Australian Prudential Regulation Authority

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To all locally incorporated authorised-deposit taking institutions, general insurers and life insurers

TAX EVENT CALL PROVISIONS IN ADDITIONAL TIER 1 AND TIER 2 CAPITAL INSTRUMENTS

The purpose of this letter is to confirm APRA's position in relation to certain tax event call provisions in Additional Tier 1 and Tier 2 capital instruments.

Under Basel III, Additional Tier 1 and Tier 2 capital instruments may only be callable at the initiative of the issuer within the first five years of issuance as a result of a tax or regulatory event. This requirement is reflected in APRA's prudential standards for authorised deposit-taking institutions, general insurers and life insurance companies.[1]

A number of APRA-regulated issuers have proposed to include provisions in the terms of capital instruments to the effect that, where the issuer is required by taxation law to withhold or deduct amounts otherwise payable to instrument holders, the issuer will make additional payments to ensure that these holders receive the amounts they would have received had no withholding or deduction been required. Issuers have also sought to include provisions allowing an option to redeem the instrument in such circumstances at any time, on the basis that this would be an eligible tax event under Basel III.

The Basel Committee on Banking Supervision has to date not published any guidance on eligible tax or regulatory events. However, in light of industry submissions and international developments, APRA confirms that it will permit the inclusion of provisions in the terms of Additional Tier 1 and Tier 2 capital instruments allowing an option to redeem in the circumstances outlined above, provided the payment of additional amounts to instrument holders is a result of a change in taxation law that could not be anticipated at the issue date of the instrument. In accordance with the prudential standards, issuers must not exercise any such option to call the instrument without APRA's prior written approval and issuers must not assume, or create market expectations, that such options will be exercised. The other requirements in the prudential standards in relation to exercising early redemption options must also be met.

Yours sincerely

Charles Littrell
Executive General Manager
Policy, Statistics and International

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[1] *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital*, Attachment E, paragraph 7 and Attachment H, paragraph 7; *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital*, Attachment C, paragraph 7 and Attachment E, paragraph 7; *Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital*, Attachment C, paragraph 7 and Attachment E, paragraph 7.