



Reserve Bank
of New Zealand
Te Pūtea Matua

BPR120

Capital Adequacy Process Requirements

Purpose of document

This document sets out processes that are associated with a bank's compliance with the minimum capital adequacy requirements summarised in BPR100. These include the required legal sign-off for a bank to be able to include an instrument as eligible **AT1 capital, Tier 2 capital**, or a mutual capital instrument, and the steps needed for a bank to redeem or replace an existing capital instrument. The document also sets out the Reserve Bank's likely actions in response to a bank falling below its prudential capital **buffer trigger ratio**. For an **IRB bank**, the document sets out requirements around accreditation and approval of changes of the bank's **IRB** models.

Document version history

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TBC 2023	Revised for 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 BPR120: Capital Definitions forms part of the requirements for the following conditions:*

- A New Zealand-incorporated **registered bank** is normally subject to a condition prohibiting it from including the amount of an **AT1 capital, Tier 2 capital** or **mutual capital instrument** in the calculation of its capital ratios unless it has completed the notification requirements provided in Part B of this document, and requiring it to follow the notification and process requirements in Part C of this document, in relation to existing capital instruments².
- An **IRB**-accredited bank is subject to a condition requiring it to follow the process set out in Part E of this document for getting approval for a change to an existing **IRB** model, and requiring it to maintain a compendium of all of its **IRB** models. The bank's use of an **IRB** model for calculating its capital ratios is dependent on it meeting these conditions³.

* 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 to 73B, 78, and 81 of the **Act**. The standard conditions are contained in Appendix 1 of document BS1: Statement of Principles.

² This condition of registration relates to the matter referred to in: section 78(1)(c) of the **Act** (capital in relation to the size and nature of the business).

³ This condition of registration relates 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

A1 Capital adequacy process and information requirements

A1.1 Overview of requirements

1. This document sets out a number of process requirements around the capital adequacy of a New Zealand-incorporated **registered bank**, involving interactions between the bank and the Reserve Bank.
2. Part B sets out the notifications and information that the bank must provide to the Reserve Bank before it issues a new **AT1 capital**, **Tier 2 capital** or **mutual capital instrument** for inclusion in its capital base.
3. Part C sets out the notification and approval requirements, in relation to the bank's existing regulatory capital instruments, that the bank must meet to comply with the standard condition of registration in that respect.
4. Part D sets out—
 - a. the actions that the Reserve Bank may take, and may require the bank to take, if the bank's **prudential capital buffer ratio** falls below various levels specified in the bank's conditions of registration; and
 - b. the considerations governing the Reserve Bank using its powers under Section 113 of the **Act** to initiate a **non-viability trigger event**, requiring the bank to convert or write off a capital instrument.

Guidance: **Non-viability trigger events** are not applicable to **AT1 capital**, **Tier 2 capital** and **mutual** capital instruments issued on or after 1 July 2021, under the revised capital adequacy framework in force from that date.

5. Part E applies only to **IRB banks**, and sets out process requirements around obtaining Reserve Bank approval for revising, or introducing new, internal models for **credit risk** and **operational risk** capital requirements, and for maintaining a compendium of approved models.

Part B: Issuance of AT1, Tier 2 and mutual capital instruments

B1 Notification requirements for issuing AT1, Tier 2 and mutual capital instruments

B1.1 Standard condition of registration

1. The standard capital process conditions of registration applying to a New Zealand-incorporated bank (set out in section C1.2 of BPR 100) include a condition that the bank must not include the amount of an **AT1 capital** or **Tier 2 capital** instrument within its regulatory capital unless it has completed the notification requirements in this Part in respect of the instrument. There are similar requirements for banks structured as **mutual entities** to cover **mutual capital instruments**.
2. This Part sets out the notification process for issuing an **AT1 capital**, **Tier 2 capital** or **mutual capital instrument**, including the documentation that the bank must submit with the notification.

Guidance: The wording of the standard legal sign-off is designed to give the Reserve Bank assurance that an instrument complies with the **AT1 capital**, **Tier 2 capital** or **mutual capital instrument** eligibility requirements, and that no additional clauses that are added to the terms and conditions of the instrument will subvert that compliance. However, the directors of a bank are responsible for ensuring that their bank's capital instruments comply with the Reserve Bank's capital adequacy framework for the entire period that the instrument is recognised as regulatory capital.

B1.2 Process and timing

1. A bank must notify the Reserve Bank of its intention to issue a new instrument that it intends to treat as **AT1 capital**, **Tier 2 capital**, or a **mutual capital instrument**, for the purpose of calculating its capital ratios.
2. A notification under subsection (1) must be accompanied by the information in section B1.3, and by any of the additional information in sections B1.4 to B1.6 that is applicable to the instrument.
3. The notification and supporting information required under this section must be provided—
 - a. in writing, to the bank's Reserve Bank supervisor; and
 - b. at least five working days before the issue date of the new instrument.

