



Prudential Standard GPS 112

Capital Adequacy: Measurement of Capital

Objectives and key requirements of this Prudential Standard

This Prudential Standard sets out the characteristics that an instrument must have to qualify for inclusion in the capital base of a general insurer or Level 2 insurance group and the various regulatory adjustments to be made to determine the capital base.

The ultimate responsibility for ensuring that the capital base of a general insurer or a Level 2 insurance group meets the requirements of this Prudential Standard rests with its Board of directors.

The key requirements of this Prudential Standard are that a general insurer or Level 2 insurance group must:

- comply with the minimum requirements regarding the size and composition of the capital base;
- include in the appropriate category of capital (i.e. Common Equity Tier 1 Capital, Additional Tier 1 Capital or Tier 2 Capital) only those capital instruments that meet the detailed criteria for that category;
- ensure all capital instruments are capable of bearing loss; and
- make certain regulatory adjustments to capital, mainly from Common Equity Tier 1 Capital, to determine the capital base.

Table of contents

Authority	3
Application	3
Level 2 insurance groups	3
Interpretation	3
Definitions	4
Capital base	5
Common Equity Tier 1 Capital	7
Additional Tier 1 Capital	10
Tier 2 Capital	11
Additional Tier 1 or Tier 2 Capital issued overseas by the regulated institution	11
Intra-group capital transactions	12
Holdings of capital instruments in group members by other group members	13
Adjustments and exclusions	14
Previous exercise of discretion	14
Attachment A – Criteria for classification as paid-up ordinary shares	15
Attachment B – Regulatory adjustments	18
Attachment C – Criteria for inclusion in Additional Tier 1 Capital	24
Attachment D – Criteria for inclusion in Tier 2 Capital	34
Attachment E – Loss absorption at the point of non-viability: Additional Tier 1 and Tier 2 Capital instruments	44
Attachment F – Level 2 insurance groups	49
Attachment G – Mutual Equity Interests	54

Authority

1. This Prudential Standard is made under section 32 of the *Insurance Act 1973* (the Act).

Application

2. Subject to paragraph 3, this Prudential Standard applies to each:
 - (a) **general insurer** authorised under the Act (insurer); and
 - (b) **Level 2 insurance group** as defined in *Prudential Standard GPS 001 Definitions* (GPS 001).

Where a requirement applies to a Level 2 insurance group, the requirement is imposed on the **parent entity** of the Level 2 insurance group

3. **Category C insurers** are not subject to this Prudential Standard. As outlined in *Prudential Standard GPS 110 Capital Adequacy* (GPS 110), a different measure of capital adequacy applies to Category C insurers. -This reflects the nature of a Category C insurer's Australian balance sheet, which does not generally include separately identifiable capital instruments.
4. This Prudential Standard applies to insurers and Level 2 insurance groups (**regulated institutions**) from 1 July 2019²³.

Level 2 insurance groups

5. Certain adjustments to the measurement of capital outlined in this Prudential Standard apply to Level 2 insurance groups. These adjustments are set out in Attachment FI.

Interpretation

6. Terms that are defined in GPS 001 appear in bold the first time they are used in this Prudential Standard.
7. Where this Prudential Standard provides for APRA to exercise a power or discretion, this power or discretion is to be exercised in writing. In this Prudential Standard, unless the contrary intention appears, a reference to an Act, Regulations, Prudential Standard, Australian Accounting Standard is a reference to the instrument as in force from time to time.
8. Unless otherwise indicated:
 - (a) The term 'accounts receivables' will be used to refer to premiums, reinsurance recoveries, non-reinsurance recoveries and other accounts receivable that have been recognised within the insurance and reinsurance contract liabilities and assets reported on the balance sheet under AASB 17 Insurance Contracts (AASB 17); and

- (b) the term ‘accounts payables’ will be used to refer to claims, reinsurance premiums, reinsurance recoveries, non-reinsurance recoveries and other accounts payable that have been recognised within the insurance and reinsurance contract liabilities and assets reported on the balance sheet under AASB 17.

5.9. For the purposes of this Prudential Standard:

- (a) a ‘component of capital’ is any form of capital defined in this Prudential Standard as eligible for inclusion in the capital base; and
- (b) a ‘category of capital’ refers to a group of components of capital.

Definitions

10. For the purposes of this Prudential Standard:

- (a) capital instruments – includes all capital instruments eligible to be included in **Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital**;
- (b) distributable items – means items which are permitted to be distributed in accordance with relevant statutory and regulatory requirements applicable to distributions by the issuer;
- (c) mutual equity interests – capital instruments issued by mutually owned regulated institutions that meet the criteria in Attachment G to this Prudential Standard;
- (d) mutually-owned regulated institution – means a regulated institution that is a ‘mutual entity’ as defined in the **Corporations Act**;
- (e) non-viability event – has the meaning in paragraph 2 of Attachment E to this Prudential Standard;
- (f) paid-up instrument means a capital instrument where:
- (i) the payment of the capital has been received with finality by the issuer;
 - (ii) the capital is reliably valued;
 - (iii) the capital is fully under the issuer’s control; and
 - (iv) the instrument does not, directly or indirectly, expose the issuer to the credit risk of an investor;
- (g) related entity – means an entity over which a regulated institution or its parent exercises control or significant influence and can include a parent company, a sister company, a subsidiary or any other affiliate.

