

## BPR110: CAPITAL DEFINITIONS

### Purpose of document

This document provides the definitions that a bank must use for calculating the value of total capital and the components of that total, for the purpose of calculating the regulatory capital ratios defined in BPR100.

Banking Prudential Requirements  
Document BPR110

## Document version history

{1 July 2021}	First issue date
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## Conditions of registration

The Reserve Bank of New Zealand Act 1989 (the **Act**) permits the Reserve Bank to impose conditions of registration (**conditions**) on registered banks<sup>1</sup>.

This document BPR110: Capital Definitions forms part of the requirements for the following conditions:\*

- A New Zealand-incorporated registered bank is normally subject to a condition requiring it to maintain capital ratios above specified minimum levels, and also to a condition imposing restrictions on its dividend payments when its prudential capital buffer ratio falls below specified levels.<sup>2</sup> This document sets out the methodology for calculating the values of the different tiers of a bank's capital, and the eligibility criteria that capital instruments issued by the bank must meet to be included in the respective tiers. A New Zealand-incorporated registered bank needs to calculate its CET1 capital, Tier 1 capital, and total capital as part of calculating its day-to-day values for the capital ratios and the capital buffer ratio, and hence monitor its compliance with these capital adequacy conditions.

*\* All of the material set out in this document forms part of the requirements of the applicable condition, except material that is expressly identified as guidance by being included in a shaded box like this.*

<sup>1</sup> The conditions can relate to any of the matters referred to in sections 73 – 73B, 78 and 81. The standard conditions are contained in Appendix 1 of document BS1: Statement of Principles.

<sup>2</sup> These conditions of registration relate to the matter referred to in: section 78(1)(c) (capital in relation to the size and nature of the business).

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## Part A: Introduction and definitions

### A1 Introduction

#### A1.1 Purpose of this document

- (1) The purpose of this document is to provide definitions of total capital and of the sub-categories of capital to be used in calculating the capital adequacy ratios specified in section B2.7 of BPR100. It specifies minimum requirements that instruments and reserves must meet to qualify for each of the categories of capital included in the capital ratio calculations.
- (2) Additional terms included in the contractual terms of a capital instrument will not disqualify the instrument from being included in the applicable capital ratio calculations, provided that those terms do not affect the instrument's compliance with the requirements contained in this document.

Source: BS2A, para 4: BS2B, para 2.1.

### A2 Definitions and transitionals

#### A2.1 Meaning of terms used in this document

In this document,—

**Additional Tier 1 capital (AT1 capital)** means capital that meets the general requirements specified in section B2.1 and that falls within the definition given in section B2.2

**associated**, in relation to a funds management or securitisation vehicle, has the meaning given to association in Part A of BPR 160

**Common Equity Tier 1 capital (CET1 capital)** means capital that meets the general requirements specified in section B1.1 and that falls within the definition given in section B1.2

**control or significant influence** means—

- (a) the ability to directly or indirectly appoint 20% or more of the members of the governing body of an entity; or

*Guidance: Members of the governing body will include, for example, a board of directors.*

- (b) the power to influence the financial and operating policy decisions of an entity; or
- (c) holding a direct or indirect qualifying interest in 20% or more of the voting securities of an entity

*Guidance: Where the employees or directors of one entity (entity A) constitute a significant portion of the board of another entity (entity B), entity A will prima facie be considered to exert control or significant influence over entity B.*

**maturity** or **maturity date** includes a maturity date or a scheduled redemption date

**related entity**, in respect of a registered bank, means an entity—

- (a) over which any member of the banking group (or the registered bank, in the case of solo capital) exercises control or significant influence; or

- (b) that exercises control or significant influence over any member of the banking group (or the registered bank, in the case of solo capital); or
- (c) over which another entity exercises control or significant influence, where that other entity also exercises control or significant influence over a member of the banking group (or the registered bank, in the case of solo capital).

*Guidance: This definition includes, but is not limited to, a holding company, a sister company, or subsidiary, of any member of the banking group.*

**repay** includes to repay by way of a call, acquisition, or redemption, and **repayment** and **repaid** have corresponding meanings

**special purpose vehicle** or **SPV** means a single purpose non-operating entity established for the principal purpose of raising regulatory capital for the banking group

**third party** means an entity that is not the registered bank or a member of the banking group

**Tier 2 capital** means capital that falls within the definition given in section B3.2

**total capital** has the meaning given in section A2.2

**written off** means written off, extinguished, or discharged.

*Source: BS2A, para 5; BS2B, para 2.2.*

## A2.2 Meaning of total capital

- (1) **Total capital** is calculated as the sum of the values of the following categories of capital:
  - (a) **Tier 1 capital** (going-concern capital), which is the sum of–
    - (i) **Common Equity Tier 1 capital (CET1 capital)**; and
    - (ii) **Additional Tier 1 capital (AT1 capital)**; and
  - (b) **Tier 2 capital** (gone-concern capital).
- (2) Each of the three categories above ((a)(i), (a)(ii) and (b)) is calculated net of associated regulatory adjustments.

*Guidance: Requirements in this document for each of the three categories of capital include eligibility requirements that a financial instrument must meet to be included in the respective category.*

*Source: BS2A, para 6(1) and (2); BS2B, paras 2.3 and 2.4.*

## A2.3 Transitional recognition of capital instruments

A bank may include in its regulatory capital a capital instrument that does not meet the requirements set out in this document, subject to the following conditions:

- (a) the instrument was issued on or before 30 June 2021; and
- (b) the instrument meets the requirements for AT1 capital or Tier 2 capital in the Reserve Bank of New Zealand document–
  - (i) *Capital Adequacy Framework (Standardised Approach) (BS2A)* dated November 2015 if issued by a standardised bank; or
  - (ii) *Capital Adequacy Framework (Internal Models Based Approach) (BS2B)* dated November 2015 if issued by an IRB bank; and

- (c) on 30 ~~June~~ ~~September~~ 2021 the bank holds a current notice of non-objection from the Reserve Bank in respect of the instrument allowing it to recognise the instrument as–
- (i) an AT1 capital instrument (referred to in section A2.4 as a “transitional AT1 capital instrument”); or
  - (ii) a Tier 2 capital instrument (referred to in section A2.4 as a “transitional Tier 2 capital instrument”); and
- (d) the recognition of the instrument in regulatory capital is phased out beginning on 1 ~~January~~ ~~July~~ 2022~~4~~, following the approach set out in section A2.4; and
- (e) in all cases no portion of the value of the instrument can be included in regulatory capital on or after 1 July 2028.

#### A2.4 Phasing out of transitional recognition of capital instruments

- (1) A bank must phase out the recognition of an instrument included in its regulatory capital under section A2.3 in accordance with this section.
- (2) The total value of a bank’s transitional AT1 capital instruments that it may include in total AT1 capital on any date on or after 1 ~~October~~ ~~July~~ 2021 is the lesser of–
- (a) the sum of the outstanding amounts of those instruments as at that date; and
  - (b) the cap on transitional AT1 capital instruments applying at that date, calculated by multiplying the total nominal amount of such instruments outstanding and recognised as AT1 capital on 30 ~~September~~ ~~June~~ 2021 by the applicable percentage for the relevant date in accordance with Table A2.4.
- (3) The total value of a bank’s transitional Tier 2 capital instruments that it may include in total Tier 2 capital on any date on or after 1 ~~October~~ ~~July~~ 2021 is the lesser of–
- (a) the sum of the outstanding amounts of those instruments ~~that would have been eligible as Tier 2 capital in terms of BS2A or BS2B, as the case may be, as at that date, in accordance with BS2A or BS2B;~~ and
  - (b) the cap on transitional Tier 2 capital instruments applying at that date, calculated by multiplying the total nominal amount of such instruments outstanding and recognised as Tier 2 capital on 30 ~~September~~ ~~June~~ 2021, after applying any required amortisation, by the applicable percentage for the relevant date in accordance with Table A2.4.

**Table A2.4 – Transitional phase-out schedule**

<i>Period</i>	<i>Percentage cap</i>
<del>1 October 2021 to 31 December 2021</del>	<del>100%</del>
<del>1 January</del> <del>July</del> 2022 <del>4</del> to <del>31 December 2022</del> <del>30 June 2022</del>	87.5%
<del>1 January 2023 to 31 December 2023</del> <del>1 July 2022 to 30 June 2023</del>	75%
<del>1 January 2024 to 31 December 2024</del> <del>1 July 2023 to 30 June 2024</del>	62.5%



<u>1 January 2025 to 31 December 2025</u> <del>1 July 2024 to 30 June 2025</del>	50%
<u>1 January 2026 to 31 December 2026</u> <del>1 July 2025 to 30 June 2026</del>	37.5%
<u>1 January 2027 to 31 December 2027</u> <del>1 July 2026 to 30 June 2027</del>	25%
<u>1 January 2028 to 30 June 2028</u> <del>1 July 2027 to 30 June 2028</del>	12.5%
On and after 1 July 2028	0%

Source: BS2A, para 6(3)(a)-(f); BS2B, para 2.5 (re-worked).

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## Part B: Categories of capital

### B1 Common Equity Tier 1 capital

#### B1.1 General principles

Common Equity Tier 1 capital is the highest quality of capital, and must–

- (a) provide a permanent and unrestricted commitment of funds; and
- (b) be freely available to absorb losses; and
- (c) not impose any unavoidable servicing charge against earnings.

*Source: BS2A, para 7(1); BS2B, para 2.7.*

#### B1.2 Definition of Common Equity Tier 1 capital

- (1) Common Equity Tier 1 capital (**CET1 capital**) must be calculated as the sum of the values of the components specified in subsection (2) and the regulatory adjustments specified in sections B1.3 to B1.13.

*Guidance: A regulatory adjustment may result in an addition to or subtraction from the total CET1 figure, as specified in each of those sections.*

*Additional deductions from CET1 capital may be required under the corresponding deductions approach provided in Part C.*

*Any asset that is deducted from CET1 capital should not be included in the calculation of risk-weighted assets*

*Banks structured as mutual societies, such as building societies or credit unions, will not always have paid up ordinary shares, such as those held by companies. This is because their mutual nature often means their customers are members and they do not have separate ordinary shares.*

*Source: BS2A, para 7(3)(n) & 7(5); BS2B, para 2.9(n) & 2.11. Guidance 1<sup>st</sup> and last paragraph sentence are new text*

- (2) The components of CET1 capital are–
- (a) paid-up ordinary shares, issued by the ~~registered~~ bank, that meet the criteria in subpart D1; and
  - (b) share premium resulting from the issue of ordinary shares included in CET1 capital; and
  - (c) retained earnings net of any appropriations such as tax payable, dividends to be paid, or transfers to other reserves; and
  - (d) accumulated other comprehensive income and other disclosed reserves–
    - (i) including, but not limited to, reserves that are created or increased by appropriations of retained earnings and unrealised gains and losses on measuring assets at fair value through other comprehensive income in accordance with NZ IFRS 9; but
    - (ii) excluding–
      - (A) reserves that are earmarked to particular assets or particular categories of banking activities; and
      - (B) reserves held on account of any assessed likelihood of loss; and

- (C) revaluation reserves that may be included in Tier 2 capital under subsection B3.2(2)(d); and
- (e) interests arising from the issue of ordinary shares to third parties (**minority interests**) by a fully consolidated subsidiary (calculated in accordance with subpart E1) that meet the eligibility criteria in section E1.2.

Source: BS2A, para 7(2); BS2B, para 2.8.

### B1.3 Goodwill deduction

- (1) Goodwill and other intangible assets, including amounts specified in subsection (2), must be deducted from CET1 capital.
- (2) The deduction for goodwill must include any goodwill included in the valuation of a significant investment—
- in the regulatory capital of a bank, non-bank deposit taker, or insurance entity (or overseas equivalent); and
  - in the equity of another entity that is a financial institution and is outside the scope of consolidation for the capital ratio calculation.
- (3) The amount of goodwill to be deducted may be reduced by the value of any associated deferred tax liability that would be extinguished if the assets involved became impaired or derecognised under GAAP.
- (4) In subsection (2), **significant investment** means an investment in the ordinary shares of another entity that exceeds 10% of the issued ordinary shares of that entity.

Source: BS2A, para 7(3)(a); BS2B, para 2.9(a), and subs(4) moved from definitions sections.

### B1.4 Deferred tax asset deduction

- (1) Deferred tax assets must be deducted from CET1 capital, subject to netting against deferred tax liabilities, as provided for in subsections (2) and (3).
- (2) The value of the deferred tax asset deduction may be reduced by the value of deferred tax liabilities, but only if the deferred tax assets and liabilities to be netted meet all of the following criteria:
- the deferred tax assets and liabilities arise as a result of deductible temporary differences (as defined by NZ IAS 12); and
  - the deferred tax assets and liabilities do not arise from the carry forward of unused tax losses or tax credits; and
  - ~~(c)~~ the deferred tax assets and liabilities relate to taxes levied by the New Zealand Inland Revenue; and
  - ~~(d)~~ the deferred tax assets and liabilities netted may be offset under NZ IAS 12.
- (3) The value of deferred tax liabilities that is netted may not exceed the value of deferred tax assets, which, to avoid doubt, means that any excess of deferred tax liabilities over assets cannot be added to CET1 capital.