B1.3 Legal sign-off

1. A bank's notification of a new **AT1 capital**, **Tier 2 capital** or **mutual capital instrument** must be accompanied by legal sign-off consisting of the following documents and meeting the requirements of subsection (2):
 - a. a signed opinion from a New Zealand law firm, using the standard wording in the template in Appendix 1; and
 - b. a completed copy of the applicable Reserve Bank checklist provided in –
 - i. Appendix 1 of BPR110 for an **AT1 capital** instrument; or

- ii. Appendix 2 of BPR110 for a **Tier 2 capital** instrument; or
 - iii. Appendix 3 of BPR110 for a **mutual capital instrument**; and
 - c. a copy of the terms sheet for the instrument (if any); and
 - d. copies of the constituting documents for the instrument that are listed in the legal sign-off; and
 - e. if one of more of the terms of the instrument is governed by a **permitted foreign law** (see [D1A.3 and D3.3](#) in BPR110), a signed foreign law opinion, in a form acceptable to the Reserve Bank in all respects.
- 2. A signed opinion required under subsection (1)(a) or (1)(e) must be provided by a law firm that, in the opinion of the Reserve Bank, has sufficient experience and expertise in the area of law to which the opinion relates.

Guidance: The checklist must be completed for any new **AT1 capital, Tier 2 capital** or mutual capital instrument. It is not acceptable to replace the checklist with an alternative document.

Guidance: If one or more terms of the instrument are governed by a **permitted foreign law**, that **permitted foreign law** must not override (or negatively impact) the [eligibility requirements that must be met for regulatory capital in Part D of BPR110](#) for inclusion in the relevant category of capital (as replicated in the checklists). As set out in [subsection \(1\)\(e\)](#) above, the Reserve Bank will require a foreign law opinion (in a form acceptable to it in all respects) to provide this comfort. The legal opinion should cover the following matters:

- that the permitted foreign law will not override New Zealand law in relation to any terms that are governed by New Zealand law (e.g. for instruments with hybrid governing law);
- whether there are known impediments in that jurisdiction (including conflict of laws issues) that could affect the terms of the instrument operating as intended.

B1.4 Additional information: capital instrument issued in foreign currency

- 1. If a bank intends to issue a capital instrument ([other than a mutual capital instrument](#)) that will be denominated in a foreign currency, the bank must provide the following additional information with the required notification:
 - a. a statement of the bank's intended accounting treatment of the instrument and any associated swaps or other associated hedging instruments; and
 - b. forecasts of the bank's capital ratios, on a quarterly basis over the next two years, that demonstrate the sensitivity of the value of regulatory capital to fluctuations in currency values, including—
 - i. a reverse stress test showing how far the exchange rate has to change in value before the bank's **prudential capital buffer ratio** falls below its buffer trigger ratio; and

- ii. a forecast of capital ratios based on expected changes in the exchange rate.

Guidance: A bank may issue a capital instrument in a foreign currency, as BPR110 does not otherwise restrict the currency of issuance to NZD. **Tier 2 capital** instruments issued in a foreign currency must be valued for regulatory capital purposes in NZD at the spot exchange rate. **AT1 capital** instruments issued in a foreign currency should be valued in NZD in line with the appropriate accounting rules for **equity instruments**, which generally do not require revaluation at the spot exchange rate.

2. If a bank intends to issue a **mutual capital instrument** that will be denominated in a foreign currency, and intends to combine that with any associated swaps or other associated hedging instruments, the bank must demonstrate the sensitivity of **CET1 capital** values to gains and losses associated with any swaps or other associated hedging instruments, in addition to the required notification.

Guidance: **Mutual capital instruments** issued in foreign currency should be valued in NZD in line with the appropriate accounting rules for **equity instruments**, which generally do not require revaluation at the spot exchange rate. However, if a bank uses hedges to smooth its future dividend payments in a foreign currency it must demonstrate how **CET1 capital** values respond to gains and losses on the hedges.

B1.5 Additional information: intra-group issues

If a bank intends to issue a capital instrument to a related party, it must provide information on any related transactions in respect of the ultimate source of funding for that instrument.

Guidance: For example, if the bank intends to issue a capital instrument to a **holding company**, it should provide information on any related funding transactions for that **holding company** and also funding of entities further up the ownership structure. BPR110 limits the extent to which some types of related party of a bank can purchase or fund an eligible capital issue.

B1.6 Additional information: capital instrument issued via SPV

If a bank intends to issue a capital instrument out of an **SPV** to qualify as **AT1 capital** or **Tier 2 capital** for the **banking group**, the bank must, to confirm that the arrangements will meet the requirements of subpart E2 of BPR110, provide the notifications required under section B1.2 in respect of–

- a. the capital instrument to be issued by the **SPV**; and
- b. the required matching instrument issued by the bank to the **SPV**, as if that instrument was itself subject to the capital instrument notification requirements.

Guidance: Subpart E2 of BPR110 requires that the instrument issued by the **SPV** must be matched by an instrument with identical terms issued by the bank to the **SPV**. This section requires notification of that instrument, to match by the required notification of the instrument issued out of the group to **third party** investors.