Capital base

6.11. The capital base of a regulated institution consists of the following categories:

- (a) Tier 1 Capital, which comprises:
 - (i) Common Equity Tier 1 Capital; ~~and~~
 - (ii) Additional Tier 1 Capital; and
 - ~~(ii)(iii)~~ Paid-up mutual equity interests issued by a mutually-owned regulated institution that meet the criteria in paragraph 1 of Attachment G to this Prudential Standard and are above the limit specified in paragraph 4 of Attachment G; and
 - (b) Tier 2 Capital.
- that satisfy the criteria in this Prudential Standard.

7.12. A regulated institution must ensure that at all times:

- (a) the Common Equity Tier 1 Capital for the regulated institution exceeds 60 per cent of the **prescribed capital amount** of the regulated institution;
- (b) the Tier 1 Capital for the regulated institution exceeds 80 per cent of the prescribed capital amount of the regulated institution; and
- (c) the capital base for the regulated institution exceeds the **Prudential Capital Requirement** of the regulated institution.

8.13. APRA may require, by notice in writing, a regulated institution to hold a higher percentage of its prescribed capital amount as Common Equity Tier 1 Capital and/or Tier 1 Capital.

9.14. A regulated institution must ensure that any ~~component item~~ of capital that the regulated institution includes in a particular category of included in its capital base satisfies, in both form and substance, all requirements in this Prudential Standard for the particular category of capital in which it is included.

15. A regulated institution must not include an ~~component item~~ of capital in a particular category of its capital base if that ~~component item~~, when considered in conjunction with other related transactions that affect its overall economic substance, could be reasonably considered not to satisfy the requirements of this Prudential Standard for that category of the capital base.

16. A regulated institution must ensure that the category of the capital base in which a component of capital is included, when measured at Level 1 or equivalent, is not upgraded to a higher category of the capital base when measured in a

regulated institution's capital base at Level 2. Any such component of capital must be reclassified to the appropriate lower category of the capital base when measured at Level 2.

~~10.17.~~ A regulated institution must not include a capital instrument in a category of the capital base based on a future event¹, ~~such as the future sale or issuance of a higher quality capital instrument~~, until such time as:

- (a) the future event occurs, and
- (b) the proceeds have been irrevocably received by the regulated institution.

~~11.18.~~ APRA may ~~, in writing,~~ require a regulated institution to:

- (a) exclude from its capital base any ~~component—item included as a component~~ of capital that in APRA's opinion is not a genuine contribution to the financial strength of the regulated institution; or
- (b) reallocate to a lower category of the capital base any component of capital that in APRA's opinion does not satisfy the requirements of this Prudential Standard for the category of the capital base to which it was originally allocated.

19. A capital instrument is not eligible for inclusion in a category of the capital base if the nature or complexity of its terms, its location of issue, or its structure raises concerns over whether the instrument fully, and unequivocally, satisfies the requirements for the category of the capital base in this Prudential Standard.

20. A regulated institution must not include a capital instrument that involves the use of a special purpose vehicle (SPV), or a stapled security structure consisting of the issue of a preference share and a stapled instrument of another form, in its regulatory capital.

21. A regulated institution must not include a capital instrument in its capital base if the capital instrument has features that hinder recapitalisation of the regulated institution, or any other members of the group to which the regulated institution belongs. This includes features that require the regulated institution or any other members of the group, to compensate investors if a new instrument is issued at a lower price during a specified timeframe.

22. A capital instrument is not eligible for inclusion in the capital base if it contains any terms that could inhibit the regulated institution's ability to be managed in a sound and prudent manner, particularly in times of financial difficulty, or restrict APRA's ability in its role as a prudential regulator to resolve any problems encountered by the regulated institution.

¹ This includes, but is not limited to, the future sale or issuance of a capital instrument and the future conversion of an instrument or debt into ordinary shares or mutual equity interests.

