



Reserve Bank
of New Zealand
Te Pūtea Matua

BPR110

Capital Definitions Exposure Draft Consultation December 2022

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.

Document version history

1 July 2021	First issue date
1 October 2021	Revised edition with minor edits
1 October 2023	Revised edition to include the mutual capital instrument

Conditions of registration

The Banking (Prudential Supervision) Act 1989 (the **Act**) permits the Reserve Bank to impose conditions of registration (**conditions**) on **registered banks**¹.

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 levels². 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.

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

² These conditions of registration relate to the matter referred to in section 78(1)(c) of the Act (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.

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

mutual entity means a building society, co-operative company, credit union or other entity determined by the Reserve Bank to be a mutual entity for the purposes of this document and BPR120

mutual capital instrument means a capital instrument issued by a **registered bank** structured as a **mutual entity** that meets the criteria in subpart D1A

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.

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. **CET1 capital**; and
 - ii. **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.

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 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 2022, 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 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 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 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 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 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

Period	Percentage cap
1 October 2021 to 31 December 2021	100%
1 January 2022 to 31 December 2022	87.5%
1 January 2023 to 31 December 2023	75%
1 January 2024 to 31 December 2024	62.5%
1 January 2025 to 31 December 2025	50%
1 January 2026 to 31 December 2026	37.5%
1 January 2027 to 31 December 2027	25%
1 January 2028 to 30 June 2028	12.5%
On and after 1 July 2028	0%

Part B: Categories of capital

B1 Common Equity Tier 1 capital

B1.1 General principles

CET1 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.

B1.2 Definition of Common Equity Tier 1 capital

1. **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 capital** 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

2. The components of **CET1 capital** are–
 - a. paid-up ordinary shares, issued by the 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; and
- f. paid-up **mutual capital instruments** issued by the bank.

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–
 - a. in the regulatory capital of a bank, **non-bank deposit taker**, or **insurance entity** (or overseas equivalent); and
 - b. 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 or **mutual capital instruments** of another entity that exceeds 10% of the issued ordinary shares or **mutual capital instruments**, as the case may be, of that entity.

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:
 - a. the deferred tax assets and liabilities arise as a result of deductible temporary differences (as defined by **NZ IAS 12**); and
 - b. 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**.

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 section 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.

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.

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.

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.

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.

B1.10 Holdings of own shares

1. The value of any holding of the bank's own ordinary shares or **mutual capital instruments** 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 ordinary shares or **mutual capital instruments**, 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 ordinary shares or **mutual capital instruments**.

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.

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.

B1.13 IRB bank expected losses

An **IRB bank** must deduct from **CET1 capital** the amounts required by subsections 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**.

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.

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 Part 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 capital** instruments are reflected in the checklist 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 bank; and
 - ii. is held by **third parties**; and
 - iii. meets the conditions set out in subsection (3); and

- d. the total value of a bank's **transitional AT1 capital instruments** calculated in accordance with subsection A2.4(2).

Guidance: The case of minority interests in **AT1 capital** 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**.

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 capital** or **AT1 capital**, but are available to absorb losses ahead of more senior creditors of the **banking group** in a winding up.

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 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 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 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; and
 - e. the total value of a bank's **transitional Tier 2 capital instruments** calculated in accordance with subsection A2.4(3).
3. An **IRB bank** may include in **Tier 2 capital** the amount specified in subsections 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**.

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.

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.

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**.

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**.

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**.

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 sections 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 capital**, **AT1 capital** 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, or the issued **mutual capital instruments**, 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**.

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, or the issued **mutual capital instruments**, 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).

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.

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.

Part D: Eligibility criteria for capital instruments

D1 Eligibility of CET1 (ordinary shares)

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 an ordinary share 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: **mutual entities** that adopt a 'one member, one vote' rule are not, merely through the adoption of that rule, prevented from satisfying this condition.

- e. the instrument represents the most subordinated claim in the liquidation of the bank; and
- f. the instrument holder is entitled to a claim on the residual assets of the 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 (if applicable), or the relevant incorporating legislation of the bank, no principal is **repaid** outside of liquidation, that is, the shares are not redeemable; 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.