Guidance: This means that any excess of deferred tax liabilities over assets cannot be added to CET1 capital.

Source: BS2A, para 7(3)(b); BS2B, para 2.9(b), 2(b) is new text.

**B1.5 Deductions for funds management, securitisation, and insurance business**

The following amounts must be deducted from CET1 capital:

- (a) a credit enhancement provided to any associated funds management or securitisation SPV in accordance with subsection A2.3(3) of BPR 160, unless the bank has chosen to consolidate the SPV or expense the amount of the credit enhancement as provided for in that section; and
- (b) a credit enhancement provided to any member of an affiliated insurance group in accordance with subsection B2.1 of BPR 160, unless the bank has chosen to expense the amount of the credit enhancement as provided for in that section; and
- (c) the full amount of funding provided to an affiliated insurance group in accordance with section B3.1 of BPR160 if the minimum separation requirements in that section are not met; and
- (d) the full amount of aggregate funding provided to all affiliated insurance groups, and to all associated funds management and securitisation vehicles that are not consolidated for the purpose of the capital ratio calculation, if that amount exceeds 10% of CET1 capital, as provided for in section C1.1 of BPR160.

Source: BS2A, subparas 7(3)(d) to (g); BS2B, subparas 2.9(d) to (g).

**B1.6 Connected capital lending deduction**

- (1) Any advance of a capital nature provided to a connected person must be deducted from CET1 capital.
- (2) For the purpose of subsection (1), an advance of a capital nature provided to a connected person has the meaning given in the Reserve Bank document *Connected Exposures Policy (BS8)*, in the version applying to the bank in its conditions of registration.

Source: BS2A, para 7(3)(h); BS2B, para 2.9(h).

**B1.7 Fair value gains and losses to be excluded**

The following amounts must be excluded from CET1 capital:

- (a) any unrealised gain or loss that has resulted from a change in the fair value of liabilities due to a change in the creditworthiness of—
  - (i) a member of the banking group, for the purpose of the group capital ratio calculation; or
  - (ii) an entity within the scope of the solo capital ratio calculation, for the purpose of that calculation; and
- (b) any fair value gain or loss relating to a financial instrument for which a fair value cannot reliably be calculated, but, to avoid doubt, this case must not be used to add back to CET1 capital a fair value loss arising from credit impairment on a loan and recognised in retained earnings.

*Guidance: Excluding such items means that gains must be deducted and losses may be added back.*

Source: BS2A, subparas 7(3)(i) and (j); BS2B, subparas 2.9(i) and (j).

**B1.8 Removal of cash flow hedge reserve**

The reserves included in CET1 capital must be adjusted to remove the amount of the cash flow hedge reserve that relates to the hedging of items that are not recorded at fair value on the balance sheet (including projected cash flows).

*Guidance: Any gains on hedges are to be deducted and any losses on hedges added back.*

*Source: BS2A, para 7(3)(c); BS2B, para 2.9(c).*

**B1.9 Superannuation fund assets and liabilities**

- (1) Any asset on the balance sheet arising from a defined benefit superannuation fund must be deducted from CET1 capital in accordance with subsection (2).
- (2) The amount to be deducted under subsection (1) is the value of the asset net of any associated deferred tax liability that would be extinguished if the asset should become impaired or derecognised under GAAP.
- (3) Any liability on the balance sheet arising from a defined benefit superannuation fund must be fully recognised in the calculation of CET1 capital.

*Guidance: This means that CET1 capital cannot be increased through derecognising these liabilities. There is an asymmetry in the treatment of superannuation fund assets and liabilities.*

*Source: BS2A, para 7(3)(k) and 7(4); BS2B, para 2.9(k) and 2.10.*

**B1.10 Holdings of own shares**

- (1) The value of any holding of the bank's own ordinary shares that meets the conditions in subsection (2) must be deducted from CET1 capital, unless the holding is eliminated through the application of GAAP.
- (2) The conditions referred to in subsection (1) are as follows:
  - (a) the bank owns the shares, whether directly or indirectly, and regardless of whether they are held for trading or held for investment purposes; or
  - (b) the bank or a member of the banking group could be contractually obliged to purchase the shares.

*Source: BS2A, para 7(3)(l); BS2B, para 2.9(l).*

**B1.11 Unrealised loss on securities held**

- (1) Any unrealised revaluation loss on a holding of securities that arises in the circumstances described in subsection (2) must be deducted from CET1 capital.
- (2) For the purpose of subsection (1), an unrealised loss arises where the book value of the securities exceeds the market value but the resulting unrealised loss has not been incorporated into the accounts, and the amount to be deducted is the full value of the difference.

*Source: BS2A, para 7(3)(m); BS2B, para 2.9(m).*

**B1.12 Deduction for under-collateralised reverse mortgages**

- (1) A deduction from CET1 capital must be made if—
  - (a) the loan value of a reverse residential mortgage loan on the balance sheet exceeds the value of the security for the loan; and
  - (b) the security is residential property.

- (2) The amount of the deduction required under subsection (1) is the amount by which the loan value exceeds the security value.

*Guidance: This treatment is part of the standardised risk-weighting approach for residential mortgage loans set out in Subpart C3 of BPR131.*

*Source: BS2A, para 7(3)(o); BS2B, para 2.9(p). (New guidance added).*

### B1.13 IRB bank expected losses

An IRB bank must deduct from CET1 capital the amounts required by section F1.5(1) and (2) of BPR133.

*Guidance: These deductions arise from the amount, if any, by which expected credit losses exceed eligible credit impairment allowances on credit exposures risk-weighted using the IRB approach.*

*Source: BS2B, para 2.9(o) (not in BS2A).*

## B2 Additional Tier 1 capital

### B2.1 General principles

Additional Tier 1 capital comprises high-quality capital and must–

- (a) provide a permanent and unrestricted commitment of funds; and
- (b) be freely available to absorb losses; and
- (c) provide for fully discretionary capital distributions.

*Source: BS2A, para 8(1); BS2B, para 2.12.*

### B2.2 Definition of Additional Tier 1 capital

- (1) Additional Tier 1 capital (**AT1 capital**) must be calculated as the sum of the values of the components specified in subsection (2), less any amounts required to be deducted from AT1 capital under the corresponding deductions approach specified in subpart C.

- (2) The components of AT1 capital are–

- (a) any instrument issued by the bank, or an SPV of the bank, that–
  - (i) is not included in CET1 capital; and
  - (ii) meets the criteria for AT1 capital instruments set out in subpart D2; and

*Guidance: The criteria in subpart D2 for AT1 instruments are reflected in the checklist supported by the template terms sheet set out in Appendix 1.*

- (iii) if issued by an SPV, meets the criteria in subpart E2; and
- (b) share premium resulting from the issue of any instrument included in AT1 capital; and
- (c) interests arising from any instrument that–
  - (i) is issued by a fully consolidated subsidiary of the ~~registered~~ bank; and
  - (ii) is held by third parties; and
  - (iii) meets the conditions set out in subsection (3).

*Guidance: The case of minority interests in AT1 instruments does not arise when calculating the registered bank's solo capital ratio.*

- (3) The conditions referred to in subsection (2)(c)(iii) are that–
- (a) the instrument must meet the eligibility criteria in section E1.4; and
  - (b) the value to be included is calculated in accordance with section E1.5; and
  - (c) **fully consolidated subsidiary** is limited to a fully consolidated subsidiary that is also an associated person of the registered bank, as defined in section 2(2) of the Act.

*Source: BS2A, para 8(2); BS2B, paras 2.13 and 2.14.*

## B3 Tier 2 capital

### B3.1 Characteristics

Tier 2 capital comprises certain types of reserves and subordinated debt instruments that do not qualify as CET1 or AT1 capital, but are available to absorb losses ahead of more senior creditors of the banking group in a winding up.

*Source: BS2A, para 9(1); BS2B, para 2.15.*

### B3.2 Definition of Tier 2 capital

- (1) Tier 2 capital must be calculated as the sum of the values of the components specified in subsections (2) and (3), less any amounts required to be deducted from Tier 2 capital under the corresponding deductions approach specified in Part C.

- (2) The components of Tier 2 capital are–

- (a) any instrument issued by the bank, or an SPV of the bank, that–
  - (i) is not included in Tier 1 capital; and
  - (ii) meets the criteria for inclusion in Tier 2 capital in subpart D3;
  - (iii) if issued by an SPV, meets the criteria in subpart E2; and

*Guidance: The criteria in subpart D3 for Tier 2 instruments are reflected in the checklist supported by the template terms sheet set out in Appendix 2.*

- (b) share premium resulting from the issue of instruments included in Tier 2 capital; and
- (c) any instrument that–
  - (i) is issued by a fully consolidated subsidiary of the ~~registered~~ bank; and
  - (ii) is held by third parties; and
  - (iii) meets the conditions set out in subsection (4); and

*Guidance: The case of minority interests in Tier 2 instruments does not arise when calculating the registered bank's solo capital ratio.*

- (d) revaluation reserves, comprising–
  - (i) reserves arising from a revaluation of tangible fixed assets, including owner-occupied property, and cumulative fair value gains on investment property, which have been subject to audit or review by the ~~registered~~ bank's auditor; and

*Guidance: Cumulative losses below depreciated cost value on any individual property must not be netted against revaluation gains on other property. Such losses impact on CET1 capital via the accounting treatment, and no regulatory adjustment should be made to that impact.*

- (ii) foreign currency translation reserves; and
  - (iii) reserves arising from a revaluation of security holdings, with the value to be included in Tier 2 capital being–
    - (A) the full value of any such reserves that have been incorporated into the accounts; and
    - (B) 45% of the value of any such reserves that have not been incorporated into the accounts.
- (3) An IRB bank may include in Tier 2 capital the amount specified in section F1.5(3) and (4) of BPR133.

*Guidance: This addition to Tier 2 capital arises where an IRB bank's eligible impairment allowances on non-defaulted IRB-risk-weighted loans exceed the bank's estimate of expected loss on such loans. The amount that can be included in Tier 2 capital is capped at 0.6% of total RWAs on IRB-risk-weighted loans.*

- (4) The conditions referred to in subsection (2)(c) are that–
- (a) the instrument must meet the eligibility criteria in section E1.6; and
  - (b) the value to be included is calculated in accordance with section E1.7; and
  - (c) **fully consolidated subsidiary** is limited to a fully consolidated subsidiary that is also an associated person of the registered bank as defined in section 2(2) of the Act.

*Source: BS2A, para 9(2); BS2B, paras 2.16 and 2.17.*



## Part C: Deductions from total capital

### C1 Corresponding deductions approach

#### C1.1 Purpose

- (1) This subpart specifies the deductions that must be made from the values of CET1 capital, AT1 capital, or Tier 2 capital that are to be used for the capital ratio calculations.
- (2) The deductions specified in this subpart are in addition to those specified in subpart B1 and, if a deduction has already been made from CET1 capital in accordance with sections B1.3 to B1.13, no further deduction is required.

*Source: BS2A, para 10(2); BS2B, para 2.19, and new text.*

*Guidance: BPR130 section A1.3(4) specifies that assets deducted according to the corresponding deductions approach should not be included in the calculation of risk-weighted assets.*

*Source: BS2A, para 10(5); BS2B, para 2.22.*

#### C1.2 Corresponding deductions approach

- (1) The deductions in this subpart must be made using the corresponding deductions approach, under which the portion of the value of an instrument to be deducted must be deducted from the category of capital for which the instrument itself would qualify if it was issued by a member of the banking group.
- (2) If the amount of a deduction from a particular category of capital exceeds the total value of that category of capital, the amount of the excess must be deducted from a higher quality category of capital.

*Guidance: For example, if the banking group starts with 100 AT1 capital and is required to deduct 150 from AT1 capital under this subpart, the banking group is left with nil eligible AT1 capital and 50 must be deducted from CET1 capital.*

*Source: BS2A, para 10(1); BS2B, paras 2.18.*

- (3) If the capital instrument of the entity in which the investment is made does not meet the criteria for CET1 capital, AT1 capital, or Tier 2 capital, the capital is to be considered ordinary shares for the purposes of the corresponding deductions approach.

*Source: BS2A, para 10(4); BS2B, para 2.21.*

#### C1.3 Reciprocal cross-holdings

A reciprocal cross-holding in the capital of a bank, non-bank deposit taker, or insurance entity (or overseas equivalent), or in the equity of another entity that is a financial institution, must be deducted from capital following the corresponding deductions approach.

*Source: BS2A, para 10(3)(a); BS2B, para 2.20(a).*

#### C1.4 Aggregate of stakes of 10% or less

- (1) If the aggregate of investments meeting the criteria in subsection (3) and in section C1.6 is greater than 10% of the banking group's CET1 capital, the amount by which that aggregate exceeds 10% of CET1 capital must be deducted using the corresponding deductions approach.