Part C: Notifications and limitations on changes in capital

C1 Notification requirements

C1.1 Notification process

A bank that is required to give notice under this subpart must give the notice, in writing, to the bank's Reserve Bank supervisor.

C1.2 Fall in CET1 capital ratio below 5.125%

A bank that has issued and still has outstanding a **transitional AT1 capital instrument** must notify the Reserve Bank immediately if the **banking group's CET1 capital ratio** falls below 5.125%.

C1.3 Fall in CET1 capital of more than 10% over 12 months

1. Subsection (2) applies where, as a result of any of the events described in that subsection (either by itself or when added to other such payments over the 12 months prior to the payment), the result is a reduction in the amount of **CET1 capital** to a level that is more than 10% lower than the amount of **CET1 capital** 12 months ago.
2. A bank must notify the Reserve Bank of any—
 - a. dividend, except for distributions to customers of a mutual entity that the entity is contractually obliged to make; and
 - b. purchase of ordinary shares; and
 - c. other capital return in respect of **CET1 capital**.
3. A notification required under subsection (2) must be made—
 - a. at least five working days prior to the payment taking place; or
 - b. in the case of a series of payments, at least five working days prior to the payment that causes the 10% threshold to be exceeded.

C2 Limitations on capital transactions and amendments

C2.1 Application process

A bank that is providing notification or seeking approval under this subpart must provide the notification to, or seek the approval from, the bank's Reserve Bank supervisor, in writing.

C2.2 Capital redemptions

1. A bank may redeem an **AT1 capital** instrument, or may redeem a **Tier 2 capital** instrument prior to maturity, only if one of the **circumstances** described in subsection (2) or (3) applies.
2. The first **circumstance** is that the bank has—
 - a. provided the information required under subpart C3 to the Reserve Bank; and
 - b. received the prior written approval of the Reserve Bank to make the redemption; and

- c. either–
 - i. –prior to, or concurrent with, the redemption, replaced the instrument with a paid-up capital instrument–
 - A. of the same, or better, quality and contributing at least the same regulatory capital amount (for the purposes of the Reserve Bank capital adequacy requirements applying to the bank at the time); and
 - B. the terms and conditions of which are sustainable for the income capacity of the **banking group**; or
 - ii. if the bank does not intend to replace the instrument, demonstrated, to the Reserve Bank’s satisfaction, that, after the redemption, the **banking group’s**–
 - A. capital ratios would be sufficiently above their respective minimums; and
 - B. **prudential capital buffer ratio** would be sufficiently above its **buffer trigger ratio**.

Guidance: The requirements of subsection (2)(c)(i) mean that a replacement capital issue must have at least the same total value as the capital it replaces. An instrument will be considered to be issued concurrently with an instrument that is being repaid if it is issued on the same day that the other instrument is repaid.

For subsection (2)(c)(ii) to be met, the Reserve Bank must be satisfied that the **banking group** will meet its minimum capital requirements and be above its **buffer trigger ratio** both at the point of redemption and for at least one year after that.

Where a bank issues a call notice prior to redeeming the instrument, the instrument may continue to be recognised as regulatory capital until redeemed unless, on issuing the call notice, the bank becomes subject to an unconditional, unsubordinated obligation to redeem the instrument on the redemption date.

The Reserve Bank will not permit the redemption of an **AT1 capital** instrument or redemption of a **Tier 2 capital** instrument prior to maturity as a result of a tax or regulatory event if it forms the view that the tax or regulatory event could reasonably have been anticipated by the bank –at the time of issuance or if it forms the view that the tax or regulatory event is minor or not applicable.

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

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

- 3. The second situation is that the capital instrument was issued on or before 30 June 2021 and the bank is subject to either–

- a. a loss absorption trigger event; or
- b. a **non-viability trigger event**.

C2.3 Purchases of own capital

1. No member of a bank's **banking group** may purchase an **AT1 capital** or **Tier 2 capital** instrument if–
 - a. that instrument was previously issued by the **banking group**; and
 - b. that purchase would result in the **banking group** owning a position of more than 5% of the total outstanding value of the instruments issued as **AT1 capital** and **Tier 2 capital** instruments by the **banking group**.
2. However, the limitation in subsection (1) does not apply if–
 - a. the Reserve Bank has given prior approval to the transaction; or
 - b. the transaction is–
 - i. a redemption or payment on maturity under the terms of the contract; or
 - ii. in relation to a capital instrument issued on or before 30 June 2021, a repurchase or redemption to give effect to a loss absorption trigger event or a **non-viability trigger event**.

Guidance: Despite anything in this section, sections D2.8 and D3.9 of BPR110 provide that an instrument ceases to be regulatory capital from the time that the bank, or an entity over which the bank exercises **control or significant influence**, purchases the instrument or indirectly funds the purchase of the instrument. A bank should have systems in place to ensure any such purchases are deducted from its capital base.