D1.3 Distribution requirements

1. For an instrument classified as an ordinary share 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 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 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 bank at a later date.
5. Non-payment of distributions must not be an event of default of the 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 not paid by the bank until all legal and contractual obligations have been met and payments on more senior capital instruments have been made.

D1.4 Issuance requirements

1. An instrument classified as an ordinary share must be issued by the 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 bank; or

- ii. an entity over which the bank exercises **control or significant influence**.
3. However, nothing in subsection (2) 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.

D1A Eligibility of CET1 (mutual capital instruments)

D1A.1 Mutual capital instruments

1. To be included in **CET1 capital** as a mutual capital instrument, an instrument must satisfy all the criteria set out in this subpart.

D1A.2 Overview of checklist for mutual capital instruments

1. Appendix 3 sets out a checklist, which replicates the prudential requirements specified in this subpart that a mutual capital instrument must comply with to qualify as **CET1 capital**.
2. Section B1.3 of BPR120 requires a completed copy of the checklist to be submitted to the Reserve Bank in respect of any new mutual capital instrument that the **registered bank** proposes to issue and to treat as **CET1 capital**, in order to demonstrate compliance with all requirements of mutual capital instruments.
3. In the event of any inconsistency between the checklist in Appendix 3 and any requirement in Parts A to E of this document, the requirement in Parts A to E of this document prevails.
4. As specified in subsection 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 **CET1 capital**, provided that those terms do not affect the instrument's compliance with this document.

D1A.3 General requirements

1. An instrument classified as a mutual capital instrument must satisfy the following criteria:
 - a. the instrument must be issued by a **registered bank** structured as a mutual entity; and
 - b. the instrument is classified as **equity** under **GAAP**; and
 - c. only the paid-up amount of the mutual capital instrument, irrevocably received by the **registered bank**, is included as **CET1 capital**; and
 - d. holders of the mutual capital instrument have full voting rights arising from the ownership of the instrument; and

Guidance: **mutual entities** that adopt a 'one member, one vote' rule are not, merely through the adoption of that rule, prevented from satisfying this condition.

- e. the instrument represents the most subordinated claim in the liquidation of the **registered bank**; and

Guidance: The holders' claim must rank junior to all other liabilities, including members' deposits, as well as any **AT1 capital** and **Tier 2 capital** instruments.

The holders' claim should rank equally with the right of members to share in surplus assets upon liquidation, according to the formulas set out in the requirements below. This is the mechanism that ensures that the mutual capital instrument has properties that are as close as possible to ordinary shares and matches subordination and proportionality requirements.

- f. in a liquidation of the **registered bank**, if there are no surplus assets, the holders of the **mutual capital instrument** will receive no return on their investment; and
- g. in a liquidation of the **registered bank**, if there are surplus assets following the settlement of all senior claims, holders of the **mutual capital instrument** as a class and other members of the **registered bank** as a class are each entitled to a proportionate share of surplus assets (expressed as a percentage), where the share of surplus assets allocated to holders as a class is calculated according to the predetermined formula below at the first issuance and then recalculated at each subsequent issuance or cancellation of the **mutual capital instrument**; (each issuance or cancellation is represented as a time period 't')

ii $MCICP_t$ (%)

$$= \frac{\text{new issuance amount}_t + (MCICP_{t-1} \times \text{total CET1 capital}_t) - \text{cancellation share}_t}{\text{new issuance amount}_t + \text{total CET1 capital}_t - \text{cancellation amount}_t}$$

$MCICP_t$ is the proportion, expressed as a percentage, of Total CET1 capital (for clarity, without disregarding any amounts per the definition below) at time 't' to have been reflect the contribution of **mutual capital instrument** holders to CET1 capital.

$MCICP_{t-1}$ is the proportion, expressed as a percentage, of total CET1 capital (for clarity, without disregarding any amounts per the definition below) calculated at the determination time immediately preceding 't'.

Total CET1 capital refers to the amount of CET1 capital at 't', adjusted as necessary to disregard the impact of (i) any new issuance amount as a result of any new **mutual capital instruments** being issued at 't', (ii) any Cancellation Amount as a result of any **mutual capital instruments** being cancelled at 't', and (iii) any **mutual capital instruments** held, as a result of treasury trading, by the **registered bank** in its treasury function as at 't', in each case having regard to the capital requirements in the Banking Prudential Requirements and accounting standards then applicable.

