



**RESERVE
BANK**

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

Application requirements for capital recognition or repayment and notification requirements in respect of capital

Prudential Supervision Department

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Part 1 - Introduction

1. New Zealand-incorporated registered banks are required as a condition of their registration to receive a notice of non-objection from the Reserve Bank before including any Additional Tier 1 (AT1) or Tier 2 capital instrument within regulatory capital. Part 2 of this document sets out the process requirements in respect of obtaining a notice of non-objection.
2. New Zealand-incorporated registered banks are required as a condition of their registration to meet the requirements of Part 3 of this document. Part 3 sets out certain notification requirements and requirements in relation to the repayment or repurchase of capital instruments.
3. Part 4 of this document sets out the information requirements in respect of seeking approval from the Reserve Bank for the repayment of capital instruments.
4. The requirements of this document do not apply to overseas-incorporated registered banks.

Information in grey boxes is for guidance only

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

Introduction

5. It is a condition of registration of New Zealand-incorporated registered banks that the bank must have received a notice of non-objection from the Reserve Bank before including any Additional Tier 1 or Tier 2 instrument within regulatory capital.

The directors of a registered bank remain 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 Reserve Bank will not issue a notice of non-objection unless it is satisfied that the bank has undertaken sufficient due diligence to satisfy itself that the instrument complies with the requirements of the capital adequacy framework. The non-objection requirement is designed to provide comfort to the Reserve Bank that on the basis of the information it receives from the bank, there is no reason to object to the instrument being recognised as regulatory capital in accordance with the Reserve Bank's capital adequacy framework. A notice of non-objection does not guarantee that the instrument complies with the Reserve Bank's capital adequacy framework.

Overview of the process to obtain a notice of non-objection

6. The process for obtaining a notice of non-objection is intended to broadly follow the process set out in Appendix A. However the exact process will depend on idiosyncratic factors. The Reserve Bank can give no guarantee as to how long it will take to assess a capital instrument. The process will generally have the following steps:
 - a. initial application to the Reserve Bank;
 - b. provision of an issues list by the Reserve Bank;
 - c. response to issues list by the registered bank;
 - d. repeat of steps b and c until the Reserve Bank has no further issues;
 - e. internal Reserve Bank Committee consideration and, if satisfactory, confirmation that nothing has come to the Reserve Bank's attention to cause it to object to the instrument being treated as regulatory capital;
 - f. provision of finalised documentation, tax ruling and required board approvals and attestations ("final application");
 - g. issue of the notice of non-objection if the Reserve Bank has no objection to the proposed treatment of the instrument.
7. A registered bank should ensure that the initial application is provided well in advance of the intended launch date. The amount of time it will take for the Reserve Bank to assess an instrument will depend on the complexity of the instrument and cannot be set in advance. A registered bank should allow five

working days between steps f and g of paragraph 6, assuming that there have been no significant changes to documentation since consideration by the internal Reserve Bank Committee. The information requirements at initial and final application are set out below.

Initial Application

8. Applications for a notice of non-objection should be made to the registered bank's Reserve Bank supervisor. On making an initial application for a notice of non-objection, the information below is to be provided to the Reserve Bank along with any other information requested by the Reserve Bank.

Draft terms of the instrument

9. The relevant legal documentation constituting the instrument (e.g. terms, deed poll, relevant inter company agreements).

Draft self-assessment

10. A self-assessment (BS16 assessment), in table format, of compliance with the relevant capital adequacy framework providing the following information:
 - a. the proposed tier of the instrument (Additional Tier 1 or Tier 2);
 - b. the nominal value of the instrument and the value of the instrument that will be recognised as regulatory capital. The registered bank must explain whether or not it is intending on making any adjustment to the regulatory value for a tax liability that could potentially occur at the point of conversion or write-off. The registered bank must provide its interpretation of any binding ruling obtained or, if no ruling is required (or the ruling has not yet been obtained), its view on any tax consequences of a conversion or write-off;
 - c. which of subparts 2B-2G of BS2A or BS2B (as relevant) the instrument must comply with;
 - d. for each criterion within each relevant subpart, 2B-2G, an assessment of whether and why the instrument complies, with reference to the relevant clause(s) in the instrument's documentation and whether any other terms may undermine compliance;
 - e. for instruments with a conversion feature, a description of how the conversion mechanism works.