C2.4 Funding of own capital

1. No member of a bank's **banking group** may fund, whether directly or indirectly, the purchase of an instrument if–
 - a. that instrument has been issued as **AT1 capital**, **Tier 2 capital** or a mutual capital instrument for the **banking group**; and
 - b. that funding would result in that **banking group** being the ultimate source of funds for more than 5% of the total amount of instruments issued as **AT1 capital**, **Tier 2 capital** and mutual capital instruments by the **banking group**.
2. However, the limitation in subsection (1) does not apply if–
 - a. the Reserve Bank has given prior approval to the transaction; or
 - b. the funding is lending by the bank to a customer to fund the purchase of a diversified portfolio.

Guidance: The guidance to section C2.3 applies equally to this section.

C2.5 Capital amendments

1. A bank must give the Reserve Bank at least five working days prior notice of any amendment to the terms of an **AT1 capital**, **Tier 2 capital** or mutual capital instrument that it treats as regulatory capital for the purpose of calculating its capital ratios.
2. The notification required by subsection (1) must be accompanied by—
 - a. a signed opinion from a law firm, using the standard wording in the template in Appendix 2, confirming that, once the amendments are in effect, the instrument will continue to qualify as regulatory capital of the category for which it qualified before the amendments; and
 - b. copies of the constituting documents and the amending documents for the instrument that are listed in the legal sign-off.

C3 Supporting information for capital redemption

C3.1 General information requirements

A bank must provide the following information to the Reserve Bank in support of an application to redeem an **AT1 capital** or **Tier 2 capital** instrument, as provided for in subsection C2.2(2):

- a. the key identifying features of the instrument; and
- b. the proposed date of redemption; and
- c. any other information requested by the Reserve Bank.

C3.2 Additional information where instrument replaced

A bank must provide the following information to the Reserve Bank in support of an application to redeem a capital instrument if the bank intends to replace the capital instrument being redeemed:

- a. the legal sign-off and supporting documentation for the replacement instrument, as required under Part B for any issuance of an **AT1 capital** or **Tier 2 capital** instrument; and
- b. in relation to the instrument that the bank proposes to redeem, details of—
 - i. the interest or dividend rate that applies prior to redemption; and
 - ii. the expected interest or dividend rate on that instrument if it were not redeemed; and
- c. where the replacement instrument is of a different tier from the instrument being redeemed, projections of the **banking group's CET1 capital ratio**, **Tier 1 capital ratio**, **Total capital ratio**, and **prudential capital buffer ratio**—
 - i. from the date of redemption and for the four quarter ends following redemption of the capital instrument; and

- ii. with a list of assumptions underpinning the projections.

C3.3 Additional information where instrument not replaced

A bank must provide the following information to the Reserve Bank in support of an application to redeem a capital instrument if the bank does not intend to replace that instrument:

- a. the rationale for not replacing the instrument; and
- b. projections of the **banking group's CET1 capital** ratio, **Tier 1 capital ratio**, **Total capital ratio**, and **prudential capital buffer ratio**—
 - i. from the date of redemption and for the four quarter-ends following redemption of the instrument; and
 - ii. with a list of assumptions underpinning the projections.

Part D: Reserve Bank supervisory responses

D1 Capital buffer response framework

D1.1 Introduction

This subpart sets out the steps that the Reserve Bank will take when a bank's **prudential capital buffer ratio** falls by specified amounts below the bank's **buffer trigger ratio** (the **capital buffer response framework**). Regardless of the size of the **PCB**, the Reserve Bank may take actions at any time to address prudential concerns about the bank, whether related directly to capital adequacy or other matters.

Guidance: The steps outlined here do not preclude any other steps the Reserve Bank may take at the same time to address prudential concerns about the bank, whether related directly to capital adequacy or other matters. They also do not preclude the Reserve Bank responding when a bank's **PCB** has fallen below its **buffer trigger ratio**, but has not reached the level that defines Stage 1.

D1.2 Overview and application

1. The capital buffer response framework comprises three progressively more interventionist steps in relation to the relevant bank, as follows:
 - a. Stage 1: a requirement for the bank to implement a capital restoration plan (see section D1.3):
 - b. Stage 2: a Reserve Bank review of the capital restoration plan (see section D1.4):
 - c. Stage 3: a requirement for the bank to implement a recapitalisation plan (see section D1.5).
2. A bank is subject to—
 - a. Stage 1 when its distributions on **CET1 capital** are limited by its conditions of registration to a maximum of 60% of its earnings;
 - b. Stage 2 when its distributions on **CET1 capital** are limited by its conditions of registration to a maximum of 30% of its earnings;
 - c. Stage 3 when its distributions on **CET1 capital** are limited by its conditions of registration to a maximum of 0% of its earnings.

Guidance: A bank's **CET1** distributions are increasingly limited when its **prudential capital buffer ratio** falls below certain levels specified in its conditions of registration. These levels differ between **D-SIB** and non-**D-SIB** banks, and will increase over time in line with transitional arrangements. The details are set out in Part B1 of BPR100.

D1.3 Stage 1: capital restoration plan

1. When a bank's **prudential capital buffer ratio** falls to, or below, the point at which Stage 1 applies, the Reserve Bank will require the bank to develop a capital restoration plan.