Cancellation Share_t is a dollar amount (which for the avoidance of doubt shall be zero if no **mutual capital instruments** are being cancelled at 't') equal to:

$$(N \times \text{Notional}_t) + MCICP_{t-1} [\text{Cancellation Amount}_t - (N \times \text{Notional}_t)]$$

Where:

N is the number of mutual capital instruments being cancelled at t; and

Notional_t is the deemed notional contribution of each mutual capital instrument to CET1 capital at t, calculated as follows:

$$\frac{\text{Total CET1 capital}_t \times MCICP_{t-1}}{\text{Number of mutual capital instruments outstanding immediately prior to cancellation}}$$

Cancellation Amount_t is a dollar amount by which Total CET1 capital is reduced as the result of a discretionary purchase by the **registered bank** of the **mutual capital instruments** which are cancelled at 't',

- h.** the proportionate amount of surplus assets determined to be the entitlement of **mutual capital instrument** holders as a class (determined by multiplying surplus assets by MCICP_t where 't' is the determination time immediately prior to liquidation), must then be shared among the holders, pro rata, based on the number of **mutual capital instruments** they each hold, unless the entitlement of each **mutual capital instrument** holder has been limited to the amount paid in by holders or an average principal amount per **mutual capital instrument** and this is specified in the terms and conditions of the instrument; and

Guidance: The holders of the **mutual capital instrument** as a class are allocated a share of surplus assets calculated in accordance with subsection D1A.3(g). This amount is then allocated on a pro rata basis among the holders. However, the **registered bank** can choose to limit the amount paid to holders upon liquidation at the amount paid-up by the holders, so long as this is specified in the instrument's terms and conditions.

- i.** the principal amount of the instrument is perpetual, that is, the instrument has no maturity date; and
- j.** setting aside discretionary acquisitions permitted by section 58 of the Companies Act 1993 (if applicable), or the relevant incorporating legislation of the mutual entity, no principal is repaid outside of liquidation, that is, the **mutual capital instruments** are not redeemable; 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".

- k.** 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
- l.** 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; and
- m.** the terms of the instrument must be governed by New Zealand law or by a **permitted foreign law**; and
- n.** 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 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 subsections D1A.3(Error! Reference source not found.) and (n), the **permitted foreign laws** are: New South Wales (Australia), Victoria (Australia), England and New York.

D1A.4 Distribution requirements

1. For an instrument classified as a **mutual capital instrument** to qualify as **CET1 capital**, distributions on the instrument must meet the requirements in this section.
2. The **registered bank** must have an indicative discretionary distribution policy published separately to the terms of the instrument.
3. 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

Guidance: This requirement does not prevent the **registered bank** from indicating an intended or projected return or distributions per **mutual capital instrument** to investors as part of the discretionary distribution policy.

- c. must not be subject to a contractual cap (except that the bank is unable to pay distributions that exceed the level of distributable items).

Guidance: 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.

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

D1A.5 Issuance requirements

1. An instrument classified as a **mutual capital 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 bank; or
 - ii. an entity over which the bank exercises **control or significant influence**.
3. However, nothing in subsection (2) prevents the **registered bank** undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the **mutual capital instrument**.

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 subsection B2.2(2)(a) unless it satisfies the criteria set out in this subpart.

D2.2 Overview of checklist for AT1 instruments

1. Appendix 1 sets out a checklist, which replicates the prudential requirements specified in this subpart that an instrument must comply with to qualify as **AT1 capital**.
2. Section B1.3 of BPR120 requires a completed copy of the 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 capital**, in order to demonstrate compliance with all requirements of **AT1 capital** instruments.
3. In the event of any inconsistency between the checklist in Appendix 1 and any requirement in Parts A to E of this document, the requirement in Parts A to E of this document prevails.
4. As specified in subsection 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.

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 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 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.

D2.4 No conversion or write-off feature

The terms of an **AT1 capital** 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.