23. A capital instrument is not eligible for inclusion in the capital base if it includes any 'repackaging' arrangements that have the effect of compromising the quality of capital raised.²
24. A regulated institution or any other member of the group to which the regulated institution belongs, must not create an expectation at issuance that a capital instrument will be bought back, redeemed or cancelled, and the statutory or contractual terms of the instrument must not include any feature that may give rise to such an expectation. A regulated institution or any other members of the group, must not assume, or create market expectations, that supervisory approval will be forthcoming for the regulated institution or any other members of the group, to buy back, redeem or cancel an instrument.
- ~~12.25.~~ A regulated institution may not, without obtaining APRA's prior written approval, enter into an arrangement where it may purchase, or provide financial assistance with a dominant purpose of facilitating the purchase by another party of, its own capital instruments. Any such arrangement, if approved by APRA, shall be subject to a limit agreed with APRA.
- ~~13.26.~~ A regulated institution must provide APRA, as soon as practicable, with copies of documentation associated with the issue of Additional Tier 1 Capital and Tier 2 Capital instruments.
27. Where the terms of a capital instrument depart from established precedent, a regulated institution must consult with APRA on the eligibility of the capital instrument for inclusion in a category of—in the regulated institution's capital base in advance of the issuance of the capital instrument, and provide APRA with all information it requires to assess the eligibility of the capital instrument.
28. As part of the documentation provided for the purposes of paragraphs 26 and 27 of this Prudential Standard, a regulated institution must include a statement of compliance of the capital instrument signed by a senior manager of the regulated institution, or if issued by a member of the Level 2 insurance group, signed by a senior manager of the regulated institution or authorised NOHC with group responsibility. The statement must:
- (a) address how the issuer is satisfied that each required capital eligibility criterion set out in this Prudential Standard is met and will continue to be met in the future; and
 - (a)—clearly set out references to supporting documents and opinions that demonstrate that the criteria are met.
 - (b) A regulated institution must obtain APRA's written consent—approval before the terms—or conditions of an instrument are amended—altered in a way that may affect its eligibility as a component of the capital base.

² As an example, repackaging may occur where an instrument is not marketed in line with its prudential treatment, or if the transaction documentation suggests to investors that the instrument has attributes of a lower level of capital than claimed for prudential treatment.

Common Equity Tier 1 Capital

~~14.29.~~ Common Equity Tier 1 Capital comprises the highest quality components of capital that fully satisfy all of the following characteristics:

- (a) provide a permanent and unrestricted commitment of funds;
- (b) are freely available to absorb losses;
- (c) do not impose any unavoidable servicing charge against earnings; and
- (d) rank behind the claims of policyholders and other creditors in the event of winding-up of the issuer.

~~15.30.~~ Common Equity Tier 1 Capital consists of the sum of:

- ~~(a)~~ paid-up ordinary shares issued by a regulated institution (whether listed on exchange or unlisted) that meet the criteria in Attachment A to this Prudential Standard;
- ~~(b)~~ paid-up mutual equity interests issued by a mutually-owned regulated institution that meet the criteria in paragraph 1 of Attachment G to this Prudential Standard and are above the limit specified in paragraph 4 of Attachment G;
- ~~(a)(c)~~ retained earnings;
- ~~(b)(d)~~ undistributed current year earnings (refer to paragraph 31 to 34 of this Prudential Standard);
- ~~(e)(e)~~ accumulated other comprehensive income and other disclosed reserves (refer to paragraphs 35 and 36 to this Prudential Standard);
- ~~(d)(f)~~ technical provisions³ in surplus or deficit of those required by *Prudential Standard GPS 340 Insurance Liability Valuation* (GPS 340)⁴; and
- ~~(e)(g)~~ regulatory adjustments applied in the calculation of Common Equity Tier 1 Capital required under Attachment B to this Prudential Standard.

~~16.31.~~ Current year earnings must take into account:

- (a) negative goodwill;
- (b) expected tax expenses; and

³ Technical provisions in this instance refer to insurance contract and reinsurance contract liabilities and assets both net outstanding claims provisions and net unearned premium calculated under Australian Accounting Standards. Technical provisions in surplus or deficit relating to premiums liabilities also include the deferred reinsurance expense accruals for the cost of reinsurance not recognised in the accounts required to cover premiums liabilities, for future business not yet written.

⁴ Technical provisions in surplus or deficit of those required by GPS 340 must be adjusted to take account of tax effects.

- (c) dividends when declared in accordance with Australian Accounting Standards.

32. Declared dividends for the purpose of paragraph 31(c) of this Prudential Standard may be reduced by the expected proceeds, as agreed in writing by APRA, of a Dividend Reinvestment Plan (DRP) to the extent that dividends are used to purchase new ordinary shares issued by the regulated institution. A regulated institution must review every six months the expected subscription for new ordinary shares under its DRP having regard to experience over previous years and reasonable expectations of the level of subscription that might apply in future. If a regulated institution identifies any material change in the expected level of future subscription for new ordinary shares under its DRP, it must notify APRA and obtain APRA's agreement–approval to a new amount by which declared dividends may be reduced for regulatory capital purposes.