*Guidance: The value of CET1 capital to be used for applying the threshold in subsection (1) is the value after applying all the regulatory adjustments to CET1 capital set out in section B1.3 to B1.13.*

- (2) The amount to be deducted under this section from a specific category of capital is equal to:
- (a) the amount in excess of 10% of the banking group's CET1 capital, referred to in subsection (1), multiplied by—
  - (b) the ratio between—
    - (i) the value of the banking group's investments that both meet the criteria in subsection (3) and C1.6 and are in that category of capital: and
    - (ii) the total value of the banking group's investments that meet the criteria in subsection (3) and C1.6.

*Guidance: This means that the total amount to be deducted under this section is allocated across CET1, AT1 and Tier 2 capital in proportion to the share that each category of capital has in the total of capital instruments the banking group owns falling within the scope of this deduction.*

- (3) The criterion referred to in subsections (1) and (2) is that the banking group does not own more than 10% of the issued ordinary share capital of the entity in which the investment is held.
- (4) This section also applies to the solo capital calculation, with references to the banking group replaced with references to the registered bank.

*Source: BS2A, para 10(3)(b); BS2B, para 2.20(b); and new text.*

#### **C1.5 Individual stakes exceeding 10% and investments in related entities**

- (1) The full amount of any investment meeting the criteria in subsection (2) and in section C1.6 must be deducted using the corresponding deductions approach.
- (2) The criterion referred to in subsection (1) is that the banking group (or registered bank, for solo capital calculation) owns more than 10% of the issued ordinary share capital of the entity in which the investment is made, or the entity is a related entity of any member of the banking group (or registered bank, for solo capital).

*Source: BS2A, para 10(3)(c); BS2B, para 2.20(c).*

#### **C1.6 General criteria for investments to be deducted**

The criteria for an investment to fall within the scope of the deductions in section C1.4 or section C1.5 are that the investment –

- (a) is in the form of a holding of an instrument issued by an entity that is outside the scope of consolidation of the capital ratio calculation; and
- (b) is held directly, indirectly, or through an index; and
- (c) does not arise from an underwriting position that is held for five days or less; and
- (d) is in—
  - (i) an instrument that qualifies as regulatory capital of a bank, non-bank deposit taker, or insurance entity (or overseas equivalent); or
  - (ii) the equity of another entity that is a financial institution; and

- (e) has not already been deducted from CET1 capital under any of sections B1.3 to B1.13.

*Source: BS2A, para 10(3)(b) and (c); BS2B, para 2.20(b) and (c).*

#### **C1.7 Investments in unconsolidated subsidiaries**

The corresponding deductions approach must be applied to any investment that has not been deducted from capital under any other requirement, in the following cases:

- (a) where, in a group capital ratio calculation, the investment is in the ordinary share capital of a subsidiary of the registered bank and the subsidiary has not been included in the scope of that calculation:
- (b) where, in a solo capital ratio calculation, the investment is in the ordinary share capital of a subsidiary of the registered bank and the subsidiary has not been included in the scope of that calculation as specified in section B2.4 of BPR100.

*Source: BS2A, para 10(3)(d) and (e); BS2B, para 2.20(d) and (e)..*

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## Part D: Eligibility criteria for capital instruments

### D1 Eligibility of CET1

#### D1.1 Ordinary shares

To be included in CET1 capital, ordinary shares must satisfy the criteria set out in this subpart.

#### D1.2 General requirements

An instrument classified as ordinary shares must satisfy the following criteria:

- (a) the instrument is classified as equity under GAAP; and
- (b) only the paid-up amount of the instrument, irrevocably received by the registered bank, is included as CET1 capital; and
- (c) after retained earnings and other reserves, the instrument takes the first and proportionately greatest share of any losses as they occur, and individual ordinary shares must absorb losses on a going-concern basis proportionately and *pari passu* with each other; and

*Guidance: This condition is still deemed to be met if the bank has issued an instrument other than ordinary shares that has a write-off or conversion feature.*

- (d) holders of the instrument have full voting rights arising from the ownership of the shares; and

*Guidance: The "one member, one vote" rule for entities established under the Building Societies Act 1965 does not prevent building society shares from satisfying this condition.*

- (e) the instrument represents the most subordinated claim in the liquidation of the ~~registered~~ bank; and
- (f) the instrument holder is entitled to a claim on the residual assets of the ~~registered~~ bank that is proportional to its share of issued capital, after all senior claims have been repaid in liquidation; and

*Guidance: This means an unlimited and variable claim, not a fixed or capped claim.*

- (g) the principal amount of the instrument is perpetual, that is, the instrument has no maturity date; and
- (h) setting aside discretionary acquisitions permitted by section 58 of the Companies Act 1993, no principal is repaid outside of liquidation, that is, the shares are not redeemable as defined in section 68 of the Companies Act 1993; and

*Guidance: A building society's right to repay funds under section 11(2) of the Building Societies Act 1965 is not considered to make building society shares "redeemable".*

- (i) no member of the banking group does anything to create an expectation at issuance that the instrument will be repaid or cancelled, nor do the contractual terms of the instrument provide any feature that may give rise to such an expectation; and
- (j) the paid-up amount of the instrument, or any future payments related to the instrument, is neither secured nor covered by a guarantee of any member of

the banking group or a related entity, or subject to any other arrangement that legally or economically enhances the seniority of the claim.

Source: BS2A, para 10a(1)(a)-(f), (j)-(k) and (m); BS2B, para 2.23(a) to (f), (j)-(k) and (m).

### D1.3 Distribution requirements

- (1) For an instrument to qualify as CET1 capital, distributions on the instrument must meet the requirements in this section.
- (2) The amount that may be paid in distributions—
  - (a) must be paid out of distributable items, including retained earnings; and
  - (b) must not be in any way linked to the amount paid at issuance; and
  - (c) must not be subject to a contractual cap (except to the extent that ~~the a registered~~ bank is unable to pay distributions that exceed the level of distributable items).

*A registered bank's conditions of registration typically limit the proportion of distributable earnings that the bank may pay out if the prudential capital buffer ratio of the banking group (as defined in BPR100) is below a specified amount.*

- (3) There must be no circumstances under which the distributions are obligatory and in all circumstances the ~~registered~~ bank is able to waive any distribution.
- (4) Any waived distributions must be non-cumulative, that is, they are not required to be made up by the ~~registered~~ bank at a later date.
- (5) Non-payment of distributions must not be an event of default of the ~~registered~~ bank or of any other member of the banking group.
- (6) The instrument must not have any preferential or predetermined right to distributions of capital or income, to ensure that ~~distributions are~~ must not ~~be~~ paid by the ~~registered~~ bank until all legal and contractual obligations have been met and payments on more senior capital instruments have been made.

*Guidance: This means that ordinary shares must not have any preferential or predetermined right to distributions of capital or income.*

Source: BS2A, para 10a(1)(g)-(j); BS2B, para 2.23(g) to (i).

### D1.4 Issuance requirements

- (1) The instrument must be issued by the ~~registered~~ bank (and not out of an SPV).
- (2) The instrument must not have been purchased, and the purchase must not have been funded, whether directly or indirectly, by—
  - (i) the ~~registered~~ bank; or
  - (ii) an entity over which the ~~registered~~ bank exercises control or significant influence.
- (3) However, nothing in subsection (2) prevents a holding company of the ~~registered~~ bank from purchasing the instrument, nor prevents the ~~registered~~ bank undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the capital instrument.

Source: BS2A, para 10a(1)(l); BS2B, para 2.23(l).

## D2 Eligibility of AT1 capital instruments

### D2.1 Additional Tier 1 capital

An instrument must not be included in AT1 capital for the purpose of section B2.2(2)(a) unless it satisfies the criteria set out in this subpart.

*New introductory text*

### D2.2 Overview of ~~template terms sheet~~ checklist for AT1 instruments

- (1) Appendix 1 sets out a ~~template terms sheet~~ checklist, which ~~replicates~~ includes the ~~standard features~~ prudential requirements specified in this subpart that an instrument must ~~possess~~ comply with to qualify as AT1 capital.
- (2) Section B1.3 of BPR120 requires a completed copy of the ~~template checklist~~ to be submitted to the Reserve Bank in respect of any new instrument that the bank proposes to issue and to treat as AT1 regulatory capital, in order to demonstrate ~~confirm compliance with all requirements of AT1 instruments~~.
- ~~(3) Although deviations from the standard terms in the template will not automatically disqualify an instrument from qualifying as AT1 capital, the instrument must still fully comply with this subpart and, if there are any deviations from the standard template, the submitted terms sheet must be marked up to show them.~~
- ~~(34)~~ In the event of any inconsistency between ~~a part of the template terms sheet~~ checklist in Appendix 1 and ~~a part of this~~ any requirement in Parts A to E of this document (other than the template terms sheets), ~~the requirement in Part A to E of this~~ document prevails.
- ~~(45)~~ As specified in section A1.1(2), additional terms of a capital instrument, not relating to the requirements listed in the checklist, will not disqualify the instrument from being treated as AT1 capital, provided that those terms do not affect the instrument's compliance with this document.

*New introductory text*

### D2.3 General requirements

To qualify as AT1 capital, an instrument must satisfy the following criteria:

- (a) only the paid-up amount of the instrument, irrevocably received by the ~~registered~~ bank, may be included in the amount of AT1 capital; and
- (b) the instrument must represent the most subordinated claim in the liquidation of the ~~registered~~ bank after CET1 capital; and
- (c) the instrument must be structured as legal-form "equity" (as defined in section 8(2) of the Financial Markets Conduct Act 2013); and
- (d) the instrument must be classified as equity under New Zealand GAAP; and
- (e) the instrument and all constituting documents must be governed by New Zealand law; and
- (f) the paid-up amount of the instrument, or any future payment related to the instrument, must not be secured or covered by a guarantee from any member of the banking group or a related entity, nor subject to any other arrangement that legally or economically enhances the seniority of the holder's claim vis-à-vis the bank's creditors; and
- (g) the instrument must not be subject to netting or offset claims on behalf of the holder of the instrument, except as mandatorily provided by law.

Source: BS2A, para 10b(1)(a) to (c); BS2B, para 2.24(a) to (c); subs (c)-(e) are new text.

#### D2.4 No conversion or write-off feature

The terms of an AT1 instrument must not—

- (a) include any conversion feature that specifies circumstances in which a holder's interests in the instrument will be replaced with interests in a different form of instrument; or
- (b) confer any right on a holder to subscribe for new securities of the bank, or to otherwise participate in the profits or property of the bank, except by receiving payments as set out in the terms of the instrument; or
- (c) include any write-off feature which specifies circumstances in which some or all of a holder's claims on the bank arising from the instrument are irrevocably cancelled.

*Guidance: AT1 capital instruments constitute going-concern capital. This is intended to allow the registered bank to continue to operate and maintain solvency once the holders absorb the losses that the bank has incurred.*

New text

#### D2.5 Redemption or call dates

- (1) Subject to subsections (2) to (4), the principal amount of an AT1 instrument must be perpetual, that is, the instrument must have no maturity date.
- (2) An AT1 instrument may be callable or redeemable at the initiative of the ~~registered~~ bank after a minimum of five years from the date on which the ~~registered~~ bank irrevocably received payment for the instrument, and more than one such call or redemption may be provided for.
- (3) An AT1 instrument may provide for the ~~registered~~ bank to have a right to call or redeem the instrument ~~within the first five years of issuance~~ as a result of a tax or regulatory event ~~(including during the first five years of the term)~~, provided that the terms of that provision do not permit early call or redemption if—
  - (a) the tax or regulatory event could reasonably have been anticipated at the time the instrument was issued; or
  - (b) the tax or regulatory event is minor (or words to that effect).

*Guidance: See section C2.2 of BPR120, and the guidance notes following that section, for further detail on when tax or regulatory events will be considered to be anticipated.*

- (4) The contractual terms of an AT1 instrument—
  - (a) must provide that the ~~registered~~ bank is required to receive the prior written approval of the Reserve Bank to make any repayment of principal; and
  - (b) must not include any feature that might give rise to an expectation that the instrument will be repaid.

*Guidance: The requirements a bank must meet for repayment of an AT1 instrument are set out in subpart C2 of BPR120.*

Source: BS2A, para 10b(1)(d) and (e); BS2B, para 2.24(d) and (e).

#### D2.6 No step-ups or incentives to redeem

- (1) An AT1 instrument must not contain any step-ups or incentives for the bank to redeem, within the meaning given in this section.
- (2) To meet the requirements of subsection (1), the terms of an AT1 instrument must provide for the interest or dividend rate to be fixed for the entire term of the instrument and must not provide for that rate to be altered or reviewed, except in the following circumstances:
  - (a) where the interest payment or dividend is cancelled, in whole or part; or
  - (b) where there is a variable rate and the formula for setting the rate is fixed for the term of the instrument at the outset.