D2.5 Redemption or call dates

- 1.** Subject to subsections (2) to (4), the principal amount of an **AT1 capital** instrument must be perpetual, that is, the instrument must have no maturity date.
- 2.** An **AT1 capital** instrument may be callable or redeemable at the initiative of the bank after a minimum of five years from the date on which the bank irrevocably received payment for the instrument, and more than one such call or redemption may be provided for.
- 3.** An **AT1 capital** 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 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 capital** 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**.

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

D2.6 No step-ups or incentives to redeem

1. An **AT1 capital** 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 capital** 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;
 - c. a fixed rate being reset on an optional call date at a new fixed rate, provided that—
 - i. 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
 - ii. there is no change in the margin above the 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.

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 bank must have full discretion at all times to cancel distributions on the instrument.
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.
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 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 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 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. 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 capital** instrument.
8. The bank must have full access to cancelled distributions to meet obligations as they fall due.
9. The 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.

D2.8 Other requirements on AT1 instruments

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.

Guidance: This prohibition does not prevent the instrument being purchased by:

- a subsidiary of the bank in its capacity as custodian for a discretionary investment management service provided by the banks; or
- a supervisor for a managed investment scheme in respect of which a subsidiary of the bank is the manager, acting as the legal purchasing entity of the instrument,

This applies so long as:

- third parties bear the risk and rewards associated with the investment in the instrument;
- the purchase of the instrument was not funded by the bank; and
- the bank can demonstrate to the Reserve Bank, if required, that the decision to purchase the instrument was made independently of the bank in its role as issuer and in the interests of the third parties who ultimately bear the risk and rewards of the investment in the instrument.

The definition of **control or significantly influence** also captures instruments issued to an SPV.

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.
3. The instrument must not include any features that hinder recapitalisation of the 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.

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.

D3.2 Template checklist for Tier 2 instruments

1. Appendix 2 sets out a template checklist, which replicates the prudential requirements specified in this subpart that an instrument must comply with to qualify as **Tier 2 capital**.
2. Section B1.3 of BPR120 requires a completed copy of the 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 capital**, in order to confirm compliance with all requirements of **Tier 2 capital** instruments.
3. In the event of any inconsistency between a part of the checklist in Appendix 2 and any requirement in Parts A to E of this document, the requirement in Parts A to E of this document prevails.

4. As specified in subsection 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.

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 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; 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 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 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 subsections (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.

D3.4 No conversion or write-off feature

1. The terms of a **Tier 2 capital** 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 capital** 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 capital** 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.

D3.5 Redemption or call dates

1. Subject to subsections (2) to (4), a **Tier 2 capital** instrument must have a minimum **original maturity** of at least five years.
2. A **Tier 2 capital** 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 bank irrevocably receives payment for the instrument, and more than one such call or redemption may be provided for.
3. A **Tier 2 capital** 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 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 capital** 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 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 capital** instrument are set out in subpart C2 of BPR120.

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%

D3.7 No step-ups or incentives to redeem

1. A **Tier 2 capital** 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 benchmark 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 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.

D3.8 Distributions

A **Tier 2 capital** 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.

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 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.

Guidance: This prohibition does not prevent the instrument being purchased by:

- a subsidiary of the bank in its capacity as custodian for a discretionary investment management service provided by the bank; or
- a supervisor for a managed investment scheme in respect of which a subsidiary of the bank is the manager, acting as the legal purchasing entity of the instrument.

This applies so long as:

- third parties bear the risk and rewards associated with the investment in the instrument;
- the purchase of the instrument was not funded by the bank; and
- the bank can demonstrate to the Reserve Bank, if required, that the decision to purchase the instrument was made independently of the bank in its role as issuer and in the interests of the third parties who ultimately bear the risk and rewards of the investment in the instrument.

The definition of **control or significantly influence** also captures instruments issued to an SPV.

3. 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.
4. The instrument must not contain any features that hinder recapitalisation of the 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.

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**.

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 or mutual capital instruments 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: Ordinary shares and **mutual capital instruments** 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), (d), of (f) had the **issuer** been the **registered bank**.

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).

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), (d), or (f); or
 - b. the criteria for **AT1 capital** instruments set out in subsection B2.2(2)(a).

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 subsection (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**.