Guidance: At this point, a bank's decreased capital indicates a reduced resilience and an increased risk. However, it does not indicate any immediate danger of the bank's insolvency.

2. The plan must–
 - a. set out a clear pathway for restoring the bank to its full required capital levels (including all applicable buffers); and
 - b. specify the steps that the bank will take to limit any further deterioration in the bank's capital, and to return the bank to its full capital levels over the medium term.

Guidance: The plan should include clear goals and timelines for those goals, so enable the Reserve Bank to adequately monitor the bank's progress in implementing the plan. The medium term ordinarily envisages a time within the next 12 months.

- c. be approved by the bank's Board; and
 - d. be provided to the Reserve Bank, by the bank's Board, no later than 10 working days following the date on which the bank became aware that its capital fell to the level specified in subsection (1).
3. On receipt of the completed plan, the Reserve Bank will review it and will either approve it, or, if it is of the view that the plan will not, or will be unlikely to, meet the set objectives, may require the bank to amend the plan accordingly.

Guidance: Because the bank's reduced capital levels in these circumstances imply increased risk, the Reserve Bank will undertake enhanced supervision, including careful monitoring of the bank's implementation of the plan.

D1.4 Stage 2: review of capital restoration plan

1. When a bank's **prudential capital buffer ratio** falls to, or below, the point at which Stage 2 applies, the Reserve Bank will implement a review of the bank's capital restoration plan.

Guidance: A Reserve Bank review will occur if the bank's capital levels fall further below the initial trigger for requiring the bank to develop a capital restoration plan (Stage 1).

2. The Reserve Bank may also implement a review of a bank's capital restoration plan if Reserve Bank supervisors are concerned about the progress the bank is making in meeting the objectives of the plan.

Guidance: A Reserve Bank review of a bank's capital restoration plan will involve a detailed analysis of the reasons why the bank is continuing to face difficulties in maintaining a sufficient buffer, and how the bank might overcome those difficulties. The review should be seen as preparation for a more stringent recapitalisation plan (see section D1.5). If necessary, the Reserve Bank may use its powers under sections 93, 94, and 95 of the **Act** to gather further information and to require external expert reports. Such powers would be used to enable the Reserve Bank to gain a clear view of the bank's difficulties.

D1.5 Stage 3: recapitalisation plan

1. When a bank's **prudential capital buffer ratio** falls to, or below, the point at which Stage 3 applies, the Reserve Bank will require the bank to develop a recapitalisation plan.

Guidance: A recapitalisation plan will be required if, following a review of a bank's capital restoration plan (see section D1.4), the bank's capital levels fall further below the levels for triggering a review of the bank's capital restoration plan (Stage 2).

2. The plan must–
 - a. be more stringent and more conservative than the bank's capital restoration plan; and
 - b. contain tangible, measurable, targets to enable the bank to increase its capital; and
 - c. deal with all concerns raised by Reserve Bank supervisors, including concerns about the bank's financial situation and governance;
 - d. be approved by the bank's Board; and
 - e. be provided to the Reserve Bank, by the bank's Board.

Guidance: The overarching focus of the plan should be on ensuring that the bank remains above its minimum capital requirement.

3. The plan must be developed in consultation with, and agreed to by, the Reserve Bank, and any restrictions imposed by the Reserve Bank must be included in the plan.

Guidance: These restrictions may include amendments to the bank's conditions of registration and directions given under section 113 of the **Act**.

The restrictions will vary, depending on the particular issues that the bank is facing, but may include, for example, requirements for the bank to change its business plans, to change its governance arrangements, to limit its distributions or bonuses, or to increase its capital or liquidity.

Where necessary section 113 directions might also be used, for example, to require the bank to replace some, or all, of its Board or senior managers, to

dispose of assets, to restrict the bank's lines of business, or to require the bank to raise capital.

D2 Loss absorbency of transitional capital instruments

D2.1 Non-viability trigger events for AT1 and Tier 2 capital instruments

1. This subpart provides more background on the **non-viability trigger events** that are provided for in the contractual terms of **AT1 capital** and **Tier 2 capital** instruments that were issued on or before 30 June 2021 and may still be included in a bank's eligible regulatory capital under the transitional arrangements set out in section A2.3 of BPR110.
2. The capital eligibility requirements that were a mandatory part of the Reserve Bank's capital adequacy framework until 30 June 2021 and remained optionally applicable until 30 September 2021 required any **AT1 capital** or **Tier 2 capital** instrument to include contractual terms to ensure that, on the occurrence of a **non-viability trigger event**, the instrument will be either immediately and irrevocably converted into ordinary shares or will be written off.
3. A **non-viability trigger event** referred to in subsection (2) occurs when either—
 - a. the Reserve Bank gives a direction to a bank under section 113 of the **Act** (because the financial position of the bank means that one or more of the grounds in that section has been met), which requires the bank to exercise its rights of write-off or conversion under the instrument; or
 - b. the bank is **declared to be** subject to **statutory management** by an Order in Council made under section 117 of the **Act** and the statutory manager announces his or her decision to convert or write off the instrument.