Draft legal opinion

11. A legal opinion, consistent with either paragraph 12 or 13 as relevant, is required in respect of all applications for a notice of non-objection.
12. In respect of an instrument with a write-off feature the opinion must provide:
 - a. that in the opinion of the opinion giver, the legal mechanism to effect write-off is legally effective; and

- b. a statement of what board approvals are necessary to ensure the write-off will occur in the circumstances intended.
13. In respect of an instrument containing a conversion feature the opinion must:
- a. provide a statement of:
 - i. what the disclosure requirements are on a regulatory conversion;
 - ii. what board approvals are necessary to ensure that a regulatory conversion will occur in the circumstances intended;
 - b. provide that in the opinion of the opinion giver, there are no legal impediments to a regulatory conversion occurring in the circumstances intended, including that:
 - i. the entity that will issue shares under the conversion mechanism has the legal power to do so;
 - ii. the legal mechanism to give effect to conversion, and write-off as the secondary mechanism, is legally effective;
 - iii. any disclosure requirements at the point of conversion will not unduly delay the conversion of the instrument.

Disclosure requirements at the point of conversion will not be considered to unduly delay the conversion if the disclosure requirements will not prevent conversion from occurring within five working days of a trigger event.

Additional information for capital instruments issued in a foreign currency

14. A registered bank may issue a capital instrument in a foreign currency. Where a bank intends to do so it must provide the following additional information:
- a. a statement of the bank's intended accounting treatment of the instrument and any associated swaps or other associated hedging instruments;
 - b. forecasts of the bank's capital ratios on a quarterly basis over the next two years that demonstrate the sensitivity of the value of regulatory capital to fluctuations in currency values (forecasts should be both a reverse test showing how far the exchange rate has to change in value before the conservation buffer is breached and a forecast of capital ratios based on expected changes in the exchange rate).

Capital instruments issued in a foreign currency must be valued for regulatory capital purposes in NZD at the spot exchange rate.

Additional information for inter-group issues

15. Where a registered bank intends to issue a capital instrument to a related party, the bank must provide information on any related transactions in respect of the ultimate source of funding for that instrument. For example, if the registered bank intends to issue a capital instrument to a holding company, it should provide information on any related funding transactions for that holding company and also funding of entities further up the ownership structure.

Final Application

16. At least five working days prior to the date on which the registered bank requires a notice of non-objection, the bank should provide a final application that includes:

- a. finalised documentation, being:
 - i. the final version of the terms of the instrument;
 - ii. an updated BS16 assessment taking into account any changes to the terms and receipt of an IRD binding ruling if required;
 - iii. a draft of the IRD binding ruling if required (see below);
 - iv. a signed legal opinion;

if documents are not provided in signed form at this stage, the bank will need to confirm that there are no subsequent changes to the documents prior to the Reserve Bank issuing a notice of non-objection.

- b. evidence that all board approvals (set out in the opinion) have been completed.

This evidence may be provided in the following forms:

- i. the legal opinion may provide that all necessary board approvals have been obtained. In this case the legal opinion should set out the documentation cited to form this view; or
 - ii. confirmation from the company secretary that all the necessary board approvals set out in the opinion have been obtained; or
 - iii. provision of the signed board approvals;
- c. an attestation from the board that:
 - i. after having made due inquiry, in the opinion of the board:
 1. the information provided in the final BS16 assessment is accurate;
 2. the issue complies with the requirements of the relevant capital adequacy framework for the relevant Tier of capital;
 - ii. the board acknowledges the notice of non-objection issued by the Reserve Bank is a 'no objections' sign off and does not provide a positive confirmation of eligibility for treatment as Additional Tier 1 or Tier 2 capital.