33. Current year earnings include the full value of fee income provided that:

- (a) the fee income has either been received in cash or has been debited by the general insurer to an account to be paid by the provider of the fees or otherwise forms part of the upfront fees owed to the general insurer;
- (b) outstanding amounts of fee income debited by the general insurer to the account are claimable in full in the event of default on the amounts receivable or capable of being sold to a third party as part of outstanding debts;
- (c) the provider of the fee income has no recourse for repayment in part or full of any prepaid income;
- (d) the fees debited by the general insurer to the account cannot be cancelled by the provider of the fee income where the fees were obliged to be paid upfront; and
- (e) there is no requirement for the provision of continuing additional services or products associated with the fee income concerned.

34. Fee income may include net positive amounts arising from the netting of deferred or future income and capitalised expenses associated with a product class provided the conditions in paragraph 33 of this Prudential Standard are satisfied. Any deferred income or future income that do not satisfy the conditions in paragraph 33, if not already excluded from current year or retained earnings, must be deducted from Common Equity Tier 1 Capital.

17.35. Accumulated other comprehensive income and other disclosed reserves include, but are not limited to:

- (a) unrealised gains or losses recognised on the balance sheet;
- (b) reserves from equity-settled share-based payments (share or share options) granted to employees as part of their remuneration package provided that:

- (i) the share or share options granted relate only to the ordinary shares of the regulated institution;
- (ii) the ordinary shares comprise only new ordinary shares to be issued by the regulated institution, or new ordinary shares to be already issued by the regulated institution to employees, or new ordinary shares already issued by the regulated institution to employees for this specific purpose; and
- (iii) there are no circumstances under which such remuneration can be converted into another form (e.g. cash).

~~Any other reserves associated with share-based payments must be excluded from the regulated institution's capital base;~~

- (c) foreign currency translation reserve;
- (d) general reserves;
- (e) cumulative unrealised gains or losses on hedges⁵ offsetting gains or losses included in Common Equity Tier 1 Capital (such as movements in the currency value of foreign currency-denominated hedging instruments that offset movements in foreign-currency-denominated items recognised in the foreign currency translation reserve). This includes **fair value** gains or losses on derivatives representing effective economic hedges of assets; and
- (f) any other gains and losses in accumulated other comprehensive income and other disclosed reserves that may be specified by APRA in writing.

For the purposes of paragraph 35(b) any other reserves associated with share-based payments must be excluded from the capital base.

~~18.36.~~ Revaluation of property holdings ~~where the holdings are not held at fair value~~ on the balance sheet may be included as part of other disclosed reserves only if:

- (a) the property is owned by the regulated institution or member of the Level 2 insurance group at Level 2;
- (b) the property comprises only land and buildings;
- (c) the property is readily available to be sold. A property need not be scheduled for sale, nor need a sale be intended. However, such a property must be capable of being readily sold within six months were a decision made to sell the property;
- (d) the reserves are shown as a component of equity in the audited published financial accounts of the regulated institution;

⁵ This includes cumulative unrealised gains or losses on effective cash flow hedges as defined in Australian Accounting Standards.

- (e) the revaluations are reliable, in accordance with **Australian Accounting Standards**, and subject to audit or review consistent with Australian **Auditing and Assurance Standards**. ~~An investment~~ property must be measured at fair value in accordance with Australian Accounting Standards; and
- (f) the amount of reserves incorporates the full effect of any fair value gains or losses and any gains or losses on hedges offsetting revaluations of the property included in the reserves.

Additional Tier 1 Capital

~~19.37.~~ Additional Tier 1 Capital comprises high quality components of capital that satisfy the following essential characteristics:

- (a) provide a permanent and unrestricted commitment of funds;
- (b) are freely available to absorb losses;
- (c) rank behind the claims of policyholders and other more senior creditors in the event of winding-up of the issuer; and
- (d) provide for fully discretionary capital distributions.

~~20.38.~~ Additional Tier 1 Capital consists of:

- (a) instruments issued by a regulated institution that are not included in Common Equity Tier 1 Capital and which meet:
 - (i) the criteria for inclusion in Additional Tier 1 Capital set out in Attachment C to this Prudential Standard; and
 - (ii) the requirements for loss absorption at the point of non-viability set out in Attachment ~~EG~~ to this Prudential Standard; and
- ~~(b)~~ regulatory adjustments applied in the calculation of Additional Tier 1 Capital as required under Attachment B to this Prudential Standard.

~~(e)(b) Instruments may also be included in Additional Tier 1 Capital in accordance with Attachment H.~~

~~21. An Additional Tier 1 Capital instrument may be a stapled security structure provided the structure meets the criteria in Attachment D.~~

Tier 2 Capital

~~22.39.~~ Tier 2 Capital includes other components of capital that, to varying degrees, fall short of the quality of Tier 1 Capital but nonetheless contribute to the overall strength of a regulated institution and its capacity to absorb losses.