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 **mutual capital instruments** set out in subsection B1.2(2)(f); or
 - c. the criteria for **AT1 capital** instruments set out in subsection B2.2(2)(a); or
 - d. the criteria for **Tier 2 capital** instruments set out in subsection B3.2(2)(a).

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 subsection (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**.

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 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 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 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 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 bank, in addition to the requirements of subpart E1.

E2.2 Exclusion of ordinary shares

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

E2.3 Exclusion of mutual capital instruments

Mutual capital instruments issued under an arrangement that involves an **SPV** may not be included in **CET1 capital**.

Appendix 1

ADDITIONAL TIER 1 CHECKLIST: PERPETUAL NON-CUMULATIVE [REDEEMABLE] PREFERENCE SHARES

Purpose of this checklist

The purpose of this Appendix 1, is to provide a checklist of requirements that an instrument must meet to qualify as **AT1 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 **AT1 capital** (refer to subpart D3.2 of BPR110). The completed checklist must also be appended to the legal sign-off for the issue (refer to subpart B1.3 of BPR120).³

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D2.3 requirements		
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 ”		
D2.3 (b) “the instrument must represent the most subordinated claim in the liquidation of the bank after CET1 capital ”		
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)”		
D2.3 (d) “the instrument must be classified as equity under New Zealand GAAP ,”		
D2.3 (e) “the instrument and all constituting documents must be governed by New Zealand law”		

³ This checklist sets out the prudential requirements that the instrument must comply with 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

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
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 <u>banking group</u> 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"		
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"		
D2.4 Requirements		
D2.4 (a) "The terms of an <u>AT1 capital</u> 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"		
D2.4(b) "The terms of an <u>AT1 capital</u> 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."		
D2.4 (c) "The terms of an <u>AT1 capital</u> 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"		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D2.5 requirements		
D2.5 (1) "Subject to subsections (2) to (4), the principal amount of an AT1 capital instrument must be perpetual, that is, the instrument must have no maturity date."		
D2.5 (2) "An AT1 capital instrument may be callable or redeemable at the initiative of the bank after a minimum of five years from the date on which the bank irrevocably received payment for the instrument, and more than one such call or redemption may be provided for."		
D2.5 (3) "An AT1 capital 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 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)."		
D2.5 (4) "The contractual terms of an AT1 capital 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 ."		

Relevant clause of BPR110**Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents****Comments****D2.6 requirements**

D2.6 (1) "An AT1 capital instrument must not contain any step-ups or incentives for the bank to redeem, within the meaning given in this section."

D2.6 (2) "To meet the requirements of subsection (1), the terms of an AT1 capital 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."

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."

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:

- (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
- (c) a fixed rate being reset on an optional call date at a new fixed rate, provided that—