*Guidance: For example, it would be acceptable to specify the interest rate as a fixed margin above a recognised market benchmark such as the bank bill rate.*

- (3) The following are considered incentives to redeem—
  - (a) a change in the margin; or
  - (b) conversion from a fixed rate to a floating rate that is calculated as a benchmark rate plus a margin, if there is an increase in the margin relative to that implied for the fixed rate.
- (4) Provided that no member of the banking group does anything that creates an expectation that a call will be exercised, the following will not be considered incentives to redeem:
  - (a) the inclusion of a zero floor on the interest or dividend rate, so long as there is no zero floor applied to the benchmark rate.
  - ~~(b)~~ a conversion from a fixed rate to a floating rate (or vice versa) on an optional call date without any increase in credit spread; ~~or~~
  - ~~(cb)~~ a fixed rate being reset on an optional call date at a new fixed rate, provided that—
    - (i) the new rate is a ~~market benchmark~~ rate ~~plus a margin~~ on that date applicable to the period over which the new rate will apply plus a margin; and
    - (ii) there is no change in the margin above the ~~benchmark fixed~~ rate.
  - ~~(d)~~ a rate being reset to a fallback benchmark rate, provided that—
    - (i) the reset is triggered through the operation of contractual fallback provisions which apply in the event that the original benchmark becomes unavailable; and
    - (ii) such provisions are designed, as far as possible, to produce a genuinely equivalent interest rate that does not result in a step-up in the margin over prevailing wholesale market rates.

Source: BS2A, para 10b(1)(f); BS2B, para 2.24(f); subsections (4)(a) and (4)(cb) ~~are~~ new.

## D2.7 Distributions



- (1) For an instrument to qualify as AT1 capital, distributions on the instrument must meet the requirements in this section.
- (2) The ~~registered~~ bank must have full discretion at all times to cancel distributions on the instrument.
- (3) The terms of the instrument must provide that the ~~registered~~ bank is required to limit distributions of earnings in accordance with the requirements of the ~~registered~~ bank's conditions of registration.
- (4) Any waived distributions must be non-cumulative, that is, the bank must be under no obligation to make up waived distributions at a later date, nor to make any bonus payment to compensate for unpaid distributions.
- (5) Cancellation or non-payment of distributions must not be an event of default of the ~~registered~~ bank or any member of the banking group.
- (6) Holders of the instruments must have no right—
- (a) to apply for the liquidation or voluntary administration of any member of the banking group; or
  - (b) to appoint a receiver of the property of any member of the banking group on the grounds that the ~~registered~~ bank fails to make, or may become unable to make, a distribution on the instrument, or for any other reason in connection with the bank's compliance with the terms of the instrument.
- ~~(7) The terms of the instrument must include a dividend stopper, being a condition that arises when a distribution is not paid in full on a distribution payment date, in which case the registered bank—~~
- ~~(a) must not—~~
    - ~~(i) make any distributions or payments on, or issue any bonus securities in respect of, any securities that rank junior to the instrument; or~~
    - ~~(ii) make any distributions or payments (other than on a pro-rata basis) on, or issue any bonus securities in respect of, any other AT1 securities or other securities that rank equally with the instrument; and~~
  - ~~(b) must not make any such distributions, payments, or issues until—~~
    - ~~(i) the next payment date at which the distribution payments are resumed; or~~
    - ~~(ii) the first date on which the instrument is no longer outstanding.~~
- ~~(78) The ~~registered~~ bank must be able to cancel distributions on the instrument without the bank or any other member of the banking group becoming subject to restrictions, except in relation to—~~
- ~~(a) —~~
    - ~~(a) the acquisition, repurchase, or redemption of capital instruments; or~~
    - ~~(b) any (b) dividend stopper arrangements if such an arrangement is included in the terms and conditions of the AT1 instrument.~~

~~as required under subsection (7).~~
- ~~(89) The ~~registered~~ bank must have full access to cancelled distributions to meet obligations as they fall due.~~
- ~~(940) The instrument must not have a credit-sensitive distribution feature.~~

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*Guidance: A credit-sensitive distribution feature includes, for example, a distribution that is reset periodically based in whole or in part on the credit standing of any member of the banking group. An instrument may utilise a broad index as a reference rate for distribution or payments calculation purposes, provided that the index does not exhibit any significant correlation with the issuer's credit standing.*

Source: BS2A, para 10b(1)(g) and (h); BS2B, para 2.24(g) and (h).

## D2.8 Other requirements on AT1 instruments

- (1) Neither the ~~registered~~ bank nor an entity over which the ~~registered~~ bank exercises control or significant influence may purchase the instrument, nor directly or indirectly have funded the purchase of the instrument.
- (2) However, nothing in this section prevents a holding company of the ~~registered~~ bank from purchasing the instrument, nor prevents the ~~registered~~ bank undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the capital instrument.
- (3) The instrument must not include any features that hinder recapitalisation of the ~~registered~~ bank or any member of the banking group.
- (4) To comply with subsection (3), the instrument must not have any terms that restrict the bank in any way from issuing, or otherwise dealing with, securities ranking junior, equal or senior to the instrument.

*Guidance: In particular, this subsection prohibits the instrument from having any terms that restrict the bank in any way from issuing, or otherwise dealing with, securities ranking junior, equal or senior to the instrument, other than the dividend stopper required by section D2.7(7).*

Source: BS2A, para 10b(1)(i) and (j); BS2B, para 2.24(i) and (j); subsection (4) guidance is new.

## D3 Eligibility of Tier 2 capital instruments

### D3.1 Tier 2 capital

An instrument must not be included in Tier 2 capital for the purpose of section B3.2(2)(a) unless it satisfies the criteria set out in this subpart.

*New introductory text.*

### D3.2 Template ~~terms sheet checklist~~ for Tier 2 instruments

- (1) Appendix 2 sets out a template ~~terms sheet checklist, which replicates including the prudential requirements standard features specified in this subpart~~ that an instrument must ~~include-comply with~~ to qualify as Tier 2 capital.
- (2) Section B1.3 of BPR120 requires a completed copy of the ~~template checklist~~ to be submitted to the Reserve Bank in respect of any new instrument that the bank proposes to issue and to treat as Tier 2 regulatory capital, in order to confirm compliance with all requirements of Tier 2 instruments.
- (3) ~~Although deviations from the standard terms in the template will not automatically disqualify an instrument from qualifying as Tier 2 capital, the instrument must still fully comply with this subpart and, if there are any deviations from the standard template, the submitted terms sheet must be marked up to show them.~~
- (4) In the event of any inconsistency between a part of the ~~template terms sheet checklist in Appendix 2 and any requirement in Parts A to E of this a part of this document (other than the template terms sheets), the requirement in Part A to E of this document prevails.~~

- (5) As specified in section A1.1(2), additional terms of a capital instrument, not relating to the requirements listed in the checklist, will not disqualify the instrument from being treated as Tier 2 capital, provided that those terms do not affect the instrument's compliance with this document.

*New introductory text*

### D3.3 General requirements

- (1) To qualify as Tier 2 capital, an instrument must satisfy the following criteria:
- (a) only the paid-up amount of the instrument, irrevocably received by the registered bank, may be included in the amount of Tier 2 capital; and
  - (b) claims of holders of the instrument must be subordinated to claims of depositors and general creditors of the ~~registered~~ bank and, in order to meet this requirement, –
    - (i) if either the ~~registered~~ bank or any subsidiary of the bank that has issued the instrument becomes subject to liquidation, claims of holders of the instrument must be subordinated to those of depositors and general creditors; and
    - (ii) prior to liquidation or the maturity date of the instrument, the ~~registered~~ bank must be under no obligation to make payments of distributions or principal in the event that the bank fails to satisfy the solvency condition; and
    - (iii) a failure to make a payment of distributions or principal on the instrument because the bank fails to meet the solvency condition must not give rise to an event of default; and
- Guidance: Unpaid interest may be treated as a liability of the issuer.*
- (c) the paid-up amount of the instrument, or any future payment related to the instrument, must not be–
    - (i) secured or covered by a guarantee from any member of the banking group or of any related entity; or
    - (ii) subject to any other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general bank creditors; and
  - (d) the instrument must not be subject to netting or offset of claims on behalf of the holder of the instrument, except as mandatorily provided by law; and
  - (e) the terms of the instrument and all constituting documents must be governed by New Zealand law or by a permitted foreign law.
  - (f) if one or more terms of an instrument is governed by a permitted foreign law, section B1.3 of BPR120 requires a signed foreign law opinion on the enforceability of the instrument in that permitted foreign law jurisdiction in a form acceptable to the Reserve Bank in all respects.

*Guidance: It is acceptable for some terms of an instrument to be governed by New Zealand law, and some by ~~foreign~~ a permitted foreign law. When using foreign governing law to cover some, or all, of the terms of an instrument, the bank must provide a legal opinion in an acceptable form, as set out in BPR 120 (B1.3 (2)).*

- (2) For the purposes of subsection (1)(b)(ii) and (iii), a bank will satisfy the solvency condition—
- (a) if the bank is solvent at the time the relevant payment is due; and
  - (b) if it will remain solvent immediately after making the payment.
- (3) For the purposes of this section, **solvent** means satisfying the solvency test in section 4 of the Companies Act 1993, whether or not the registered bank is, in fact, a company for the purposes of that Act.

(4) For the purposes of (1)(e), the permitted foreign laws are: New South Wales (Australia), Victoria (Australia), England and New York.

*Source: BS2A, para 10c(1)(a) to (c) & (l), revised: BS2B, para 2.25(a) to (c) & (l), revised. 1.3(f) and 4 are new text.*

#### **D3.4 No conversion or write-off feature**

- (1) The terms of a Tier 2 instrument must not include any conversion feature that specifies circumstances in which a holder's interests in the instrument are replaced with interests in a different form of instrument.
- (2) A Tier 2 instrument must not confer any right on a holder to subscribe for new securities of the bank, or to otherwise participate in the profits or property of the bank, except by receiving payments as set out in the terms of the instrument.
- (3) The terms of a Tier 2 instrument must not include a write-off feature that specifies circumstances in which all of a holder's claims on the bank arising from the instrument are irrevocably cancelled.

*New text.*

#### **D3.5 Redemption or call dates**

- (1) Subject to subsections (2) to (4), a Tier 2 instrument must have a minimum original maturity of at least five years.
- (2) A Tier 2 instrument may be callable or redeemable prior to maturity at the initiative of the ~~registered~~ bank after a minimum of five years from the date on which the ~~registered~~ bank irrevocably receives payment for the instrument, and more than one such call or redemption may be provided for.
- (3) A Tier 2 instrument may provide for the ~~registered~~ bank to have a right to call or redeem the instrument ~~within the first five years of issuance a~~ as a result of a tax or regulatory event (including during the first five years of the term), provided that the terms of that provision do not permit early call or redemption if—
  - (a) the tax or regulatory event could reasonably have been anticipated at the time the instrument was issued; or
  - (b) the tax or regulatory event is minor (or words to that effect).

*Guidance: See section C2.1 of BPR120, and the guidance notes following that section, for further detail on when tax or regulatory events will be considered to be anticipated.*

- (4) The contractual terms of a Tier 2 instrument—
  - (a) must provide that the ~~registered~~ bank is required to receive the prior written approval of the Reserve Bank to make any repayment of principal prior to maturity; and
  - (b) must not include any feature that might give rise to an expectation that the instrument will be repaid prior to maturity.

*Guidance: The requirements a bank must meet for repayment of a Tier 2 instrument are set out in subpart C2 of BPR120.*

*Source: BS2A, para 10c(1)(d), (f) and (g); BS2B, para 2.25(d), (f) and (g).*

### D3.6 Amortisation of eligible amount

The amount of the instrument that may be recognised in capital ratio calculations during the final four years to maturity must be amortised on a straight-line basis at a rate of 20% per annum as follows:

Years to maturity	Amount recognised
More than 4	100%
Less than and including 4 but more than 3	80%
Less than and including 3 but more than 2	60%
Less than and including 2 but more than 1	40%
Less than and including 1	20%

*Source: BS2A, para 10c(1)(e); BS2B, para 2.25(e).*

### D3.7 No step-ups or incentives to redeem

- (1) A Tier 2 instrument must not contain any step-ups or incentives for the bank to redeem, within the meaning given in this section.
- (2) To meet the requirements of subsection (1), the terms of a Tier 2 instrument must provide for the dividend or interest rate to be fixed for the entire term of the instrument and must not provide for the rate to be altered or reviewed, except in the following circumstances:
  - (a) where the dividend or interest payment is cancelled, in whole or part; or
  - (b) where there is a variable rate and where the formula for setting the rate is fixed for the term of the debt at the outset.

*Guidance: For example, it would be acceptable to specify the interest rate as a fixed margin above a recognised market benchmark such as the bank bill rate.*

- (3) The following are considered incentives to redeem—
  - (a) a change in the margin; or
  - (b) conversion from a fixed rate to a floating rate that is calculated as a benchmark rate plus a margin, if there is an increase in the margin relative to that implied for the fixed rate.
- (4) Provided that no member of the banking group does anything that creates an expectation that a call will be exercised, the following will not be considered incentives to redeem:
  - (a) the inclusion of a zero floor on the dividend or interest rate, so long as there is no zero floor applied to the benchmark rate.
  - (b) a conversion from a fixed rate to a floating rate (or vice versa) on an optional call date without any increase in credit spread; or
  - (c) a fixed rate being reset on an optional call date at a new fixed rate, provided that—
    - (i) the new rate is a market benchmark rate plus a margin rate on that date applicable to the period over which the new rate will apply plus a margin; and

- (ii) there is no change in the margin above the ~~fixed benchmark~~ rate.
- (d) a rate being reset to a fallback benchmark rate, provided that-
- (i) the reset is triggered through the operation of contractual fallback provisions which apply in the event that the original benchmark becomes unavailable; and
- (ii) such provisions are designed, as far as possible, to produce a genuinely equivalent interest rate that does not result in a step-up in the margin over prevailing wholesale market rates.