~~23.40.~~ Tier 2 Capital consists of:

- (a) instruments issued by the regulated institution that meet:
 - (i) the criteria for inclusion in Tier 2 Capital set out in Attachment ~~ED~~ to this Prudential Standard; and
 - (ii) the requirements for loss absorption at the point of non-viability set out in Attachment ~~GE~~ to this Prudential Standard; and
- (b) regulatory adjustments applied in the calculation of Tier 2 Capital as required under Attachment B.

~~Instruments may also be included in Tier 2 Capital in accordance with Attachment H.~~

Additional Tier 1 or Tier 2 Capital issued overseas by the regulated institution

~~24.41.~~ Additional Tier 1 Capital instruments and Tier 2 Capital instruments may be issued by a regulated institution either in its country of incorporation or through a branch in another country, provided the instrument:

- (a) constitutes an obligation of the regulated institution at all times;
- (b) is freely available to absorb losses across all of the operations of the regulated institution; and
- (c) meets all of the requirements of this Prudential Standard for inclusion in Additional Tier 1 Capital or Tier 2 Capital.

42. In addition to paragraph 41 of this Prudential Standard, the Level 2 capital base can include Additional Tier 1 Capital instruments and Tier 2 Capital instruments issued by the parent entity of the Level 2 insurance group, or a fully consolidated subsidiary of the group, either in its country of incorporation or through a branch in another country, provided the instrument:

- (a) represents an obligation of the parent entity or the consolidated subsidiary itself at all times;
- (b) is freely available to absorb losses across all of the operations of the Level 2 insurance group or the consolidated subsidiary that issued the instrument; and
- (c) meets all of the requirements of this Prudential Standard for inclusion in Additional Tier 1 Capital or Tier 2 Capital.

Intra-group capital transactions

43. 45.—The matters APRA may consider in assessing whether an item included by a regulated institution as a component of capital resulting from intra-group transactions is not a genuine contribution to financial strength include, but are not limited to, whether the item:

- (a) is clearly supplied from debt raised by other group members;
 - (b) results from intra-group transactions with no economic substance;
 - (c) is contributed by a member of the group using funding sources, directly or indirectly, from the regulated institution itself; and
 - (d) is contributed by a group member and the funding of which contains cross-default clauses that would be triggered as a result of the regulated institution failing to meet any servicing obligations.
44. In assessing the overall strength of Level 1 and Level 2 capital adequacy, APRA will have regard to the level of capital adequacy of individual group members of a group to which the regulated institution belongs, including any limitations in the amount of capital that may be readily extracted from individual group members to provide support, if required, to recapitalise the regulated institution or other group members.
45. In measuring the capital base at Level 2, a regulated institution must exclude any capital instrument issued by a member of the Level 2 group where the obligations under that instrument are secured, guaranteed, or subject to any other arrangement provided by a member of the group that legally or economically enhances the seniority of claims of investors.

Use of Special Purpose Vehicles to issue Additional Tier 1 and Tier 2 Capital instruments

- ~~25. Capital instruments issued through a **Special Purpose Vehicle** (SPV) must satisfy the requirements of Attachment F to be eligible Additional Tier 1 Capital or Tier 2 Capital.~~

Holding of capital instruments in group members by other group members

46. Capital instruments of a regulated institution, a member of a group headed by a regulated institution, or a NOHC at Level 2 that are held as direct investments by a vehicle, subject to consolidation within the regulated institution's financial statements in accordance with Australian Accounting Standards, may be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital, Additional and Tier 2 Capital (on both a Level 1 and Level 2 basis, as appropriate) only if:
- (a) the regulated institution (or relevant vehicle, other than a parent of the regulated institution, in respect of its own holdings of these instruments) did not fund the acquisition of the capital instruments (i.e. acquisition of capital instruments is funded by third parties such as life insurance policyholders or third-party investors);
 - (b) the risk and rewards associated with investments are borne primarily by third parties;

(c) the regulated institution can demonstrate to APRA, if required, that decisions to acquire or sell such capital instruments are made independently of the issuer of the capital instruments and in the interests of the third parties who primarily bear the risks and rewards of the investments in the instruments; and

(d) the instruments are not held for the purposes of an employee share-based remuneration scheme.

~~26.47.~~ Direct investments in shares of a regulated institution by an SPV (e.g. a trust) established under a share-based employee remuneration scheme may be included in the regulated institution's Common Equity Tier 1 Capital only if:

(a) the shares issued to the SPV represent ordinary shares of the regulated institution;

(b) the amount included in Common Equity Tier 1 Capital is matched by an equivalent charge to profit ~~and-or~~ loss of the regulated institution for expensing the issue or funding the acquisition of ordinary shares by the vehicle; and

(c) the ordinary shares issued cannot be converted to payment in another form (e.g. cash).