Guidance: In addition, any outstanding **AT1 capital** instrument that complied with the previous eligibility requirements, and that is classified as a liability under New Zealand **GAAP**, includes contractual terms to ensure that, if the **banking group's CET1 capital** ratio falls below 5.125%, the instrument will be either written off or converted into ordinary shares.

D2.2 Circumstances warranting section 113 direction

1. It is not possible to determine ex ante the circumstances in which the Reserve Bank would issue a direction to a bank under section 113(1) of the **Act** requiring conversion or write-off of a capital instrument in accordance with the terms of the instrument.
2. However, the Reserve Bank's consideration will include—
 - a. the particular circumstances of the bank; and
 - b. the relative ranking of claims; and
 - c. whether it is likely that other resolution or recovery mechanisms will be used; and
 - d. wider financial stability concerns.
3. In all cases, the guiding principle for the Reserve Bank will be that it will issue such a direction when it determines that, without conversion or write-off, the bank would become non-viable.

4. The Reserve Bank does not anticipate, but also does not rule out, that it would issue a direction if, in the view of the Reserve Bank, the bank's **prudential capital buffer ratio**—
 - a. is above the **buffer trigger ratio** specified in the bank's conditions of registration; or
 - b. is at, or below, the **buffer trigger ratio**, but the immediate risk that the bank will breach one or more of its minimum capital ratios is low.

D2.3 Effect of statutory management

1. If a bank is placed into **statutory management**, the statutory manager will have the right to decide whether any of the bank's capital instruments that has a conversion or write-off feature will be converted or written off, to the extent that conversion or write-off has not already occurred.
2. In deciding whether or not to exercise this right, the statutory manager must take into account the considerations set out in section 121 of the **Act**.

Part E: Use of internal capital models

E1 Process requirements

E1.1 Application

1. This subpart applies to a bank (a **modelling bank**) that has been accredited by the Reserve Bank to use its own internal modelling approaches for calculating its capital adequacy ratios.
2. The models referred to in this subpart comprise models for assessing **credit risk** under the Internal Ratings Based (**IRB**) approach, and models for assessing **operational risk** under the Advanced Measurement Approaches (**AMA**).

E1.2 Limitation on use of an internal model

A modelling bank may only use an internal model for the calculation of its regulatory capital adequacy requirements if the Reserve Bank has approved that model.

E1.3 Proposed changes to estimates and models

1. A bank must give the Reserve Bank notice of all **proposed changes** to its estimates and models before implementing them.
2. For the purposes of subsection (1), proposed changes means either–
 - a. periodic changes driven by new data; or

Guidance: This will include, for example, changes reflecting compositional changes in the loan book. The Reserve Bank should be informed of these, so it can consider whether they need to be approved. In principle, compositional changes are not likely to need approval. Notification of these changes provides the opportunity to check for plausibility to satisfy the Reserve Bank that they do relate to compositional shifts, and to track changes through time.

- b. changes to model structures, estimates, or judgments (including any changes proposed to **PD**, **LGD**, and **EAD** estimates).

Guidance: These changes require Reserve Bank approval and include, but are not limited to, the recalibration of a model due to, for example, material portfolio changes, the omission or addition of variables, the re-estimation of variables, or the reclassification of asset classes or segments within a model.

3. These proposed changes are subject to the formal submission requirements set out in section E1.4.

E1.4 Content of submissions

The formal submission required under [subsection E1.3\(3\)](#) must clearly set out the following matters in relation to each of the proposed changes:

- a. the rationale for the change, including the reasons why the new model is an improvement on the existing model, and supporting material; and

- b. “before” and “after” comparisons with respect to the risk parameters affected: for example, **PD**, **LGD**, and **EAD**; and

Guidance: Unless otherwise agreed to by the Reserve Bank, these comparisons should cover at least four consecutive periods. Those consecutive periods may, for example, be quarters or half years.

- c. the impacts on risk weighted assets and regulatory capital, and how these impacts are calculated; and
- d. any linkage to the bank’s ongoing accreditation requirements; and
- e. confirmation that what is proposed is consistent with the bank’s conditions of registration; and
- f. a comparison with the capital outcome under the standardised approach.

E1.5 Compendium of models

1. A modelling bank must maintain a compendium of approved models, and must obtain the Reserve Bank’s agreement to the compendium when it is first accredited as a modelling bank.
2. The bank must not use a model for regulatory capital purposes if it is not listed in the compendium.
3. The bank must–
 - a. review the compendium, and update the relevant sections, at least once in each calendar year and at intervals of no more than 15 months; and
 - b. update the compendium as soon as practicable after a model change has been approved by the Reserve Bank; and
 - c. provide the Reserve Bank a copy of its model compendium after each review described in subsection (a) and whenever the compendium has been updated in accordance with subsection (b).
4. The compendium must include–
 - a. basic model-related information; and

Guidance: This information includes, for example, the version number, approval date, risk drivers, and key parameters.

