RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

Geoff Bascand
Deputy Governor
General Manager Financial Stability

31 March 2021

Dear Chief Executive

The Reserve Bank announced this morning that the restrictions on dividends and redeeming non-Common Equity Tier 1 (CET1) capital instruments put in place in April 2020, and extended in November 2020, will be eased.

The Reserve Bank's new restrictions will allow banks to pay up to 50% of their earnings as dividends to their shareholders. Definitions and other technical details are included in the Annex to this letter.

In April 2020, at the height of the COVID-19 impact on New Zealand, a complete restriction on dividends was put in place to support financial stability and the provision of credit in the economy. The restrictions have been successful in achieving these outcomes.

The revised restrictions will continue to support financial stability and the provision of credit in the economy.

While the restrictions on dividends have been eased, the Reserve Bank expects banks to exercise prudence in determining the appropriate size of dividends to pay to their shareholders. The limit set in the revised restriction is an upper limit, and should be treated as such.

Banks should put the need to support households and businesses at the centre of their assessment of the appropriate level of dividends. Any payment of dividends should not impede the bank's ability to provide this support during what is likely to be a prolonged period of economic recovery.

The Reserve Bank expects that banks will take an ongoing measured approach to dividends. As part of this, banks that intend to pay dividends should also consider the following factors:

- Banks' decisions should reflect elevated levels of economic uncertainty and the need for banks to continue to support households and businesses.
- Banks need to be profitable and have robust capital trajectories that will enable them to meet the higher capital requirements in the medium term that result from previous Reserve Bank Capital Review decisions.
- Banks should ensure that any dividends will not create excess vulnerability to stress events.

The restriction on redeeming non-CET1 capital instruments has been lifted completely. Applications for redemptions of capital instruments should be done in line with the provisions included in Part 3 of BS16, noting that the Reserve Bank intends to take a cautious view around the capital levels that would prevail after redemption.

The Reserve Bank will be in contact with banks shortly with draft Conditions of Registration to implement the new restrictions. We intend to provide a seven day consultation period for banks

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to consider the changes. The Annex to this letter contains some further details about how we intend to amend the Conditions of Registration, but the formal process for making these changes will be covered in a separate letter.

The 50% dividend restriction will remain in place until 1 July 2022, at which point the Reserve Bank intends to normalise the dividend settings by removing the restrictions entirely (subject to no significant worsening in economic conditions). This is the same date at which higher capital requirements begin to apply to systematically significant banks, as set out in the Reserve Bank's Capital Review.

Yours sincerely

Geoff Bascand
Deputy Governor / General Manager Financial Stability

**Annex: Details of implementation and definitions**

Earnings

Earnings is defined as set in Part 3 of BS2A and BS2B, so is

(a) “prior to the deduction of distributions and
(b) “net of the tax that would have been reported had none of the distributable items been paid.”

Dividends must not exceed 50% of the above definition of earnings. For the avoidance of doubt, this means that dividends may not exceed 50% of net profit after tax reported in the bank’s most recently completed financial year.

The restrictions do not prevent a bank from paying an interim dividend (for example, at the half year). In such cases it is the total dividend paid in the year, relative to earnings in the full year, that is limited by the restriction.

Dividend payments of greater than 50% would breach the restriction, even if there were matching financial transactions designed to boost CET1 in other ways (eg. through the issuance of ordinary shares).

Distributions on AT1 capital instruments

The previous restrictions did not apply to distributions on Additional Tier 1 (AT1) capital instruments. The amended restrictions will also not apply to distributions on AT1 capital. This means that AT1 distributions do not need to be included within the 50% of earnings limit on dividends.

Process for changes to Conditions of Registration

As noted in the main text of this letter, the Reserve Bank will write to banks shortly with draft changes to Conditions of Registration. At this point we anticipate that the revised dividend restrictions will be reflected in the following way in the Conditions:

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

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

| **Banking group’s buffer ratio** | **Percentage limit on distributions of the bank’s earnings** |
|---|---|
| 0% – 0.625% | 0% |
| >0.625 – 1.25% | 20% |
| >1.25 – 1.875% | 40% |
| >1.875 – 2.5% | 50% |

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

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

For the purposes of this condition of registration,—

“buffer ratio”, “distributions”, and “earnings” have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: “Capital Adequacy Framework (Internal Models Based Approach)” (BS2B) dated November 2015;

the scalar referred to in the Reserve Bank of New Zealand document “Capital Adequacy Framework (Internal Models Based Approach)” (BS2B) dated November 2015 is 1.06.

1D. That, if the buffer ratio of the banking group is more than 2.5%, the bank must limit aggregate distributions, other than discretionary payments payable to holders of Additional Tier 1 capital instruments, to no more than 50% of the bank’s earnings.

For the purposes of this condition of registration,—

an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 2.13(a) or (c) of the Reserve Bank of New Zealand document “Capital Adequacy Framework (Internal Models Based Approach)” (BS2B) dated November 2015;

“buffer ratio”, “distributions” and “earnings” have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: “Capital Adequacy Framework (Internal Models Based Approach)” (BS2B) dated November 2015;”