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
<ul style="list-style-type: none"> (i) 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 (ii) there is no change in the margin above the benchmark rate. (d) a rate being reset to a fallback benchmark rate, provided that- <ul style="list-style-type: none"> (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.” 		
D2.7 Requirements		
D2.7 (1) “For an instrument to qualify as <u>AT1 capital</u> , distributions on the instrument must meet the requirements in this section.”		
D2.7 (2) “The bank must have full discretion at all times to cancel distributions on the instrument.”		
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.”		
D2.7 (4) “Any waived distributions must be non-cumulative, that is, the bank must be under no obligation to make up waived		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
distributions at a later date, nor to make any bonus payment to compensate for unpaid distributions.”		
D2.7 (5) “Cancellation or non-payment of distributions must not be an event of default of the bank or any member of the <u>banking group</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 <u>banking group</u> ; or (b) to appoint a receiver of the property of any member of the <u>banking group</u> 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.”		
D2.7 (7) “The bank must be able to cancel distributions on the instrument without the bank or any other member of the <u>banking group</u> becoming subject to restrictions, except in relation to (a) the acquisition, repurchase, or redemption of capital instruments or (b) any dividend stopper arrangement if such an arrangement is included in the terms of the <u>AT1 capital</u> instrument.”		
D2.7 (8) “The bank must have full access to cancelled distributions to meet obligations as they fall due.”		
D2.7 (9) “The instrument must not have a credit-sensitive distribution feature”		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D2.8 requirements		
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."		
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."		
D2.8 (3) "The instrument must not include any features that hinder recapitalisation of the bank or any member of the banking group "		
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"		
Appendix: E2.1 requirements – note that these are only relevant for instruments involving an <u>SPV</u>. If the instrument does not involve an <u>SPV</u>, banks should record the E2.1 requirements below as "Not relevant, as no <u>SPV</u> involved in the instrument."		
E2.1 (1) "A capital instrument issued under an arrangement that involves an <u>SPV</u> , whether as the purchaser or the issuer of the instrument, does not qualify as regulatory capital unless all the criteria specified in subsection (2) are met."		
E2.1 (2) "The criteria are that– (a) the <u>SPV</u> is required to be fully consolidated with the bank for the purpose of group financial statements under GAAP;"		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
<p>E2.1 (2) (b) “the bank issues an instrument to the <u>SPV</u>, the terms and conditions of that instrument matching, in all material respects, the terms and conditions of the instrument issued by the <u>SPV</u> to <u>third party</u> investors;”</p> <p>E2.1 (2) (c) “the instrument issued by the bank to the <u>SPV</u> must meet the criteria for classification as <u>AT1 capital</u> or the criteria for classification as <u>Tier 2 capital</u>, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively;”</p> <p>E2.1 (2) (d) “the instrument issued by the <u>SPV</u> would, if issued by the bank, meet the criteria for classification as <u>AT1 capital</u> or the criteria for classification as <u>Tier 2 capital</u>, as set out in subsection B2.2(2)(a) and subsection B3.2(2)(a) respectively;”</p> <p>E2.1 (e) “the proceeds from the issue of the capital instrument by the <u>SPV</u> must be immediately and directly invested in, and available without limitation to, the bank;”</p> <p>E2.1 (f) “the amount of capital issued by a consolidated <u>subsidiary</u> to <u>third parties</u> that may be included in Tier 1 or <u>total capital</u> must be determined in accordance with subpart E1, and if the <u>subsidiary</u> issues capital through an <u>SPV</u>, the requirements of this subpart must be met as if the <u>subsidiary</u> were the bank, in addition to the requirements of subpart E1.”</p>		
Additional material		
Confirm that there are no other features that would affect the compliance with BPR110.		

Appendix 2

Tier 2 Checklist: Subordinated notes

Purpose of this 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 capital** (refer to subpart D3.3 of BPR110). The completed checklist must also be appended to the legal sign-off for the issue (refer to subpart B1.3 of BPR120).⁴

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comment
D3.3 requirements		
	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 .”	
	D3.3 (1) (b) “claims of holders of the instrument must be subordinated to claims of depositors and general creditors of the 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; and (iii) a failure to make a payment of distributions or principal on the instrument because	

⁴ This checklist sheet sets out 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

