to be provided to the Reserve Bank to enable consideration of a notice of non-objection:
 - (i) The proposed tier of the instrument (either Additional Tier 1 or Tier 2);
 - (ii) The nominal value of the instrument and the value of the instrument that will be recognised as regulatory capital (deductions from capital do not need to be accounted for in providing this value);
 - (iii) Which of subparts 2B-2G of BS2A or BS2B the instrument must comply with;
 - (iv) For each criterion within each relevant subpart, 2B-2G, an assessment of whether the instrument complies (Y/N), and an explanation why it does/does not comply;
 - (v) For each criterion, reference to documentation (page and paragraph numbers) that supports the assessment in (iv) above. Also note whether there are any additional terms or conditions that could undermine the assessment in (iv).
6. Items (iv) and (v) of paragraph 5 should be provided in table format. In addition the supporting documentation noted in item (v) should be provided.
7. An instrument may contain a conversion feature for the purposes of complying with the Reserve Bank's loss absorbency requirements. An issuer may be subject to Securities Act disclosure requirements in relation to that instrument at the point of issue or on conversion. Provided that the registered bank, or any other obligated party, can provide evidence that they will be able to meet any such requirement in

a timely fashion (or that they have obtained an appropriate exemption) the Reserve Bank will not consider a requirement to disclose information on issue or conversion to be a legal impediment to conversion occurring.

8. In relation to convertible instruments the information provided to the Reserve Bank must include:
 - (i) A description of how that conversion mechanism will work;
 - (ii) A legal opinion:
 - a. to the effect that there are no known legal impediments to a conversion occurring should a non-viability event occur, including that:
 - i. the entity that will issue shares under the conversion mechanism has the legal power to do so; and
 - ii. any necessary board authorisations have been obtained;
 - b. on what the disclosure requirements are at both the point of issuance and on conversion;
 - (iii) Information on any pre-positioning work the bank intends to do to meet any disclosure requirements (e.g. preparing a draft prospectus that can be completed if required); and
 - (iv) Information on any exemptions obtained from disclosure requirements.

9. Subparts 2E and 2F of BS2A and BS2B require that in determining the value of an instrument for the purposes of regulatory capital recognition, the face value of an instrument must be reduced by any potential tax or other offsets that may reduce the amount of Common Equity Tier 1 capital generated for the registered bank as a result of conversion or write-off. Generally the Reserve Bank expects that tax will be the only significant offset. In order to determine the value of the instrument that may be recognised the Reserve Bank may require a tax opinion or binding ruling.

10. Whether the Reserve Bank will require a tax opinion or binding ruling, in order for the value of the instrument to be determined, will depend on the case. Registered banks should discuss this matter with their supervisor. However in general the Reserve Bank's approach will be:
 - (i) No legal opinion or ruling will be required where the registered bank reduces the value of the instrument, for the purposes of regulatory capital recognition, by at least the company tax rate multiplied by the value of the instrument;
 - (ii) No legal opinion or ruling will be required in respect of preference shares;
 - (iii) If 10(i) or 10(ii) does not apply:
 - a. where a registered bank first uses a particular issuance structure to issue a capital instrument, a binding ruling will be required in respect of that instrument in order for the full value of the instrument to be recognised;
 - b. further instruments that use the same issuance structure will not require a binding ruling in order for the full value of the instrument to be recognised, provided that the registered bank is able to provide a legal opinion to the effect that the issuance structure and the instrument are in all material respects the same and that there has been no change in tax law that may impact on the instrument's tax treatment.

Part 3 - Application for approval to repay capital instruments

Introduction

11. Except in the case of a loss absorption trigger event or a non-viability trigger event, a registered bank must not:
- repay an Additional Tier 1 capital instrument; or
 - repay a Tier 2 capital instrument prior to maturity; unless:
 - (i) The registered bank has received the prior written approval of the Reserve Bank; and
 - (ii) Prior to or concurrent with the repayment, the instrument is replaced with a paid-up capital instrument of the same or better quality and the terms and conditions of the replacement instrument are sustainable for the income capacity of the banking group, unless the registered bank demonstrates to the Reserve Bank's satisfaction that the banking group's capital position would be sufficiently above the minimum capital requirements after the repayment.

Supporting information required

12. The following information must be provided to the Reserve Bank in support of an application to repay a capital instrument:
- (i) Copy of the notice of non-objection (or approval) from the Reserve Bank for recognition as regulatory capital of the instrument being repaid;
 - (ii) Proposed date of repayment;
 - (iii) Any other information requested by the Reserve Bank.
13. The following information must be provided to the Reserve Bank in support of an application to repay a capital instrument when the registered bank proposes not to replace the capital instrument being repaid:
- (i) The rationale for not replacing the capital instrument;
 - (ii) Projections of the banking group's Common Equity Tier 1 capital ratio, Tier 1 capital ratio, Total capital ratio and buffer ratio for the four quarter ends following repayment of the capital instrument, and a list of assumptions underpinning the projections.
14. The following information must be provided to the Reserve Bank in support of an application to repay a capital instrument when the registered bank proposes to replace the capital instrument being repaid:

- (i) An application for a notice of non-objection for the replacement instrument containing the information specified in Part 2 of this document;
- (ii) The date the proposed replacement instrument will be fully paid in;
- (iii) In relation to the instrument that the registered bank proposes to repay, details of the interest or coupon rate that applies prior to repayment and details of the expected interest or coupon payment rate on that instrument if it were not repaid;
- (iv) Details of the expected interest or coupon payments on the proposed replacement instrument;
- (v) Details of the economic and prudential rationale for repaying the existing instrument if the expected interest or coupon rate on the proposed replacement instrument is materially higher;
- (vi) An assessment of whether there is any difference in the quality of the replacement instrument compared to the instrument being repaid (such as whether it is a different tier or differences in call terms or conversion/write-off features);
- (vii) Where the instrument is of a different tier, projections of the banking group's Common Equity Tier 1 capital ratio, Tier 1 capital ratio, Total capital ratio and buffer ratio for the four quarter ends following repayment of the capital instrument, and a list of assumptions underpinning the projections.