Source: BS2A, para 10c(1)(h); BS2B, para 2.25(h); subsections (4)(a) and (4)(db) ~~are~~ new.

### D3.8 Distributions

A Tier 2 instrument must not have a credit-sensitive distribution feature.

*Guidance: A credit-sensitive distribution feature includes, for example, a distribution that is reset periodically based in whole or in part on the credit standing of any member of the banking group. An instrument may utilise a broad index as a reference rate for distribution or payments calculation purposes, provided that the index does not exhibit any significant correlation with the issuer's credit standing.*

Source: BS2A, para 10c(1)(j); BS2B, para 2.25(j).

### D3.9 Other requirements on Tier 2 instruments

- (1) The holder of the instrument must have no rights to accelerate the repayment of future scheduled payments (whether coupon or principal), except in the event of the liquidation of the issuer.
- (2) Neither the ~~registered~~ bank nor an entity over which the ~~registered~~ bank exercises control or significant influence may purchase the instrument, nor directly or indirectly fund the purchase of the instrument.
- (3) However, nothing in this section prevents a holding company of the ~~registered~~ bank from purchasing the instrument nor prevents the ~~registered~~ bank undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the capital instrument.
- (4) The instrument must not contain any features that hinder recapitalisation of the ~~registered~~ bank or any member of the banking group.
- (5) To comply with subsection (4), the instrument must not have any terms that restrict the bank in any way from issuing, or otherwise dealing with, securities ranking junior, equal or senior to the instrument.

*Guidance: In particular, this subsection prohibits the instrument from having any terms that restrict the bank in any way from issuing (or otherwise dealing with) securities ranking junior, equal or senior to the instrument.*

Source: BS2A, para 10c(1)(i) & (k), revised; BS2B, para 2.25(i) & (k), revised; subsections (4) and (5) ~~guidance~~ are new.

## Part E: Recognition of minority interests and capital instruments issued by SPVs

### E1 Capital issued by subsidiaries and held by third parties

#### E1.1 Recognition of minority interests and other capital issued to third parties out of fully consolidated subsidiaries

- (1) Subject to the requirements of this subpart, the following may, where issued to third parties out of a subsidiary that is fully consolidated for the purposes of calculating the banking group's capital ratios, be recognised as capital of the banking group:
    - (a) CET1 capital:
    - (b) AT1 capital instruments:
    - (c) Tier 2 capital instruments:
    - (d) any interests arising from such instruments.
  - (2) However, this subpart does not apply to the calculation of a registered bank's solo capital ratio.
  - (3) Capital of a fully consolidated subsidiary held by third parties is eligible for inclusion in the capital of the banking group—
    - (a) subject to meeting the eligibility criteria for capital of that category, as set out in sections E1.2 (CET1 capital), E1.4 (AT1 capital), and E1.6 (Tier 2 capital), respectively; and
    - (b) at an amount calculated in accordance with sections E1.3, E1.5, or E1.7, as applicable to that category of capital.
- Guidance: The calculation takes account of the capital position of the fully consolidated subsidiary.*
- (4) If the fully consolidated subsidiary is not subject to the Reserve Bank's capital adequacy requirements for registered banks, for the purposes of the calculations in this subpart, calculations relating to the subsidiary's minimum capital requirements, prudential capital buffer, and total RWA equivalents must be undertaken as if the subsidiary was a bank.
  - (5) A bank may elect to give no recognition in the consolidated capital of the banking group to the capital issued by the subsidiary to third parties, but all the exposures of the fully consolidated subsidiary must be included when calculating the total RWA equivalents of the banking group.

*Source: BS2A, para 10d(1) to (3); BS2B, paras 2.26 to 2.28.*

#### E1.2 CET1 capital: eligibility

- (1) If the criteria set out in subsection (2) are met, minority interests arising from the issue of ordinary shares to third party investors by a fully consolidated subsidiary, and any associated retained earnings and reserves attributable to such investors, are eligible to receive recognition in the CET1 capital of the consolidated banking group
- (2) The criteria are that—
  - (a) the subsidiary is itself a registered bank; and

*Guidance: Common shares issued to third party investors by a consolidated subsidiary that is not a registered bank cannot be included in*

*the consolidated CET1 of the banking group. However, these amounts may be included in the consolidated Tier 1 and total capital of the banking group, subject to the conditions in section E1.4 and section E1.6.*

- (b) the instrument, retained earnings, or reserves attributable to the third party investors would meet the criteria for CET1 capital set out in subsections B1.2(2)(a),(c) or (d), had the issuer been the registered bank.

*Source: BS2A, para 10d(4); BS2B, para 2.29.*

### **E1.3 CET1 capital: portion recognised**

- (1) The amount of minority interests that may be recognised as CET1 capital of the banking group is the total amount of capital attributable to minority shareholders that meets the eligibility criteria in section E1.2, after—
- (a) making the adjustments in sections B1.3 to B1.13 attributable to the minority shareholders; and
- (b) subtracting the surplus CET1 capital of the subsidiary attributable to minority shareholders, calculated in accordance with subsection (2).

*Guidance: For the purposes of this subpart, deductions attributable to third party investors in the subsidiary relate to items on the subsidiary's balance sheet.*

- (2) The surplus CET1 capital of the subsidiary attributable to minority shareholders is calculated as the total surplus CET1 capital of the subsidiary, calculated in accordance with subsection (3), multiplied by the percentage of the CET1 capital of the subsidiary attributable to the minority shareholders.
- (3) The total surplus CET1 capital of the subsidiary is calculated as the CET1 capital of the subsidiary after—
- (a) making the adjustments specified in sections B1.3 to B1.13; and
- (b) subtracting the effective CET1 capital requirement of the subsidiary, calculated in accordance with section (4).
- (4) The effective CET1 capital requirement of the subsidiary is calculated as the sum of the minimum CET1 capital ratio requirement and the buffer trigger ratio specified in the bank's conditions of registration, multiplied by the lesser of—
- (a) the subsidiary's total RWA equivalents; and
- (b) the consolidated total RWA equivalents that relate to the subsidiary.

*Guidance: For example, when the minimum CET1 capital ratio is set at 4.5% and the buffer trigger ratio is set at 2.5%, the effective CET1 capital requirement is 7% of the total RWA equivalents specified in subsection (a) or (b).*

*Source: BS2A, para 10d(5) to 10d(7); BS2B, paras 2.30 to 2.32. Guidance added.*

### **E1.4 AT1 capital: eligibility**

- (1) If the conditions set out in subsection (2) are met, an instrument issued out of a fully consolidated subsidiary and held by a third party investor, and associated retained earnings and reserves attributable to such investors, are eligible to receive recognition in the AT1 capital of the consolidated banking group.
- (2) The conditions are that, had the issuer been a registered bank, it would have met either—
- (a) the criteria for CET1 capital set out in subsection B1.2(2)(a),(c) or (d); or



- (b) the criteria for AT1 capital instruments set out in subsection B2.2(2)(a).

*Source: BS2A, para 10d(8)); BS2B, para 2.33.*

#### **E1.5 AT1 capital: portion recognised**

- (1) The amount of capital that may be recognised as AT1 capital of the banking group under this subpart is the total amount of capital attributable to third parties that meets the criteria in section E1.4, after—
- (a) making the adjustments to Tier 1 capital in sections B1.3 to B1.13 and subpart C1 that are attributable to the third parties; and
  - (b) subtracting the surplus Tier 1 capital of the subsidiary attributable to third party investors, calculated in accordance with subsections (3) to (5).
- (2) However, the portion recognised must exclude amounts recognised as CET1 capital under section E1.3.
- (3) The surplus Tier 1 capital of the subsidiary attributable to third party investors is calculated as the total surplus Tier 1 capital of the subsidiary, calculated in accordance with subsection (4), multiplied by the percentage of the Tier 1 capital of the subsidiary attributable to third party investors or minority shareholders.
- (4) The total surplus Tier 1 capital of the subsidiary is calculated as the Tier 1 capital of the subsidiary after—
- (a) making the adjustments specified in sections B1.3 to B1.13 and subpart C1; and
  - (b) subtracting the effective Tier 1 capital requirement of the subsidiary, calculated in accordance with section (5).
- (5) The effective Tier 1 capital requirement of the subsidiary is calculated as the sum of the minimum Tier 1 capital ratio requirement and the buffer trigger ratio specified in the bank's conditions of registration, multiplied by the lesser of—
- (a) the subsidiary's total RWA equivalents; and
  - (b) the consolidated total RWA equivalents that relate to the subsidiary.

*Source: BS2A, para 10d(9) to 10d(12)); BS2B, paras 2.34 to 2.37.*

#### **E1.6 Tier 2 capital: eligibility**

- (1) If the conditions set out in subsection (2) are met, an instrument issued out of a fully consolidated subsidiary and held by a third party is eligible to receive recognition in the Tier 2 capital of the consolidated banking group.
- (2) The conditions are that, had the issuer been a registered bank, it would have met one of the following sets of criteria:
- (a) the criteria for ordinary shares set out in subsection B1.2(2)(a); or
  - (b) the criteria for AT1 capital instruments set out in subsection B2.2(2)(a); or
  - (c) the criteria for Tier 2 instruments set out in subsection B3.2(2)(a).

*Source: BS2A, para 10d(13)); BS2B, para 2.38.*

#### **E1.7 Tier 2 capital: portion recognised**

- (1) The amount of capital that may be recognised as Tier 2 capital of the banking group under this subpart is the total amount of capital attributable to third parties that meets the criteria in section E1.6 after—

- (a) making the adjustments to total capital in sections B1.3 to B1.13 and subpart C1 that are attributable to the third parties; and
  - (b) subtracting the surplus total capital of the subsidiary attributable to third party investors, calculated in accordance with subsections (3) to (5).
- (2) However, the portion recognised must exclude amounts recognised as CET1 capital under section E1.3 and amounts recognised as AT1 capital under section E1.5.
- (3) The surplus total capital of the subsidiary attributable to third party investors is calculated as the total surplus total capital of the subsidiary, calculated in accordance with subsection (4), multiplied by the percentage of total capital of the subsidiary attributable to third party investors or minority shareholders.
- (4) The total surplus total capital of the subsidiary is calculated as the total capital of the subsidiary after–
- (a) making the adjustments specified in sections B1.3 to B1.13 and subpart C1; and
  - (b) subtracting the effective total capital requirement of the subsidiary, calculated in accordance with section (5).
- (5) The effective total capital requirement of the subsidiary is calculated as the sum of the minimum total capital ratio requirement and the buffer trigger ratio specified in the bank's conditions of registration, multiplied by the lesser of–
- (a) the subsidiary's total RWA equivalents ; and
  - (b) the consolidated total RWA equivalents that relate to the subsidiary.

*Source: BS2A, para 10d(14) to 10d(17); BS2B, paras 2.39 to 2.42.*

## E2 Eligibility of capital instruments issued via an SPV

### E2.1 Requirements

- (1) A capital instrument issued under an arrangement that involves an SPV, whether as the purchaser or the issuer of the instrument, does not qualify as regulatory capital unless the criteria specified in subsection (2) are met.
- (2) The criteria are that–
- (a) the SPV is required to be fully consolidated with the registered bank for the purpose of group financial statements under GAAP; and
  - (b) the ~~registered~~ bank issues an instrument to the SPV, the terms and conditions of that instrument matching, in all material respects, the terms and conditions of the instrument issued by the SPV to third party investors; and
- Guidance: This requires that the maturity dates, interest rates, payment dates, and any repayment terms match, and that the instruments are of the same category of regulatory capital.*
- (c) the instrument issued by the ~~registered~~ bank to the SPV must meet the criteria for classification as AT1 capital or the criteria for classification as Tier 2 capital, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively; and

- (d) the instrument issued by the SPV would, if issued by the ~~registered~~ bank, meet the criteria for classification as AT1 capital or the criteria for classification as Tier 2 capital, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively; and
- (e) the proceeds from the issue of the capital instrument by the SPV must be immediately and directly invested in, and available without limitation to, the ~~registered~~ bank; and
- (f) the amount of capital issued by a consolidated subsidiary to third parties that may be included in Tier 1 or total capital must be determined in accordance with subpart E1, and if the subsidiary issues capital through an SPV, the requirements of this subpart must be met as if the subsidiary were the ~~registered~~ bank, in addition to the requirements of subpart E1.

*Source: BS2A, para 10g(1); BS2B, para 2.79.*

## **E2.2 Exclusion of ordinary shares**

Ordinary shares issued under an arrangement that involves an SPV may not be included in CET1 capital.