This attestation may be signed on behalf of all the directors of the registered bank by the Chair of the board (or the Chair's delegate when the Chair is unavailable).

17. In order to determine the value of the instrument that may be recognised as regulatory capital the Reserve Bank may require a tax opinion from legal counsel or IRD binding ruling.

18. Whether the Reserve Bank will require a tax opinion or IRD binding ruling, in order for the value of the instrument to be determined, will depend on the case. Registered banks should discuss this matter with their Reserve Bank supervisor. However in general the Reserve Bank's approach will be:

- a. no tax opinion or IRD binding ruling will be required where the bank reduces the value of the instrument, for the purposes of regulatory capital recognition, by at least the company tax rate multiplied by the value of the instrument;
- b. no tax opinion or IRD binding ruling will be required in respect of preference shares (although the requirements of paragraph 10(b) still applies);

- c. an IRD binding ruling will be required in respect of all other capital instruments that are treated as debt in the financial statements, unless otherwise communicated by the Reserve Bank.
19. A registered bank should seek to have the IRD binding ruling apply for the entire term of the instrument. Except where the instrument has one year or less until maturity following the expiry of the ruling, the Reserve Bank will expect the registered bank to seek a new IRD binding ruling if the instrument matures after the expiry of ruling.

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

Part 3 - Requirements in respect of repayment of capital instruments and notifications

Introduction

20. A registered bank must notify the Reserve Bank immediately, in writing, if the banking group's Common Equity Tier 1 (CET1) capital ratio falls below 5.125%.
21. A registered bank must notify the Reserve Bank of any:
- a. dividend, except for distributions to customers of a mutual entity that the entity is contractually obliged to make;
 - b. repayment of ordinary shares; or
 - c. other capital return in respect of CET1 capital, that either in itself, or when added with other such payments over the twelve months prior to the payment, results in a reduction of CET1 capital to a level that is more than 10% lower than the level of CET1 capital twelve months ago (this notification must be made at least five working days prior to the payment taking place, or in the case of a series of payments at least five working days prior to the payment that causes the 10% threshold to be exceeded).
22. Except in the case of a loss absorption trigger event or a non-viability trigger event, a registered bank must not:
- a. repay an Additional Tier 1 capital instrument; or
 - b. repay a Tier 2 capital instrument prior to maturity;
- unless:
- i. the bank has received the prior written approval of the Reserve Bank; and
 - ii. prior to or concurrent with the repayment, the instrument is replaced with a paid-up capital instrument of the same or better quality and the terms and conditions of the replacement instrument are sustainable for the income capacity of the banking group. However, a replacement instrument is not required where the bank can demonstrate to the Reserve Bank's satisfaction that the banking group's capital position would be sufficiently above the minimum capital requirements after the repayment.

An instrument will be considered to be issued concurrently with an instrument that is being repaid if it is issued on the same day that the other instrument is repaid.

It is likely that the Reserve Bank, for this purpose, will consider that a banking group's capital position would be sufficiently above the minimum capital requirements after the repayment if all the bank's capital ratios remain above the minimum requirements plus the conservation buffer and are expected to do so in the future.

Where a bank issues a call notice prior to repaying the instrument, the instrument may continue to be recognised as regulatory capital until repaid unless, on issuing the call notice, the bank becomes subject to an unconditional, unsubordinated obligation to repay the instrument on the repayment date.

The Reserve Bank will not permit the repayment of an AT1 instrument or repayment of a Tier 2 instrument prior to maturity as a result of a tax or regulatory event if it forms the view that the registered bank could have anticipated the tax or regulatory event at the time of issuance or if it forms the view that the tax or regulatory event is minor or not applicable. The terms of the instrument should make it clear that holders should not expect the Reserve Bank to approve repayment.