~~48.~~ If the requirements in paragraph 46 and 47 of this Prudential Standard are not satisfied, the relevant capital instruments must be treated as holdings of own capital instruments and deducted from Common Equity Tier 1 Capital ~~in accordance with paragraph 4 of Attachment B, Additional Tier 1 Capital and Tier 2 Capital, as appropriate.~~

Adjustments and exclusions

~~27.49.~~ APRA may, by notice in writing to a regulated institution, adjust or exclude a specific requirement in this Prudential Standard in relation to that regulated institution.

Determinations made under previous prudential standards

~~28.~~ ~~An exercise of APRA's discretion under the previous version of this Prudential Standard continues to have effect under this Prudential Standard. For the purposes of this paragraph, 'the previous version of this Prudential Standard' means Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital (GPS 112) made on 4 December 2012.~~

Previous exercise of discretion

~~50.~~ A regulated institution must contact APRA if it seeks to place reliance, for the purposes of complying with this Prudential Standard, on a previous exemption or other exercise of discretion made by APRA under a previous version of this Prudential Standard.

Attachment A**Criteria for classification as paid-up ordinary shares**

1. To be classified as paid-up ordinary shares in Common Equity Tier 1 Capital, an instrument must satisfy the following criteria:

(a) the instrument must be the only class of ordinary shares, except for the distinction between voting and non-voting ordinary shares. Non-voting ordinary shares must be identical to voting ordinary shares of the issuer in all respects except the absence of voting rights;

~~(a)~~(b) the instrument represents the most subordinated claim in liquidation of the issuer;

~~(b)~~(c) the instrument holder is entitled to a claim on the residual assets that is proportional to its share of issued capital, after all senior claims have been repaid in liquidation (i.e. there is an unlimited and variable claim, not a fixed or capped claim);

~~(e)~~(d) the principal amount of the instrument is perpetual (i.e. it has no maturity date) and is never repaid outside of liquidation (other than discretionary repurchases subject to APRA approval);

~~(d) the issuer, and any other member of a group to which the issuer belongs, does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled and the statutory or contractual terms of the instrument do not include any feature that might give rise to such an expectation;~~

(e) distributions on the instrument are paid out of distributable items (retained earnings included) of the issuer, and there are no features that require the issuer to make payments in kind. and the terms of the instrument do not provide for payment to investors other than in the form of a cash payment. The level of distributions must not be tied or linked to the amount paid up at issuance, or to the credit standing of the issuer, and must not be subject to a contractual cap, except to the extent that restrictions applied to the payment of distributions are in accordance with GPS 110;

(f) there are no circumstances under which the distributions are obligatory. Non-payment of a distribution does not trigger any restrictions on the issuer or any other member of the group to which the issuer belongs. Any waived distributions are non-cumulative (i.e. they are not required to be made up by the issuer at a later date). Non-payment of distributions must not be an event of default of the issuer or of any other member of the group to which the issuer belongs;

(g) distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. There are no preferential distributions, including in respect of other elements classified as Common Equity Tier 1 Capital;

- (h) the instruments take the first and proportionately greatest share of any losses as they occur.⁶ Within Common Equity Tier 1 Capital, each instrument absorbs losses proportionately, and *pari passu*, with all the other instruments included in Common Equity Tier 1 Capital;
- (i) only the paid-up amount of the instrument, irrevocably received by the issuer, is recognised as equity capital (i.e. it is not recognised as a liability) for determining balance sheet insolvency;
- (j) the paid-up amount of the instrument is classified as equity under relevant accounting standards⁷;
- (k) the instrument is directly issued by the issuer, and, except where otherwise permitted in this Prudential Standard, the issuer, any other member of a group to which the issuer belongs, or any 'related entity'⁸, cannot have purchased or directly or indirectly funded⁹ the purchase of the instrument, or be funding the instrument;
- (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 the issuer or a related entity, or subject to any other arrangement that legally or economically enhances the seniority of the claim. The instrument may not be subject to netting or offset claims on behalf of the holder or the issuer of the instrument;
- (m) the instrument is only issued with the approval of the owners of the issuer, either given directly by the owners or, if permitted by applicable law, given by the **Board** or by other persons duly authorised by the owners; and
- (n) the instrument is clearly and separately disclosed on the issuer's financial statements and in any consolidated financial statements. Disclosure must be in line with the frequency with which a regulated institution, or group of which it is a member, publishes its financial results.

2. Where issue documentation, marketing of an instrument, or any ongoing dealings with investors in the instrument, suggest the instrument has attributes not consistent with the eligibility requirements in this Attachment, the

⁶ In cases where capital instruments have a permanent write-off feature, this criterion is still deemed to be met by ordinary shares.

⁷ For Level 2 insurance groups, these must be Australian Accounting Standards.