*Source: BS2A, para 10g(2); BS2B, para 2.80.*

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## Appendix 1

### ADDITIONAL TIER 1 ~~TEMPLATE TERMS SHEET~~CHECKLIST: PERPETUAL NON-CUMULATIVE [REDEEMABLE] PREFERENCE SHARES

#### Purpose of this ~~terms sheet~~checklist

The purpose of this Appendix 1, is to provide a checklist of requirements that an instrument must meet to qualify as Additional Tier 1 capital. A completed copy of this checklist must be submitted to the Reserve Bank in respect of any new instrument that the bank proposes to issue and to treat as Additional Tier 1 regulatory capital (refer to [D3.2 of BPR110]). The completed checklist must also be appended to the legal sign-off for the issue (refer to [B1.3 of BPR120]). The purpose of this template terms sheet, as set out in section D2.2 of BPR110, is to provide guidance on the requirements that an instrument must meet to qualify as Additional Tier 1 capital. The terms of the instrument will also need to comply with the requirements for Additional Tier 1 capital contained in BPR110.<sup>3</sup>

<u>Relevant clause of BPR110</u>	<u>Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents</u>	<u>Comments</u>
<b><u>D2.3 requirements</u></b>		
<u>D2.3 (a) "only the paid-up amount of the instrument, irrevocably received by the bank, may be included in the amount of AT1 capital"</u>		
<u>D2.3 (b) "the instrument must represent the most subordinated claim in the liquidation of the bank after CET1 capital"</u>		
<u>D2.3 (c) "the instrument must be structured as legal-form "equity" (as defined in section 8(2) of the Financial Markets Conduct Act 2013)"</u>		
<u>D2.3 (d) "the instrument must be classified as equity under New Zealand GAAP, as defined in section 8(2) of the Financial Markets Conduct Act 2013 (FMCA)"</u>		
<u>D2.3 (e) "the instrument and all constituting documents must be governed by New Zealand law"</u>		

<sup>3</sup> This ~~terms sheet~~checklist sets out the prudential requirements that the instrument must comply with to key terms for the instrument to qualify as AT1 under subpart B2 of BPR110. The Issuer is expected to comply with all other applicable laws in respect of any offer of the instrument

<u>D2.3 (f) “the paid-up amount of the instrument, or any future payment related to the instrument, must not be secured or covered by a guarantee from any member of the banking group or a related entity, nor subject to any other arrangement that legally or economically enhances the seniority of the holder’s claim vis-à-vis the bank’s creditors”</u>		
<u>D2.3 (g) “the instrument must not be subject to netting or offset claims on behalf of the holder of the instrument except as mandatorily provided by law”</u>		
<b><u>D2.4 Requirements</u></b>		
<u>D2.4 (a) The terms of an AT1 instrument must not “include any conversion feature that specifies circumstances in which a holder’s interests in the instrument will be replaced with interests in a different form of instrument”</u>		
<u>D2.4(b) The terms of an AT1 instrument must not “confer any right on a holder to subscribe for new securities of the bank, or to otherwise participate in the profits or property of the bank, except by receiving payments as set out in the terms of the instrument.”</u>		
<u>D2.4 (c) “The terms of an AT1 instrument must not “include any write-off feature which specifies circumstances in which some or all of a holder’s claims on the bank arising from the instrument are irrevocably cancelled”</u>		
<b><u>D2.5 requirements</u></b>		
<u>D2.5 (1) “Subject to subsections (2) to (4), the principal amount of an AT1 instrument must be perpetual, that is, the instrument must have no maturity date.”</u>		
<u>D2.5 (2) “An AT1 instrument may be callable or redeemable at the initiative of the <del>registered</del> bank after a minimum of five years from the date on which the <del>registered</del> bank irrevocably received payment for the instrument, and more than one such call or redemption may be provided for.”</u>		
<u>D2.5 (3) “An AT1 instrument may provide for the bank to have a right to call or redeem the instrument as a result of a tax or regulatory event (including during the first five</u>		

<p><u>years of the term) provided that the terms of that provision do not permit early call or redemption if</u>  <u>(a) the tax or regulatory event could reasonably have been anticipated at the time the instrument was issued; or</u>  <u>(b) the tax or regulatory event is minor (or words to that effect).”</u></p>		
<p><u>D2.5 (4) “The contractual terms of an AT1 instrument– (a) must provide that the bank is required to receive the prior written approval of the Reserve Bank to make any repayment of principal; and (b) must not include any feature that might give rise to an expectation that the instrument will be repaid.”</u></p>		
<p><b><u>D2.6 requirements</u></b></p>		
<p><u>D2.6 (1) “An AT1 instrument must not contain any step-ups or incentives for the bank to redeem, within the meaning given in this section.”</u></p>		
<p><u>D2.6 (2) “To meet the requirements of subsection (1), the terms of an AT1 instrument must provide for the interest or dividend rate to be fixed for the entire term of the instrument and must not provide for that rate to be altered or reviewed, except in the following circumstances: (a) where the interest payment or dividend is cancelled, in whole or part; or (b) where there is a variable rate and the formula for setting the rate is fixed for the term of the instrument at the outset.”</u></p>		
<p><u>D2.6 (3) The following are considered incentives to redeem– (a) a change in the margin; or (b) conversion from a fixed rate to a floating rate that is calculated as a benchmark rate plus a margin, if there is an increase in the margin relative to that implied for the fixed rate.</u></p>		
<p><u>D2.6 (4) Provided that no member of the banking group does anything that creates an expectation that a call will be exercised, the following will not be considered incentives to redeem:</u></p>		

<p>(a) <u>the inclusion of a zero floor on the interest or dividend rate, so long as there is no zero floor applied to the benchmark rate.</u></p> <p>(b) <u>a conversion from a fixed rate to a floating rate (or vice versa) on an optional call date without any increase in credit spread; or</u></p> <p>(c) <u>a fixed rate being reset on an optional call date at a new fixed rate, provided that–</u></p> <p>(i) <u>the new rate is a benchmark rate on that date applicable to the period over which the new rate will apply plus a margin; and</u></p> <p>(ii) <u>there is no change in the margin above the benchmark rate.</u></p> <p>(d) <u>a rate being reset to a fallback benchmark rate, provided that–</u></p> <p>(i) <u>the reset is triggered through the operation of contractual fallback provisions which apply in the event that the original benchmark becomes unavailable; and</u></p> <p>(ii) <u>such provisions are designed, as far as possible, to produce a genuinely equivalent interest rate that does not result in a step-up in the margin over prevailing wholesale market rates.</u></p>		
<b><u>D2.7 Requirements</u></b>		
<p><u>D2.7 (1) For an instrument to qualify as AT1 capital, distributions on the instrument must meet the requirements in this section.</u></p>		
<p><u>D2.7 (2) “The bank must have full discretion at all times to cancel distributions on the instrument.”</u></p>		
<p><u>D2.7 (3) “The terms of the instrument must provide that the bank is required to limit distributions of earnings in accordance with the requirements of the bank’s conditions of registration.”</u></p>		

<u>D2.7 (4) "Any waived distributions must be non-cumulative, that is, the bank must be under no obligation to make up waived distributions at a later date, nor to make any bonus payment to compensate for unpaid distributions."</u>		
<u>D2.7 (5) "Cancellation or non-payment of distributions must not be an event of default of the bank or any member of the banking group."</u>		
<u>D2.7 (6) "Holders of the instruments must have no right- (a) to apply for the liquidation or voluntary administration of any member of the banking group; or (b) to appoint a receiver of the property of any member of the banking group on the grounds that the bank fails to make, or may become unable to make, a distribution on the instrument, or for any other reason in connection with the bank's compliance with the terms of the instrument."</u>		
<u>D2.7 (7) "The bank must be able to cancel distributions on the instrument without the <del>registered</del> bank or any other member of the banking group becoming subject to restrictions, except (a) in relation to the acquisition, repurchase, or redemption of capital instruments or (b) any dividend stopper arrangement if such an arrangement is included in the terms and conditions of the AT1 instrument."</u>		
<u>D2.7 (8) "The bank must have full access to cancelled distributions to meet obligations as they fall due."</u>		
<u>D2.7 (9) "The instrument must not have a credit-sensitive distribution feature"</u>		
<b><u>D2.8 requirements</u></b>		



<p><u>D2.8 (1) “Neither the bank nor an entity over which the bank exercises control or significant influence may purchase the instrument, nor directly or indirectly have funded the purchase of the instrument.”</u></p> <p><u>D2.8 (2) “However, nothing in this section prevents a holding company of the bank from purchasing the instrument, nor prevents the bank undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the capital instrument.”</u></p>		
<p><u>D2.8 (3) The instrument must not include any features that hinder recapitalisation of the bank or any member of the banking group</u></p>		
<p><u>D2.8 (4) To comply with subsection (3), the instrument must not have any terms that restrict the bank in any way from issuing, or otherwise dealing with, securities ranking junior, equal or senior to the instrument</u></p>		
<p><b><u>Appendix: E2.1 requirements – note that these are only relevant for instruments involving an SPV. If the instrument does not involve an SPV, banks should record the E2.1 requirements below as “Not relevant, as no SPV involved in the instrument.”</u></b></p>		
<p><u>E2.1 (1) A capital instrument issued under an arrangement that involves an SPV, whether as the purchaser or the issuer of the instrument, does not qualify as regulatory capital unless the criteria specified in subsection (2) are met.</u></p> <p><u>E2.1 (2) The criteria are that– (a) the SPV is required to be fully consolidated with the bank for the purpose of group financial statements under GAAP;</u></p> <p><u>E2.1 (2) (b) the bank issues an instrument to the SPV, the terms and conditions of that instrument matching, in all material respects, the terms and conditions of the instrument issued by the SPV to third party investors;</u></p> <p><u>E2.1 (2) (c) “the instrument issued by the bank to the SPV must meet the criteria for classification as AT1 capital or the criteria for classification as Tier 2 capital, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively;”</u></p> <p><u>E2.1 (2) (d) the instrument issued by the SPV would, if issued by the bank, meet the criteria for classification as</u></p>		

<p><u>AT1 capital or the criteria for classification as Tier 2 capital, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively;</u>  <u>E2.1 (e) "the proceeds from the issue of the capital instrument by the SPV must be immediately and directly invested in, and available without limitation to, the bank;"</u>  <u>E2.1 (f) "the amount of capital issued by a consolidated subsidiary to third parties that may be included in Tier 1 or total capital must be determined in accordance with subpart E1, and if the subsidiary issues capital through an SPV, the requirements of this subpart must be met as if the subsidiary were the bank, in addition to the requirements of subpart E1."</u></p>		
<p><b>Additional material</b></p>		
<p><u>Confirm that there are no other features that would affect the compliance with BPR110.</u></p>		

#### **Perpetual Non-cumulative ~~[Redeemable]~~ Preference Shares**

<b>Description</b>	<del>[Perpetual non-cumulative [redeemable] preference share (PPS)]</del>
<b>Issuer</b>	<del>[•]</del>
<b>Form</b>	<del>The PPS are fully paid perpetual non-cumulative [redeemable] preference shares of the Issuer.<sup>4</sup></del>
<b>Maturity date</b>	<del>Not applicable. Perpetual unless redeemed at the option of the Issuer.</del>
<b>Legal form</b>	<del>Equity</del>
<b>Regulatory treatment (Issuer)</b>	Additional Tier 1 capital

<sup>4</sup> If the Issuer is a co-operative company, the PPS must be issued without a nominal value or with a nominal value of zero.

<b>Accounting treatment (Issuer)</b>	Equity
<b>Issue Price</b>	[•] per PPS
<b>Issue Date</b>	[•] <sup>5</sup>
<b>Issue amount</b>	[•]
<b>Redemption at option of Issuer</b>	<del>The PPS are perpetual unless redeemed for the Redemption Price at the option of the Issuer on one or more specified redemption dates (being the 5<sup>th</sup> anniversary of the Issue Date or any scheduled distribution payment date after that date), or if a "Tax Event"<sup>6</sup> occurs or if a Regulatory Event occurs.</del>
	<del>The Issuer may only exercise its redemption option if it also satisfies the Conditions to Redemption.</del>
<b>Conditions to Redemption<sup>7</sup></b>	<del>The Issuer may only exercise its redemption option if:- (i) either  (a) prior to, or concurrent with, redemption, the Issuer replaces the PPS with a capital instrument having the same Issue Price and of the same or better quality (for the purposes of the Reserve Bank prudential standards as they are applied to the Issuer at the relevant time), the terms and</del>

<sup>5</sup> ~~Note to Issuer: This draft has been prepared on the basis that the Issuer will receive irrevocable payment in full for the PPS on the Issue Date. If this is not the case, the description of the Optional Redemption Date will need to be updated to reflect the requirements in D2.5(2) of BPR110.~~

<sup>6</sup> ~~Note to Issuer: See section C2.2 of BPR120 for guidance on permitted regulatory and tax events. The documented legal terms of the PPS must reflect this guidance.~~

<sup>7</sup> ~~See section D2.5(4) of BPR110 and section C2.2 of BPR120.~~

~~conditions of which are sustainable for the income capacity of the Issuer's group; or~~

~~(b) the Issuer obtains confirmation from the Reserve Bank that the Reserve Bank is satisfied that the Issuer's capital position would meet the Reserve Bank's capital adequacy requirements applying at that time (including the capital conservation buffers, any countercyclical buffer and any other capital buffers) after redemption; and~~

~~(ii) the Reserve Bank has given its prior written approval to the redemption. Approval is at the absolute discretion of the Reserve Bank.~~

**Redemption Price**

~~The Redemption Price is the Issue Price.~~

**Redemption at the option of the Holder**

~~Not applicable.~~

**Ranking**

~~The PPS will represent the most subordinated claim in the dissolution or liquidation of the Issuer, except for the Issuer's Common Equity Tier 1 Capital.<sup>8</sup>~~

~~The PPS rank:~~

- ~~(i) behind Senior Ranking Obligations;~~
- ~~(ii) equally with Equal Ranking Securities; and~~
- ~~(iii) ahead of Junior Ranking Securities.~~

~~"Senior Ranking Obligations" means all deposits and other liabilities, securities (including Tier 2 capital securities) and other obligations of the Issuer other than Equal Ranking Securities or Junior Ranking Securities.~~

<sup>8</sup> See section D.2.3(b) of BPR110.

