RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

Explanatory note regarding dividend restrictions

On 2 April 2020, Reserve Bank Deputy Governor and General Manager for Financial Stability Geoff Bascand announced that to further support the stability of the financial system during the period of economic uncertainty brought about by the COVID-19 pandemic, New Zealand's retail banks agreed with the Reserve Bank that during this period there will be no payment of dividends on ordinary shares, and that they should not redeem non-CET1 capital instruments.

The restrictions took effect from 2 April 2020 under revised Conditions of Registration issued to all locally-incorporated banks. They will remain in place until further notice, with the aim of relaxing them when the economic outlook has sufficiently recovered.

Restrictions on distributions on capital

Before 2 April 2020, New Zealand-incorporated banks were all subject to the following condition of registration (the "buffer ratio condition") –

1C. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:

(a) according to the following table, limit the aggregate distributions of the bank's earnings to the percentage limit to distributions that corresponds to the banking group's buffer ratio:

Banking group's buffer ratio	Percentage limit to distributions of the bank's earnings
0% – 0.625%	0%
>0.625 – 1.25%	20%
>1.25 – 1.875%	40%
>1.875 – 2.5%	60%

(b) prepare a capital plan to restore the banking group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and

(c) have the capital plan approved by the Reserve Bank.

Distributions on capital instruments have been more tightly restricted by revising the buffer ratio condition, and adding a new condition, as shown in the box below, with effect from 2 April 2020 –

1C. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:

(a) according to the following table, limit any distributions of the bank's earnings payable to holders of Additional Tier 1 capital instruments to the percentage limit on distributions that corresponds to the banking group's buffer ratio:

Banking group's buffer ratio	Percentage limit on distributions of the bank's earnings
0% – 0.625%	0%
>0.625 – 1.25%	20%
>1.25 – 1.875%	40%
>1.875 – 2.5%	60%

(b) prepare a capital plan to restore the banking group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and

(c) have the capital plan approved by the Reserve Bank.

1D. That the bank must make no distributions, whether paid out of earnings, or out of accumulated previous years' retained earnings or other reserves included within the banking group's total capital, other than discretionary payments payable to holders of Additional Tier 1 capital instruments to the extent permitted by condition 1C.

A number of the terms used in these conditions of registration are given specific definitions, for the purpose of the condition, by reference to the relevant Reserve Bank policy document. For banks accredited to use their own internal models to calculate capital ratios, the relevant document is "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B), while for other banks it is "Capital Adequacy Framework (Standardised Approach)" (BS2A).

The terms used here are defined identically for both types of bank, as follows –

- "buffer ratio" is defined as Surplus Common Equity Tier 1 capital, as a percentage of total risk-weighted assets, where …
- … "Surplus Common Equity Tier 1 capital" means any amount of Common Equity Tier 1 capital that is not required to meet minimum capital ratio requirements.
- "distributions" and "earnings" have specific meanings given in Part 3 of BS2A or BS2B for the purpose of these conditions.
- an Additional Tier 1 capital instrument is an instrument that meets the requirements specified in BS2A or BS2B.
- "total capital" refers to total regulatory capital calculated in accordance with BS2A or BS2B.

The effect of these changes is to ban, until further notice, any distributions to common equity shareholders of the bank, whether out of current year's earnings or prior years' retained earnings. The restrictions that apply when the buffer ratio falls below 2.5% now apply only to distributions on Additional Tier 1 instruments, not (as previously) to the aggregate of distributions on Additional Tier 1 instruments and common equity.

Interest payments on Tier 2 instruments were not within scope of the previous buffer ratio condition, and are also not affected by the changes, since they do not fall within the definition of "distributions" for the purpose of these conditions.

Restrictions on repayments of principal on capital instruments

New Zealand-incorporated banks are subject to requirements on existing capital instruments set out in Part 3 of the Reserve Bank of New Zealand document “Application requirements for capital recognition or repayment and notification requirements in respect of capital” (BS16). These requirements include that a bank may not repay an Additional Tier 1 capital instrument, or repay a Tier 2 capital instrument before its final maturity date, without obtaining the Reserve Bank’s prior permission.

The Reserve Bank has made it clear that in current circumstances it will not agree to any request from a bank to redeem a capital instrument in this way.

For Tier 2 instruments that have a final redemption date, this means that holders of the instrument will be repaid at that date, but cannot expect repayment on an earlier call date unless the economic outlook has improved sufficiently to justify the Reserve Bank relaxing its current stance by then.