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comment
<p>the bank fails to meet the solvency condition must not give rise to an event of default;"</p> <p>Note that the following sections are relevant for D3.3 (1) (b):</p> <p>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."</p> <p>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."</p>		
<p>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;"</p>		
<p>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;"</p>		
<p>D3.3 (1) (e) "the instrument and all constituting documents must be governed by New Zealand law, or a permitted foreign law; and</p> <p>(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</p>		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comment
permitted foreign law jurisdiction in a form acceptable to the Reserve Bank in all respects.”		
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.”		
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.”		
D3.3 (4) “For the purposes of (1)(e), the permitted foreign laws are: New South Wales (Australia), Victoria (Australia), England and New York.”		
D3.4 Requirements		
D3.4 (1) “The terms of a Tier 2 capital 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.”		
D3.4 (2) “A Tier 2 capital 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.”		
D3.4 (3) “The terms of a Tier 2 capital instrument must not include a write-off feature that specifies circumstances in which		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comment
all of a holder’s claims on the bank arising from the instrument are irrevocably cancelled.”		
D3.5 requirements		
D3.5 (1) “Subject to subsections (2) to (4), a Tier 2 instrument must have a minimum <u>original maturity</u> of at least five years.”		
D3.5 (2) “A <u>Tier 2 capital</u> 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 bank irrevocably receives payment for the instrument, and more than one such call or redemption may be provided for.”		
D3.5 (3) “A <u>Tier 2 capital</u> 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 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).”		
D3.5 (4) “The contractual terms of a <u>Tier 2 capital</u> instrument– (a) must provide that the bank is required to receive the prior written approval of the Reserve Bank to make any <u>repayment</u> of principal prior to maturity; (b) must not include any feature that might give rise to an expectation that the instrument will be <u>repaid</u> prior to maturity”		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comment
D3.7 requirements		
<p>D3.7 (1) "A <u>Tier 2 capital</u> instrument must not contain any step-ups or incentives for the bank to redeem, within the meaning given in this section."</p>		
<p>D3.7 (2) "To meet the requirements of subsection (1), the terms of a <u>Tier 2 capital</u> 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."</p>		
<p>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."</p>		
<p>D3.7 (4) "Provided that no member of the <u>banking group</u> does anything that creates an expectation that a call will be exercised, the following will not be considered incentives to redeem:</p>		
<p>(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.</p>		
<p>(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</p>		
<p>(c) a fixed rate being reset on an optional call date at a new fixed rate, provided that–</p>		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comment
<p>(i) 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</p> <p>(ii) there is no change in the margin above the benchmark rate.</p> <p>(d) a rate being reset to a fallback benchmark rate, provided that-</p> <p>(i) the reset is triggered through the operation of contractual fallback provisions which apply in the event that the original benchmark becomes unavailable; and</p> <p>(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."</p>		
D3.8 requirements		
D3.8 "A Tier 2 capital instrument must not have a credit-sensitive distribution feature."		
D3.9 Requirements		
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 "		
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."		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comment
<p>D3.9 (3) "However, nothing in this section prevents a <u>holding company</u> 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."</p> <p>D3.9 (4) "The instrument must not contain any features that hinder recapitalisation of the bank or any member of the <u>banking group</u>."</p> <p>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."</p>		
<p>Appendix: E2.1 requirements – note that these are only relevant for instruments involving an <u>SPV</u>. If the instrument does not involve an <u>SPV</u>, banks should record the E2.1 requirements below as "Not relevant, as no <u>SPV</u> involved in the instrument."</p>		
<p>E2.1 (1) "A capital instrument issued under an arrangement that involves an <u>SPV</u>, whether as the purchaser or the <u>issuer</u> of the instrument, does not qualify as regulatory capital unless the criteria specified in subsection (2) are met.</p> <p>E2.1 (2) "The criteria are that– (a) the <u>SPV</u> is required to be fully consolidated with the <u>registered bank</u> for the purpose of group financial statements under <u>GAAP</u>;"</p> <p>E2.1 (2) "(b) the bank issues an instrument to the <u>SPV</u>, the terms and conditions of that instrument matching, in all material respects, the terms and conditions of the instrument issued by the <u>SPV</u> to <u>third party</u> investors;"</p> <p>E2.1 (2) (c) "the instrument issued by the bank to the <u>SPV</u> must meet the criteria for classification as <u>AT1 capital</u> or the criteria for</p>		

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

Appendix 3

CET1 CHECKLIST: MUTUAL CAPITAL INSTRUMENT

Purpose of this checklist

The purpose of this Appendix 3 is to provide a checklist of requirements that a **mutual capital instrument** must meet to qualify as **CET1 capital**. A completed copy of this checklist must be submitted to the Reserve Bank in respect of any new mutual capital instrument that the bank proposes to issue and to treat as CET1 capital (refer to [D1A of BPR110]). The completed checklist must also be appended to the legal sign-off for the issue (refer to [B1.3 of BPR120]).⁵

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D1A.3 General requirements		
D1A.3 (1) An instrument classified as a mutual capital instrument must satisfy the following criteria:		
D1A.3 (1)(a) the instrument must be issued by a registered bank structured as a mutual entity ; and		
D1A.3 (1)(b) the instrument is classified as equity under GAAP ; and		
D1A.3 (1)(c) only the paid-up amount of the mutual capital instrument , irrevocably received by the registered bank , is included as CET1 capital ; and		
D1A.3 (1)(d) holders of the mutual capital instrument have full voting rights arising from the ownership of the instrument; and		

⁵ This checklist sets out the prudential requirements that the instrument must comply with to qualify as a mutual capital instrument under subpart D1.5 of BPR110. The Issuer is expected to comply with all other applicable laws in respect of any offer of the instrument