⁸ ~~A reference to 'related entity', which is a subset of a related party, in this Prudential Standard is one over which the regulated institution or its parent exercises control or significant influence and includes a parent company, a sister company, a subsidiary or any other affiliate. A holding company is a related entity irrespective of whether it forms part of a Level 2 insurance group or wider corporate group. This does not preclude the parent entity of the Level 2 insurance group from holding the instrument where the instrument is directly issued by an entity within the group to the parent entity.~~

⁹ Indirect exposures represent exposures that will result in a loss to the regulated institution substantially equivalent to any loss in the direct holding.

instrument will be ineligible to be included in the regulated institution's Common Equity Tier 1 Capital.

3. Where an instrument, whether issued by the regulated institution or another member of the Level 2 insurance group to which the regulated institution belongs is subject to the laws of a foreign jurisdiction~~other than Australia or its territories~~, the regulated institution must also ensure that the instrument satisfies all relevant qualifying criteria for Common Equity Tier 1 Capital under this Attachment and the laws of the foreign country do not override the provisions within the instrument designed to meet these criteria.~~that jurisdiction. APRA may require the regulated institution to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the expense of the regulated institution, confirming that the instrument meets all or any of the criteria applied to Common Equity Tier 1 Capital instruments in this Prudential Standard.~~
4. APRA may require the regulated institution to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the expense of the regulated institution, confirming that the instrument meets all or any criteria applied to Common Equity Tier 1 Capital instruments in this Prudential Standard.
- 2.5. For the purposes of Attachment G to this Prudential Standard, a reference in this Attachment (except in paragraphs 1(b), 1(c), 1(e), 1(g), and 1(h) of this Attachment) to 'paid up ordinary shares' is to be read as a reference to 'paid up mutual equity interests'.

Attachment B

Regulatory adjustments

General rules for regulatory adjustments

1. In determining the size of regulatory adjustments (i.e. deductions) from a category of a regulated institution's capital base, items must be valued on the same basis as a regulated institution's accounts prepared in accordance with the *Financial Sector (Collection of Data) Act 2001*.
2. For the purposes of ~~regulatory adjustments~~deductions to Additional Tier 1 Capital and Tier 2 Capital:
 - (a) where the amount of Additional Tier 1 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Common Equity Tier 1 Capital; and
 - (b) where the amount of Tier 2 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Additional Tier 1 Capital and, if Additional Tier 1 Capital is insufficient to cover the amount of the deductions required, the remaining amount must be deducted from Common Equity Tier 1 Capital.
3. Where a capital instrument is required to be deducted and it is not possible to determine whether it should be deducted from Common Equity Tier 1 Capital, Additional Tier 1 Capital or Tier 2 Capital, the ~~regulatory adjustment~~deduction must be made from Common Equity Tier 1 Capital. A regulated institution must consult APRA if there is uncertainty about the category of capital against which a deduction must be made.
4. For the purposes of deducting from the relevant category of the capital base, a regulated institution may net any provisions held against the relevant exposures or holdings, or the relevant non-defaulted exposures or holdings that represent identified losses, before making the necessary deductions from the relevant categories of capital.
5. A regulated institution must not recognise, for the purpose of measuring its capital adequacy, any transactions (or dealings) which have the aim of offsetting required deductions.

Holdings of own capital instruments

- ~~3.6.~~ Unless otherwise indicated, a regulated institution must deduct from the corresponding category of capital holdings of the regulated institution's own capital instruments, whether held directly or indirectly¹⁰, unless otherwise

¹⁰ Indirect exposures represent exposures that will result in a loss to the regulated institution substantially equivalent to any loss in the direct holding.

exempted in writing by APRA or unless eliminated under Australian Accounting Standards from the relevant category of capital. This deduction must include any capital instruments that the regulated institution could be contractually obliged to purchase and also all of the unused portion of any limit agreed with APRA under paragraph 25 of this Prudential Standard.

- ~~4. For the purposes of deducting holdings of Additional Tier 1 Capital and Tier 2 Capital instruments, a regulated institution may net any specific provisions raised against the relevant exposures or holdings before making the necessary deductions from the relevant categories of capital.~~

Regulatory adjustments to Common Equity Tier 1 Capital

- ~~7. A regulated institution must adjust their Common Equity Tier 1 Capital to allow for the effects of 'accounts receivables' and 'accounts payables' on the AASB 17 insurance and reinsurance contract liability (net of insurance and reinsurance contract assets and net of tax effects). 'Accounts receivables' are added to CET1 capital and 'accounts payables' are deducted from CET1 capital.~~

- ~~5.8. Additionally, aA regulated institution must make the following deductions regulatory adjustments to determine Common Equity Tier 1 Capital.~~

Cash flow hedge reserve

- ~~6. A regulated institution must eliminate 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).¹¹~~

~~9.~~

Deferred tax assets and deferred tax liabilities

Subject to paragraphs 11, 12 and 13 of this Attachment, a regulated institution must deduct deferred tax assets net of deferred tax liabilities.¹² The netting of these items must be on a consistent basis. Where deferred tax liabilities exceed deferred tax assets, the excess of deferred tax liabilities must not be added to Common Equity Tier 1 Capital (i.e. the net deduction is zero). Deferred tax assets and liabilities include any tax effects that would result from the accounts receivables and accounts payables adjustment outlined in paragraph 7 of this Attachment and the technical provisions in surplus or deficit of GPS 340 liabilities outlined in paragraph 30(f) of this Prudential Standard.