A tax or regulatory event will only be considered to be anticipated at the time of issuance if it relates to a potential change in law, or application or interpretation of law, for which there is a clearly defined policy intent and clear intention to implement. This would require for example that:

- for legislation, the Bill has been introduced into Parliament;
- for any other regulatory tool, the relevant body has issued a statement of intention to implement a defined policy.

23. Except with the prior approval of the Reserve Bank, no member of the banking group of a registered bank may purchase any Additional Tier 1 or Tier 2 capital instrument previously issued by the banking group, where that purchase would result in the banking group owning a position of more than 5% of the instruments that have been issued as Additional Tier 1 and Tier 2 instruments. This paragraph does not apply to a redemption or payment on maturity under the terms of the contract or to a repurchase or redemption to give effect to a loss absorption trigger event or a non-viability trigger event.

24. Except with the prior approval of the Reserve Bank, no member of the banking group of the registered bank may fund, whether directly or indirectly, instruments that have been issued as Additional Tier 1 or Tier 2 capital for the banking group, where that funding would result in that banking group being the ultimate source of funds for more than 5% of the total amount of instruments issued as Additional Tier 1 and Tier 2 instruments by the banking group. Lending by the registered bank to a customer to fund the purchase of a diversified portfolio is not included in the funding amount.

Notwithstanding paragraphs 23 and 24, under subparts 2A, 2B and 2C of BS2A and BS2B any instrument ceases to be regulatory capital from the point in time that either the registered bank or a related party over which the registered bank exercises control or significant influence purchases the instrument or indirectly funds the purchase of the instrument. Banks should have systems in place to ensure any such purchases are deducted from the capital base.

25. The registered bank must notify the Reserve Bank of any amendments to an Additional Tier 1 or Tier 2 instrument, for which a notice of non-objection (or approval as a transitional instrument) has been obtained, that are material to the instrument's qualification as regulatory capital. The Reserve Bank may inform the bank in writing within twenty working days of that notification that the notice of non-objection applying to that instrument has been revoked if, in the opinion of the Reserve Bank, the requirements of the relevant capital standard are no longer met.

Part 4 - Supporting information required for repayments

26. The registered bank should make the notifications above, or an application for the required approvals, to the bank's Reserve Bank supervisor.
27. The following information must be provided to the Reserve Bank in support of an application to repay an Additional Tier 1 or Tier 2 instrument:
 - a. a copy of the notice of non-objection (or approval for a transition instrument) from the Reserve Bank for recognition as regulatory capital of the instrument being repaid;
 - b. proposed date of repayment;
 - c. any other information requested by the Reserve Bank.
28. The following information must be provided to the Reserve Bank in support of an application to repay a capital instrument when the registered bank proposes not to replace the capital instrument being repaid:
 - a. the rationale for not replacing the capital instrument;
 - b. projections of the banking group's Common Equity Tier 1 capital ratio, Tier 1 capital ratio, Total capital ratio and buffer ratio from the date of repayment and for the four quarter ends following repayment of the capital instrument, and a list of assumptions underpinning the projections.
29. The following information must be provided to the Reserve Bank in support of an application to repay a capital instrument when the registered bank proposes to replace the capital instrument being repaid:
 - a. an initial application for a notice of non-objection for the replacement instrument (or an indication of when that application will be provided);
 - b. the date the proposed replacement instrument is intended to be fully paid in;
 - c. in relation to the instrument that the registered bank proposes to repay, details of the interest or dividend rate that applies prior to repayment and details of the expected interest or dividend rate on that instrument if it were not repaid;
 - d. details of the expected interest or dividend rate on the replacement instrument;
 - e. where the instrument is of a different tier, projections of the banking group's Common Equity Tier 1, Tier 1 and Total capital ratio and buffer ratio from the date of repayment and for the four quarter ends following repayment of the capital instrument, and a list of assumptions underpinning the projections.

Appendix A