- b. information from the most recent annual validation report on **RWA** and **EAD**; and
- c. the validation date; and
- d. the model outlook; and
- e. any other model-related information required by the Reserve Bank.

Guidance: A template of the compendium is included in Appendix 3. This is provided for convenience, and the exact content of a bank's compendium may vary from the template, subject to the Reserve Bank's agreement under [subsection E1.5\(1\)](#).

Appendix 1

Draft legal sign-off for AT1/Tier 2/ Mutual capital instruments

[External law firm letterhead]

Reserve Bank of New Zealand
2 The Terrace
Wellington

Attention: Director, Prudential Policy

[Name of issuer] – proposed issue of [perpetual non-cumulative preference shares/subordinated notes/ mutual capital instruments]

1. Introduction

We are acting for [name of issuer] (the **Issuer**) in relation to its proposed issue of [perpetual non-cumulative preference shares/subordinated notes/ mutual capital instruments] (the **Capital Instruments**) [having an aggregate [issue price/face value] of [Specify currency][Specify amount]] [Drafting note: issue amount only required if known when opinion issued_ otherwise please adjust accordingly].

The Issuer intends that the Capital Instruments will constitute [AT1 capital/Tier 2 capital/ CET1 capital only in the case of mutual capital instruments] for the purposes of Reserve Bank Document BPR110 (**BPR110**).

2. Checklist and Constituting Documents

Checklist

We attach to this opinion as Appendix 1 a copy of the Reserve Bank's checklist from Appendix [1][2][3] of BPR110. The checklist has been completed for the Capital Instruments.

Constituting Documents

The terms of the Capital Instruments are set out in the following documents:

- (a) [list documents - Drafting Note: please describe the executed (as applicable) final versions of the documents];
- (b) [list documents],

together, the **Constituting Documents**.

We attach to this opinion as Appendix 2 a copy of each Constituting Document.

[Drafting Note: If any of the Constituting Documents are attached in draft (e.g., due to the issue amount not being known as at the date of this opinion), please add a paragraph to provide that the final executed copies will be provided to the Reserve Bank within three (3) business days of becoming available, together with a written confirmation from the law firm (or issuer) to the Reserve Bank that the signed versions are in the same form as the drafts attached to this opinion (subject to the issue amount being inserted). That confirmation can be provided in a memorandum or email form.]

3. *Our confirmations and opinions*

We confirm that:

- (a) we accept responsibility to the Reserve Bank for the confirmations and opinions set out below; and
- (b) we have not acted for the Reserve Bank in relation to the issue of Capital Instruments; and
- (c) notwithstanding the provisions of the sign-off, we reserve the right to represent and advise the Issuer (if instructed) in relation to any matters relating to the issue at any time in the future, and the fact that we provided the sign-off to the Reserve Bank will not be deemed to have caused any conflict of interest in relation to the giving of such advice; and
- (d) we have reviewed, and are familiar with, the Checklist and each of the Constituting Documents; and
- (e) [the Issuer has confirmed to us], the Constituting Documents are the only documents that prescribe the terms of the Capital Instruments; and
- (f) [each Constituting Document is] / [[*insert names of Constituting Documents* are] governed by New Zealand law.]

[AND (if applicable):

the [*insert names of Constituting Documents*] are governed by the laws of [*insert permitted foreign law*]. In accordance with the requirement set out in [BPR120], the Issuer has confirmed to us that a separate opinion will be provided to the Reserve Bank to opine on the Capital Instruments under [*insert governing law*]; and

[Drafting Note: If one or more of the Constituting Documents contains a hybrid governing law clause, please adapt the above paragraphs, as necessary.]

- (g) in our opinion—
 - (i) the Checklist accurately reflects in all respects the relevant terms of the Capital Instruments as prescribed in the Constituting Documents; and
 - (ii) the terms of the Capital Instruments as set out in the Constituting Documents comply in all respects with the requirements for [*AT1 capital/Tier 2 capital/ CET1 only in the case of mutual capital instruments*] in BPR110; and
 - (iii) there are no matters in the Constituting Documents that raise issues reasonably capable of dispute or differing interpretation as to compliance with BPR110 [*other than [identify]*].

4. *Basis on which our confirmations and opinions are given*

Our confirmations and opinions above are given on the following basis:

- (a) they are given solely for the benefit of the Reserve Bank and are not to be relied upon by any other person without our prior written consent; and

- (b) they do not extend to any subsequent or amended versions of the Constituting Documents; and
- (c) they relate solely to New Zealand law in force at the date of this opinion and are given on the basis that they will be construed in accordance with New Zealand law;
- (d) we provide no opinion as to whether the Constituting Documents contain appropriate restrictions or provisions for the protection of holders of the Capital Instruments; and
- (e) they are based on the version of BPR110 in effect at the date of this opinion, and do not extend to subsequent or amended versions of BPR110; and
- (f) we provide no opinion as to whether the Constituting Documents comply with financial markets law or any other applicable laws; and
- (g) they are strictly limited to the matters stated in this letter and do not extend by implication to any other matter.