~~"Equal Ranking Securities" means the PPS and any other securities which rank or are expressed to rank equally with the PPS in a dissolution or liquidation of the Issuer.~~

~~"Junior Ranking Securities" means all fully paid ordinary shares in the capital of the Issuer.<sup>9</sup>~~

~~**No events of default or right to appoint insolvency official**~~

~~No Holder has any right to apply for the dissolution, liquidation or administration of the Issuer or any other member of the Issuer's group, or to cause a receiver or receiver and manager to be appointed in respect of the Issuer or any other member of the Issuer's group on the grounds of the Issuer's failure to pay distributions on the PPS or for any other reason in connection with the Issuer's compliance with the terms of the PPS.<sup>10</sup>~~

~~**Rights in dissolution and liquidation**~~

~~In the dissolution or liquidation of the Issuer, the PPS will confer upon its holder the right to payment in cash of an amount equal to the Issue Price, but no further or other right to participate in the surplus assets of the Issuer.~~

~~**Voting Rights**~~

~~No Holder will have the right to receive notice of, attend, participate in or vote at meetings of shareholders of the Issuer or any other member of the Issuer's group, except in relation to amendments relating to the rights, privileges, limitations and conditions attached to the PPS.~~

<sup>9</sup> ~~For issuers that do not have ordinary shares this would be adjusted to reflect the particular corporate structure. The intention is that Junior Ranking Securities are securities that, in a dissolution or liquidation, are entitled to share in any surplus assets of the Issuer.~~

<sup>10</sup> ~~See section D2.7(6) of BPR110.~~

~~No participation in issues of securities~~ A PPS does not confer any right on a Holder to subscribe for new securities of the Issuer, or to otherwise participate in the profits or property of the Issuer, except by receiving payments as set out in the PPS terms.

~~Distribution Rate~~ ~~[Issuer to insert Distribution Rate]~~<sup>14</sup>

~~Payment of Distributions~~ Distributions will be scheduled to be paid ~~[issuer to insert scheduled payment dates]~~

~~The Issuer has full discretion at all times to cancel Distributions on the PPS.~~<sup>12</sup>

~~A Distribution cannot be paid if the Payment Conditions are not met.~~

~~Payment Conditions~~ The payment of Distributions is subject to the Issuer's discretion and to the following payment conditions being met on the relevant payment date:

- ~~(i) the payment of the Distribution not resulting in a breach of the Issuer's conditions of registration;~~
- ~~(ii) the Issuer being able to make the payment and remain solvent (satisfy the "Solvency Condition"), and otherwise comply with any applicable law, directive or requirement.~~

~~The Issuer will satisfy the Solvency Condition if it is "solvent" at the time the relevant payment is due and will remain "solvent" immediately after making the payment. For these purposes, "solvent" means~~

<sup>14</sup> See section D2.6 and D2.7 of BPR110 for requirements for AT1 dividend/distribution rates (and payment related features). Note in particular that an AT1 instrument must not contain any step-ups or incentives for the bank to redeem or credit sensitive distribution features.

<sup>12</sup> See section D2.7(2) of BPR110.

~~satisfying the solvency test in section 4 of the Companies Act 1993.<sup>43</sup>~~

~~No event of default arises if the Issuer fails to make a payment because the Issuer does not satisfy the Solvency Condition.~~

#### **Non-cumulative Distributions<sup>44</sup>**

~~If a Distribution is not paid on a scheduled Distribution payment date for any reason, then the Issuer has no obligation to pay that Distribution and any right to that Distribution shall be cancelled.~~

~~No interest accrues on any unpaid Distributions and the Holder will have no claim or entitlement with respect to interest on any unpaid Distributions.~~

~~The Issuer will not make any bonus payments or issues of securities or pay any other type of compensation to Holders for unpaid Distributions.~~

~~Non-payment of any Distribution will not constitute an event of default.~~

#### **Dividend stopper**

~~If a Distribution is not paid in full on a Distribution payment date, then the Issuer must not make:~~

- ~~(i) any distributions or payments on, or issue any bonus securities in respect of, any securities that rank junior to the PPS; or~~
- ~~(ii) any distributions or payments (other than on a pro-rata basis) on, or issue any bonus securities in respect of, any other Additional Tier 1 securities or other securities that rank equally with the PPS;~~

~~until such time as~~

<sup>43</sup> ~~If the Issuer is not a "company" as defined in the Companies Act, it should be treated as such for the purposes of applying this solvency test.~~

<sup>44</sup> ~~See section D2.7(4) and (5) of BPR110.~~

- ~~(i) the next payment date at which the Distribution payments are resumed; or~~
- ~~(ii) the PPS are no longer outstanding~~

~~This term of the PPS is referred to as the "Dividend Stopper".~~

**No restrictions on other securities** ~~Other than the Dividend Stopper, the terms of the PPS will not limit, or otherwise restrict, the Issuer from issuing (or otherwise dealing with) equal, junior or senior securities in its absolute discretion.<sup>15</sup>~~

**Variation of rights** ~~Prior notification must be given to the Reserve Bank of any amendment to the terms of the PPS if such amendment would impact (or potentially impact) the capital treatment of the PPS under the Reserve Bank's prudential standards.<sup>16</sup>~~

**Set-off and offsetting rights** ~~[Except to the extent required by law, the PPS may not be subject to netting or offset claims on behalf of the Holder.]~~

**Conversion or exchange** ~~Not applicable.~~

**No guarantee** ~~PPS are not guaranteed by any person.~~

**Documents** ~~[Deed Poll (including terms of PPS)]~~

~~[Information Memorandum]~~

**Governing Law** ~~The PPS and all relevant transaction documents will be governed by the laws of New Zealand.~~

<sup>15</sup> See section D2.8(3) of BPR110.

<sup>16</sup> See section C2.5 of BPR120.



**Selling restrictions**

~~Neither the Issuer nor an entity over which the Issuer exercises control or significant influence is eligible to purchase the PPS, or directly or indirectly fund the purchase of the PPS.~~

~~This restriction does not prevent a holding company of the Issuer from purchasing the PPS, or prevent the Issuer from undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio, that may include PPS.<sup>17</sup>~~

~~[Issuer to insert additional selling restrictions for compliance with laws/regulations, as required].~~

~~The Issuer may want to include additional terms, which may include:~~

~~Credit rating [•]~~

~~Minimum denominations [•]~~

~~Listing [•]~~

~~Transfers [•]~~

~~Documentation [•]~~

<sup>17</sup> See section D2.8 of BPR110.

## Appendix 2

### TIER 2 ~~CHECKLIST TEMPLATE TERMS SHEET~~: SUBORDINATED NOTES

#### Purpose of this ~~terms sheet~~ checklist

The purpose of this Appendix 2, is to provide a checklist of requirements that an instrument must meet to qualify as Tier 2 capital. A completed copy of this checklist must be submitted to the Reserve Bank in respect of any new instrument that the bank proposes to issue and to treat as Tier 2 regulatory capital (refer to [D3.3 of BPR110]). The completed checklist must also be appended to the legal sign-off for the issue (refer to [B1.3 of BPR120]). ~~The purpose of this template terms sheet, as set out in section D3.2 of BPR110, is to provide guidance on the requirements that an instrument must meet to qualify as Tier 2 capital. The terms of the instruments will also need to comply with the requirements for Tier 2 capital contained in BPR110.~~<sup>18</sup>

<u>Relevant clause of BPR110</u>	<u>Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents</u>	<u>Comment</u>
<b><u>D3.3 requirements</u></b>		
<u>D3.3 (1) To qualify as Tier 2 capital, an instrument must satisfy the following criteria: “(a) only the paid-up amount of the instrument, irrevocably received by the bank, may be included in the amount of Tier 2 capital.”</u>		
<u>D3.3 (1) (b) “claims of holders of the instrument must be subordinated to claims of depositors and general creditors of the registered bank and, in order to meet this requirement, – (i) if either the bank or any subsidiary of the bank that has issued the instrument becomes subject to liquidation, claims of holders of the instrument must be subordinated to those of depositors and general creditors; and (ii) prior to liquidation or the maturity date of the instrument, the bank must be under no obligation to make payments of distributions or principal in the event that the bank fails to satisfy the solvency condition;</u>		

<sup>18</sup> This ~~terms checklist~~ sheet sets out the ~~key terms for the prudential requirements that the~~ instrument must comply with to qualify as Tier 2 under BPR110. The issuer is expected to comply with all other applicable laws in respect of any offer of the instrument

<p><u>and (iii) a failure to make a payment of distributions or principal on the instrument because the bank fails to meet the solvency condition must not give rise to an event of default;”</u></p> <p><u>Note that the following sections are relevant for D3.3 (1) (b):</u></p> <p><u>D3.3 (2) “For the purposes of subsection (1)(b)(ii) and (iii), a bank will satisfy the solvency condition– (a) if the bank is solvent at the time the relevant payment is due; and (b) if it will remain solvent immediately after making the payment.”</u></p> <p><u>D3.3 (3) “For the purposes of this section, solvent means satisfying the solvency test in section 4 of the Companies Act 1993, whether or not the bank is, in fact, a company for the purposes of that Act.”</u></p>		
<p><u>D3.3 (1) (c) “the paid-up amount of the instrument, or any future payment related to the instrument, must not be– (i) secured or covered by a guarantee from any member of the banking group or of any related entity; or (ii) subject to any other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general bank creditors;”</u></p>		
<p><u>D3.3 (1) (d) “the instrument must not be subject to netting or offset of claims on behalf of the holder of the instrument, except as mandatorily provided by law;”</u></p>		
<p><u>D3.3 (1) (e) “the instrument <del>and all constituting documents</del> must be governed by New Zealand law, or by <del>Australian</del> a permitted foreign law <del>English or New York law</del>; and</u></p> <p><u>(f) if one or more terms of an instrument is governed by <del>Australian, English or New York law</del> a permitted foreign law, section B1.3 of BPR120 requires a signed foreign law opinion on the enforceability of the instrument in that permitted foreign law jurisdiction in a form acceptable to the Reserve Bank in all respects.”</u></p>		
<p><u>D3.3 (2) “For the purposes of subsection (1)(b)(ii) and (iii), a bank will satisfy the <del>solvency</del> condition– (a) if the bank is solvent at the time the relevant payment is due;</u></p>		

<u>and (b) if it will remain solvent immediately <del>after making the payment.</del></u>		
<u>D3.3 (3) "For the purposes of this section, solvent means satisfying the solvency test in section 4 of the Companies Act 1993, whether or not the bank is, in fact, a company for the purposes of that Act."</u>		
<u>D3.3(4) "For the purposes of (1)€, the permitted foreign laws are: New South Wales (Australia), Victoria (Australia), England and New York."</u>		
<b>D3.4 Requirements</b>		
<u>D3.4 (1) "The terms of a Tier 2 instrument must not include any conversion feature that specifies circumstances in which a holder's interests in the instrument are replaced with interests in a different form of instrument."</u>		
<u>D3.4 (2) "A Tier 2 instrument must not confer any right on a holder to subscribe for new securities of the bank, or to otherwise participate in the profits or property of the bank, except by receiving payments as set out in the terms of the instrument."</u>		
<u>D3.4 (3) "The terms of a Tier 2 instrument must not include a write-off feature that specifies circumstances in which all of a holder's claims on the bank arising from the instrument are irrevocably cancelled."</u>		
<b>D3.5 requirements</b>		
<u>D3.5 (1) "Subject to subsections (2) to (4), a Tier 2 instrument must have a minimum original maturity of at least five years."</u>		
<u>D3.5 (2) "A Tier 2 instrument may be callable or redeemable prior to maturity at the initiative of the bank after a minimum of five years from the date on which the <del>registered</del> bank irrevocably receives payment for the instrument, and more than one such call or redemption may be provided for."</u>		
<u>D3.5 (3) "A Tier 2 instrument may provide for the bank to have a right to call or redeem the instrument as a result of a tax or regulatory event (including during the first five</u>		