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D1A.3 (1)(e) the instrument represents the most subordinated claim in the liquidation of the registered bank ; and		
D1A.3 (1)(f) in a liquidation of the registered bank , if there are no surplus assets, the holders of the mutual capital instrument will receive no return on their investment; and		
<p>D1A.3 (1)(g) in a liquidation of the registered bank, if there are surplus assets following the settlement of all senior claims, holders of the mutual capital instrument as a class and other members of the registered bank as a class are each entitled to a proportionate share of surplus assets (expressed as a percentage), where the share of surplus assets allocated to holders as a class is calculated according to the predetermined formula (included in Subpart D1A.3(1)(g) of BPR110) at the first issuance and then recalculated at each subsequent issuance or cancellation of the mutual capital instrument;</p> <p>Refer to Subpart D1A.3 (1)(g) of BPR110 for the formula and formula description.</p>		
D1A.3 (1)(h) the proportionate amount of surplus assets determined to be the entitlement of mutual capital instrument holders as a class (determined by multiplying surplus assets by $MCICP_t$ where 't' is the determination time immediately prior to liquidation), must then be shared among the holders, pro rata, based on the number of mutual capital instruments they each hold, unless the entitlement of each mutual capital instrument holder has been limited to the amount paid in by holders or an average principal amount per mutual capital instrument and this is specified in the terms and conditions of the instrument; and		
D1A.3 (1)(i) the principal amount of the instrument is perpetual, that is, the instrument has no maturity date; and		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D1A.3 (1)(j) setting aside discretionary acquisitions permitted by section 58 of the Companies Act 1993 (if applicable), or the relevant incorporating legislation of the mutual entity, no principal is repaid outside of liquidation, that is, the mutual capital instruments are not redeemable; and		
D1A.3 (1)(k) 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		
D1A.3 (1)(l) 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; and		
D1A.3 (1)(m) the terms of the instrument must be governed by New Zealand law or by a permitted foreign law ; and		
D1A.3 (1)(n) 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.		
D1A.3 (2) For the purposes of (Error! Reference source not found.)(Error! Reference source not found.), the permitted foreign laws are: New South Wales (Australia), Victoria (Australia), England and New York.		
D1A.4 Distribution requirements		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D1A.4 (1) For an instrument classified as a mutual capital instrument to qualify as CET1 capital , distributions on the instrument must meet the requirements in this section.		
D1A.4 (2) The registered bank must have an indicative discretionary distribution policy published separately to the terms of the instrument.		
<p>D1A.4 (3) The amount that may be paid in distributions –</p> <p>D1A.4 (3)(a) must be paid out of distributable items, including retained earnings; and</p> <p>D1A.4 (3)(b) must not be in any way linked to the amount paid at issuance; and</p> <p>D1A.4 (3)(c) must not be subject to a contractual cap (except that the bank is unable to pay distributions that exceed the level of distributable items).</p>		
D1A.4 (4) There must be no circumstances under which the distributions are obligatory and in all circumstances the bank is able to waive any distribution.		
D1A.4 (5) Any waived distributions must be non-cumulative, that is, they are not required to be made up by the bank at a later date.		
D1A.4 (6) Non-payment of distributions must not be an event of default of the bank or of any other member of the banking group .		
D1A.4 (7) The instrument must not have any preferential or predetermined right to distributions of capital or income, to ensure that distributions are not paid by the bank until all legal and contractual obligations have been met and payments on more senior capital instruments have been made.		

Relevant clause of BPR110	Evidence of compliance with relevant clause of BPR110, including references to the relevant clause/clauses of constituting documents	Comments
D1A.5 Issuance requirements		
D1A.5 (1) An instrument classified as a mutual capital instrument must be issued by the registered bank and not out of an SPV .		
<p>D1A.5 (2) The instrument must not have been purchased, and the purchase must not have been funded, whether directly or indirectly, by –</p> <ul style="list-style-type: none"> i. the bank; or ii. an entity over which the bank exercises control or significant influence. 		
D1A.5 (3) However, nothing in subsection (2) prevents the registered bank undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the mutual capital instrument .		