Yours faithfully
[Law firm]

[Appendix 1]

[Completed copy of Checklist,]

[Appendix 2]

[Constituting Documents]

See section [C2.4]

Appendix 2

Draft legal sign-off for amendments to terms of AT1/Tier 2/ Mutual capital instruments

[External law firm letterhead]

Reserve Bank of New Zealand
2 The Terrace
Wellington

Attention: Director, Prudential Policy

[Name of issuer] – proposed amendment to terms of *[perpetual non-cumulative preference shares/subordinated notes/mutual capital instruments]*

1. *Introduction*

We are acting for *[name of issuer]* (the **Issuer**) in relation to a proposed amendment to the terms of the *[perpetual non-cumulative preference shares/subordinated notes/ mutual capital instruments]* (the **Capital Instruments**) issued by it on *[date]*.

The Issuer intends that, once these amendments are in effect, the Capital Instruments will continue to constitute *[AT1 capital/Tier 2 capital/ CET1 (only in the case of mutual capital instruments)]* for the purposes of Reserve Bank Document BPR110 (**BPR110**).

2. *Constituting and Amending Documents*

Constituting Documents

The existing terms of the Capital Instruments, incorporating all amendments previously notified to the Reserve Bank, are set out in the following documents:

- (a) *[list documents - Drafting Note: please describe the executed (as applicable) final versions of the documents];*
- (b) *[list documents],*

together, the **Constituting Documents**.

We attach to this opinion as Appendix 1 a copy of each Constituting Document.

Amending Documents

The proposed amendments to the Capital Instruments are set out in the following documents:

- (c) *[list documents];*
- (d) *[list documents],*

together, the **Amending Documents**.

We attach to this opinion as Appendix 2 a copy of each Amending Document.

3. *Our confirmations and opinions*

We confirm that:

- (a) we accept responsibility to the Reserve Bank for the confirmations and opinions set out below; and
- (b) we have not acted for the Reserve Bank in relation to the issue of Capital Instruments; and
- (c) notwithstanding the provisions of the sign-off, we reserve the right to represent and advise the Issuer (if instructed) in relation to any matters relating to the issue at any time in the future, and the fact that we provided the sign-off to the Reserve Bank will not be deemed to have caused any conflict of interest in relation to the giving of such advice; and
- (d) we have reviewed, and are familiar with, each of the Constituting Documents and each of the Amending Documents; and
- (e) [the issuer has confirmed to us], the Constituting Documents and, once executed and in effect, the Amending Documents are the only documents that prescribe the terms of the Capital Instruments; and
- (f) in our opinion:
 - (i) the terms of the Capital Instruments as prescribed in the Constituting Documents and, once executed and in effect, the Amending Documents comply in all respects with the requirements for [AT1 capital/Tier 2 capital/ CET1 in the case of mutual capital instruments] in BPR110; and
 - (ii) there are no matters in the Constituting Documents or the Amending Documents that raise issues reasonably capable of dispute or differing interpretation as to compliance with BPR110 [other than [identify]].

4. *Basis on which our confirmations and opinions are given*

Our confirmations and opinions above are given on the following basis:

- (a) they are given solely for the benefit of the Reserve Bank and are not to be relied upon by any other person without our prior written consent; and
- (b) they do not extend to any subsequent or amended versions of the Constituting Documents, other than the Amending Documents; and
- (c) they relate solely to New Zealand law in force at the date of this opinion and are given on the basis that they will be construed in accordance with New Zealand law; and
- (d) we provide no opinion as to whether the Constituting Documents or the Amending Documents contain appropriate restrictions or provisions for the protection of holders of the Capital Instruments; and
- (e) they are based on the version of BPR110 in effect at the date of this opinion, and do not extend to subsequent or amended versions of BRP110; and
- (f) we provide no opinion as to whether the Constituting Documents or the Amending Documents comply with financial markets law or any other applicable laws; and

- (g) they are strictly limited to the matters stated in this letter and do not extend by implication to any other matter.

Yours faithfully
[Law firm]

[Appendix 1]

[Constituting Documents]

[Appendix 2]

[Amending Documents]

Appendix 3

Internal models compendium template

Date:													
Model	Model version number	Model Approval Date	Model risk drivers (i.e. explanatory variables)	Average parameter estimate (e.g. for a <u>PD</u> model, the expected average <u>PD</u> when approved)	Expected portfolio <u>RWA</u> when approved	Expected portfolio <u>EAD</u> when approved	Expected impact on portfolio <u>RWA</u> when approved	Conditions of approval	Date of most recent update (annual columns only)	<u>RWA</u> at most recent update	<u>EAD</u> at most recent update	Model outlook (keep / rebuild / decommission)	Next validation date (month/year)
<i>Each line to be updated at approval</i>									<i>Each line to be updated annually</i>				
Credit risk													
<i>Corporate</i>													
<i>Sovereign</i>													
<i>Bank</i>													
<i>Retail</i>													
<i>Equity</i>													
<u>Operational risk</u>													