<p><u>years of the term), provided that the terms of that provision do not permit early call or redemption if– (a) the tax or regulatory event could reasonably have been anticipated at the time the instrument was issued; or (b) the tax or regulatory event is minor (or words to that effect).”</u></p>		
<p><u>D3.5 (4) “The contractual terms of a Tier 2 instrument– (a) must provide that the <del>registered</del> bank is required to receive the prior written approval of the Reserve Bank to make any repayment of principal prior to maturity;” (b) must not include any feature that might give rise to an expectation that the instrument will be repaid prior to maturity”</u></p>		
<p><b><u>D3.7 requirements</u></b></p>		
<p><u>D3.7 (1) “A Tier 2 instrument must not contain any step-ups or incentives for the bank to redeem, within the meaning given in this section.”</u></p>		
<p><u>D3.7 (2) “To meet the requirements of subsection (1), the terms of a Tier 2 instrument must provide for the dividend or interest rate to be fixed for the entire term of the instrument and must not provide for the rate to be altered or reviewed, except in the following circumstances: (a) where the interest payment is cancelled, in whole or part; or (b) where there is a variable rate and where the formula for setting the rate is fixed for the term of the debt at the outset.”</u></p>		
<p><u>D3.7 (3) “The following are considered incentives to redeem– (a) a change in the margin; or (b) conversion from a fixed rate to a floating rate that is calculated as a benchmark rate plus a margin, if there is an increase in the margin relative to that implied for the fixed rate.”</u></p>		
<p><u>D3.7 (4) (4) Provided that no member of the banking group does anything that creates an expectation that a call will be exercised, the following will not be considered incentives to redeem: (a) the inclusion of a zero floor on the dividend or interest rate, so long as there is no zero floor applied to the benchmark rate.</u></p>		

<p>(b) <u>a conversion from a fixed rate to a floating rate (or vice versa) on an optional call date without any increase in credit spread; or</u>                  (c) <u>a fixed rate being reset on an optional call date at a new fixed rate, provided that-</u>                  (i) <u>the new rate is a benchmark rate plus a margin on that date applicable to the period over which the new rate will apply plus a margin ; and</u>                  (ii) <u>there is no change in the margin above the benchmark rate.</u>                  (d) <u>a rate being reset to a fallback benchmark rate, provided that-</u>                  (i) <u>the reset is triggered through the operation of contractual fallback provisions which apply in the event that the original benchmark becomes unavailable; and</u>                  (ii) <u>such provisions are designed, as far as possible, to produce a genuinely equivalent interest rate that does not result in a step-up in the margin over prevailing wholesale market rates.</u></p>		
<p><b>D3.8 requirements</b></p>		
<p><u>D3.8 "A Tier 2 instrument must not have a credit-sensitive distribution feature."</u></p>		
<p><b>D3.9 Requirements</b></p>		
<p><u>D3.9 (1) The holder of the instrument must have no rights to accelerate the repayment of future scheduled payments (whether coupon or principal), except in the event of the liquidation of the issuer.</u></p>		
<p><u>D3.9 (2) Neither the bank nor an entity over which the bank exercises control or significant influence may purchase the instrument, nor directly or indirectly fund the purchase of the instrument.</u></p>		
<p><u>D3.9 (3) However, nothing in this section prevents a holding company of the bank from purchasing the instrument nor prevents the registered bank undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the capital instrument.</u></p>		

D3.9 (4) The instrument must not contain any features that hinder recapitalisation of the registered bank or any member of the banking group.

D3.9 (5) To comply with subsection (4), the instrument must not have any terms that restrict the bank in any way from issuing, or otherwise dealing with, securities ranking junior, equal or senior to the instrument.

**Appendix: E2.1 requirements – note that these are only relevant for instruments involving an SPV. If the instrument does not involve an SPV, banks should record the E2.1 requirements below as “Not relevant, as no SPV involved in the instrument.”**

E2.1 (1) A capital instrument issued under an arrangement that involves an SPV, whether as the purchaser or the issuer of the instrument, does not qualify as regulatory capital unless the criteria specified in subsection (2) are met.

E2.1 (2) The criteria are that– (a) the SPV is required to be fully consolidated with the registered bank for the purpose of group financial statements under GAAP;

E2.1 (2) (b) the bank issues an instrument to the SPV, the terms and conditions of that instrument matching, in all material respects, the terms and conditions of the instrument issued by the SPV to third party investors;

E2.1 (2) (c) “the instrument issued by the bank to the SPV must meet the criteria for classification as AT1 capital or the criteria for classification as Tier 2 capital, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively;”

E2.1 (2) (d) the instrument issued by the SPV would, if issued by the bank, meet the criteria for classification as AT1 capital or the criteria for classification as Tier 2 capital, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively;”

E2.1 (e) “the proceeds from the issue of the capital instrument by the SPV must be immediately and directly invested in, and available without limitation to, the bank;”

E2.1 (f) “the amount of capital issued by a consolidated subsidiary to third parties that may be included in Tier 1 or total capital must be determined in accordance with subpart E1, and if the subsidiary issues capital through an SPV, the requirements of this subpart must be met as

if the subsidiary were the bank, in addition to the requirements of subpart E1.”		
<b>Additional material</b>		
Confirm that there are no other features that would affect the compliance with BPR110.		

**Subordinated Notes**

<b>Description</b>	[Subordinated notes (Notes)]
<b>Issuer</b>	[•]
<b>Form</b>	<del>The Notes are subordinated, unsecured debt obligations of the Issuer. The Notes are not deposit liabilities of the Issuer.</del>
<b>No-guarantee</b>	The Notes are not guaranteed by any person. <sup>19</sup>
<b>Maturity date</b>	[Insert maturity date ≥ 5yrs] <sup>20</sup>
<b>Legal form</b>	Debt

<sup>19</sup> See section D3.3(1)(c) of BPR110.

<sup>20</sup> See section D3.5 of BPR110.



<b>Regulatory treatment (Issuer)</b>	Tier 2 Capital
<b>Accounting treatment (Issuer)</b>	Liability
<b>Face Value</b>	[•] per Note
<b>Issue Date</b>	[•] <sup>24</sup>
<b>Issue amount</b>	[•]
<b>Redemption on the Maturity Date</b>	Notes will be redeemed on the Maturity Date for Face Value (unless previously redeemed on an optional redemption date).
<b>Early redemption at option of Issuer</b>	Notes may be redeemed for the Early Redemption Price at the option of the Issuer on one or more specified early redemption dates (being the 5 <sup>th</sup> anniversary of the Issue Date or any scheduled interest payment date after that date), or if a "Tax Event" <sup>22</sup> occurs or if a "Regulatory Event" occurs.

<sup>24</sup> *Note to Issuer: This draft has been prepared on the basis that the Issuer will receive irrevocable payment for the Notes on the Issue Date. If this is not the case, the description of the Optional Redemption Date will need to be updated to reflect the requirements in section D3.5(2) of BPR110.*

<sup>22</sup> *Note to Issuer: See section C2.2 of BPR120 for guidance on permitted regulatory and tax events. The documented legal terms of the Notes must reflect this guidance.*

~~The Issuer may only exercise its redemption option if it also satisfies the Conditions to Early Redemption.~~

**Conditions to Early Redemption<sup>23</sup>**

~~The Issuer may only exercise its early redemption option if:~~

~~(i) either~~

~~(a) prior to, or concurrent with, redemption, the Issuer replaces the Notes with a capital instrument having the same Face Value and of the same or better quality (for the purposes of the Reserve Bank prudential standards as they are applied to the Issuer at the relevant time), the terms and conditions of which are sustainable for the income capacity of the Issuer's group; or~~

~~(b) the Issuer obtains confirmation from the Reserve Bank that the Reserve Bank is satisfied that the Issuer's capital position would meet the Reserve Bank's capital adequacy requirements applying at that time (including the capital conservation buffers, any countercyclical buffer and any~~

<sup>23</sup> ~~See section D3.5(4) of BPR110 and section C2.2 of BPR120.~~

~~other capital buffers) after redemption; and~~  
~~(ii) the Reserve Bank has given its prior written approval to the redemption. Approval is at the absolute discretion of the Reserve Bank.~~

**Early Redemption Price**

~~{•}~~

**Redemption at the option of the Holder**

~~Holders have no ability to redeem the Notes before the Maturity Date other than in a dissolution or liquidation of the Issuer.~~

**Ranking**

~~The Notes will be subordinated in the dissolution or liquidation of the Issuer to the claims of depositors and unsubordinated creditors of the Issuer.<sup>24</sup>~~

~~The Notes rank:~~

- ~~(i) behind Unsubordinated Obligations;~~
- ~~(ii) equally with Equal Ranking Securities;~~
- ~~and~~
- ~~(iii) ahead of Junior Ranking Securities.~~

~~“Unsubordinated Obligations” means all deposits and other liabilities, securities and other obligations of the Issuer other than Equal Ranking Securities or Junior Ranking Securities.~~

<sup>24</sup>See section D3.3(1)(b) of BPR110.

~~“Equal Ranking Securities” means the Notes and all securities that qualify as Tier 2 Capital, or which rank or are expressed to rank equally with such securities in a dissolution or liquidation of the Issuer.~~

~~“Junior Ranking Securities” means all fully paid Tier 1 instruments (ordinary shares and perpetual preference shares) in the capital of the Issuer and all other securities which rank or are expressed to rank behind Equal Ranking Securities.<sup>25</sup>~~

**Rights in dissolution and liquidation**

~~In the dissolution or liquidation of the Issuer, the Note will confer upon its Holder the right to payment in cash of an amount equal to the Face Value plus accrued but unpaid interest, but no further or other right to participate in the surplus assets of the Issuer.~~

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<sup>25</sup> ~~Note to Issuer: For Issuers that do not have ordinary shares this would be adjusted to reflect the particular corporate structure~~

**No participation in issues of securities**

~~The Notes confer no rights on a Holder to subscribe for new securities of the Issuer, or to otherwise participate in the profits or property of the Issuer, except by receiving payments as set out in the Note terms.~~

**Interest Rate**

~~[Issuer to insert Interest Rate]<sup>26</sup>~~

**Margin**

~~[Issuer to insert Margin]<sup>27</sup>~~

**Interest payment dates**

~~[Issuer to insert payment dates]~~

**Solvency Condition**

~~[Prior to the Maturity Date or the dissolution or liquidation of the Issuer, the Issuer is under no obligation to make any payment on the Notes (interest or principal) if the Issuer is not able to make the payment and remain solvent (satisfy the "Solvency Condition").]<sup>28</sup>~~

The Issuer will satisfy the **Solvency Condition** if it is "solvent" at the time the relevant payment is due and will remain "solvent" immediately after making the payment. For these purposes, "solvent" means satisfying the

<sup>26</sup> ~~Note to Issuers: See sections D3.7 and D3.8 of BPR110 for requirements for Tier 2 interest rates (and payment related features). Note in particular that a Tier 2 instrument must not contain any step-ups for incentives for the bank to redeem or credit sensitive distribution features.~~

<sup>27</sup> ~~Note to Issuers: Again, see sections D3.7 and D3.8 of BPR110.~~

<sup>28</sup> ~~See section D3.3(1)(b)(ii) of BPR 110.~~

~~solvency test in section 4 of the Companies Act 1993.<sup>29</sup>~~

~~No event of default arises if the Issuer fails to make a Note payment because the Issuer does not satisfy the Solvency Condition.~~

**~~[No restrictions on other securities]~~**

~~[The terms of the Notes will not limit, or otherwise restrict, the Issuer from issuing (or otherwise dealing with) equal, junior or senior securities in its absolute discretion.<sup>30</sup>]~~

**~~Set-off and offsetting rights~~**

~~[Except to the extent required by law, the Notes may not be subject to netting or offset claims on behalf of the Holder.]~~

**~~Variation of Rights~~**

~~Prior notification must be given to the Reserve Bank of any amendment to the terms of the Notes if such amendment would impact (or potentially impact) the capital treatment of the Notes under the Reserve Bank's prudential standards at the relevant time<sup>31</sup>~~

<sup>29</sup> ~~If the Issuer is not a "company" as defined in the Companies Act, it should be treated as such for the purposes of applying this solvency test.~~

<sup>30</sup> ~~See section D3.9(4) of BPR110.~~

<sup>31</sup> ~~See section C2.5 of BPR120.~~

**Conversion or exchange**

~~Not applicable.~~

**Documents**

~~[Deed Poll (including terms of Notes)]~~

~~[Information Memorandum]~~

**Governing Law**

~~The Notes and all relevant transaction documents will be governed by the laws of New Zealand.~~

**Selling Restrictions**

~~Neither the Issuer nor an entity over which the Issuer exercises control or significant influence is eligible to purchase Notes, or directly or indirectly fund the purchase of Notes. This restriction does not prevent the Issuer's [parent entity] from purchasing Notes, or prevent the Issuer from undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio, that may include Notes.~~

~~[Issuer to insert additional selling restrictions for compliance with laws/regulations, as required].<sup>32</sup>~~

<sup>32</sup> See section D3.9 of BPR110.

*The Issuer may want to include additional terms, which may include:*

- Credit rating** {•}
- Listing** {Issuer to insert}
- Transfers** {Issuer to insert}
- Documentation** {Issuer to insert}

DRAFT