Reserve Bank of New Zealand
Te Pūtea Matua

BS16 Guidance note.

Application requirements for recognition of Tier 2 capital instruments

17 June 2021

Application requirements for recognition of Tier 2 Capital Instruments

On 17 June the Reserve Bank published the finalised *Banking Prudential Requirements* (BPRs), which implement the December 2019 Capital Review decisions.

The BPR documents set out the details of the policy framework and rules that will apply to registered banks in New Zealand from 1 October 2021. The BPRs replace the capital adequacy portions of the existing *Banking Supervision Handbook* (the 'Handbook'). The Handbook documents will continue to apply until the new BPRs take effect from 1 October 2021.

This Guidance Note provides an amendment to BS16 ('*Application requirements for capital recognition or repayment and notification requirements in respect of capital*') to allow banks to issue Tier 2 capital instruments under the revised capital framework (contained in the BPRs), from 1 July 2021 until 1 October 2021. This Note outlines the approach the Reserve Bank intends to take from now until 30 September 2021 if a bank wishes to issue a new Tier 2 capital instrument that complies with the requirements set out in BPR110. The Guidance Note will expire on 1 October 2021.

Amendment to BS16 for new (consistent with BPR110) Tier 2 capital instrument issuance

New Zealand-incorporated registered banks are required as part of their Conditions of Registration (CoR) to receive a notice of non-objection from the Reserve Bank before including any Additional Tier 1 (AT1) or Tier 2 capital instrument as regulatory capital. Part 2 of BS16 sets out the non-objection process.

In the case of AT1 capital instruments, all of the existing requirements in the current Handbook will continue to apply until the BPRs take effect on 1 October 2021. This Guidance Note does not change any aspects of BS16 regarding AT1 instruments, as it only covers Tier 2 instruments.

In the case of Tier 2 capital instruments, all existing requirements in the Handbook will also continue to apply until the new BPRs take effect on 1 October 2021. However, the Reserve Bank intends to change existing processes to provide scope for banks to issue Tier 2 instruments that are compliant with the new BPRs, but are not compliant with the current Handbook (including the capital instrument requirements in BS2A and BS2B). This will provide banks flexibility to raise capital in the immediate future in the form of the new-style Tier 2 instruments.

The key change is that we will be amending banks' CoRs to provide for Tier 2 instruments issued in accordance with the provisions of BPR110 to be recognised as regulatory capital. We will be writing to banks to implement this change, with a seven-day consultation period for banks to provide us feedback.

The proposed changes to banks' CoRs mean that a bank could issue a new-style Tier 2 capital instrument, and include this as regulatory capital before 1 October 2021, so long as the following conditions are met:

- The newly issued Tier 2 capital instrument must meet all of the requirements for Tier 2 capital set out in BPR110.
- The bank issuing the Tier 2 instrument must comply with the new notification process set out in BPR120.

If a bank meets these conditions, the Reserve Bank will issue a non-objection notice under BS16, so long as we are satisfied that the registered bank has undertaken sufficient due diligence to meet the new requirements.

A bank will not need to undertake processes under BS16 that are not required under BPR110 or BPR120, for example, providing a binding IRD ruling. While Board approvals and attestations set out in BS16 will not be required, banks should ensure that all processes are carried out in a way that is consistent with the guidance provided in B1.1 of BPR120:

> "…the directors of a bank are responsible for ensuring that their bank's capital instruments comply with the Reserve Bank's capital adequacy framework for the entire period that the instrument is recognised as regulatory capital."

The revised approach to BS16 set out in this Note will expire on 30 September 2021. From 1 October 2021 the BPRs will replace the existing capital adequacy portions of the Handbook, as well as the provisions set out in this Guidance Note.

Bank disclosure requirements are set by Order in Council. To ensure that total capital ratios published in disclosure statements as at 30 September 2021 can include the value of any new Tier 2 instruments issued, the Reserve Bank will be recommending to the Minister of Finance that the necessary revisions be made to the disclosure Order in Council for New Zealand-incorporated banks. The Reserve Bank is in the process of consulting banks on the proposed Amending Order.