~~10.~~

¹¹ Any gains on hedges are to be deducted and any losses on hedges added back to Common Equity Tier 1 Capital.

¹² Excluding any deferred tax liabilities which have already been netted off elsewhere in accordance with this Prudential Standard.

11. The netting of deferred tax assets and deferred tax liabilities must only be applied where the regulated institution has a legally enforceable right to set-off current tax assets against current tax liabilities where they relate to income taxes levied by the same taxation authority and the taxation authority permits the regulated institution to make or receive a single net payment.

12. The deferred tax liabilities and deferred tax assets that may be netted must exclude amounts that have been used to adjust:

(a) goodwill and intangible assets; and

(a)(b) defined benefit superannuation assets.

7.13. In order to apply the treatment in paragraph 8-10 of this Attachment, a regulated institution must:

(a) have procedures in place to monitor changes in relevant laws and taxation practices that may affect the written opinions it is required to obtain covering netting of deferred tax assets and deferred tax liabilities; and

(b) ensure that the written opinions are updated in the event of changes in laws or taxation practices overseas that could materially impact on overseas taxation authorities continuing to allow netting of deferred tax assets and deferred tax liabilities.

~~Fair value~~ Gains and losses arising from changes in own creditworthiness

8.14. A regulated institution must eliminate all unrealised gains and losses that have resulted from changes in the ~~fair~~-value of liabilities (including capital instruments) and any associated embedded derivatives,⁺³ due to changes in the regulated institution's own creditworthiness. Additional Tier 1 and Tier 2 capital instruments must continue to be measured for capital adequacy purposes at their contractual values. Additional Tier 1 Capital and Tier 2 Capital instruments can be hedged in accordance with accounting standards.

Goodwill and other intangibles

9.15. Subject to paragraph 17 of this Attachment, a regulated institution must deduct the following ~~items~~⁺⁴, net of any associated deferred tax assets and deferred tax liabilities ~~liability~~ that would be extinguished if the assets involved become impaired or derecognised under Australian Accounting Standards:

⁺³ ~~Additional Tier 1 Capital and Tier 2 Capital instruments must continue to be measured for capital adequacy purposes at their contractual values. Additional Tier 1 Capital and Tier 2 Capital instruments may be hedged in accordance with accounting standards.~~

⁺⁴ ~~For the avoidance of doubt, this deduction, subject to paragraph 13 of this Attachment, must include goodwill and intangibles attributable to investments in subsidiaries, joint ventures and associates.~~

- (a) goodwill and any other intangible assets¹⁵ arising from an acquisition, net of adjustments to profit or loss reflecting any changes arising from 'impairment' of goodwill; and
- (b) other intangible assets net of adjustments to profit or loss reflecting amortisation and impairment. Intangible assets are as defined in Australian Accounting Standards and include capitalised expenses and capitalised transaction costs. These ~~expenses~~ include, but are not limited to:
 - (i) costs associated with debt raisings and other similar transaction-related costs that are capitalised as an asset;
 - (ii) costs associated with issuing capital instruments if not already charged to profit and loss;
 - (iii) capitalised information technology software costs; and
 - (iv) other capitalised expenses including capitalised expenses of a general nature such as strategic business development initiatives. These include, in addition to the above listed items, other forms of transaction costs and like costs that are required to be deferred/capitalised and amortised as part of the measurement of assets and liabilities under Australian Accounting Standards.

16. The balance of any transaction costs and like items that are capitalised and deferred as an asset must be netted off against the balance of any income deferred as a liability relating to the products giving rise to the capitalised transaction costs (i.e. only deferred costs and income in particular product portfolios may be netted). Any net balance of capitalised transaction costs must be deducted from Common Equity Tier 1 Capital in accordance with this Prudential Standard. Any surplus of fee income received over deferred costs may be included in Common Equity Tier 1 Capital provided the fee income received satisfies the criteria in paragraph 33 of this Prudential Standard. Otherwise, up-front fee income received must not be added to capital.

~~10.~~

~~11.~~17. An investment in a subsidiary, joint venture¹⁶ or **associate** that:

- (a) is operationally independent;
- (b) represents a genuine arm's-length investment;
- (c) is not subject to prudential capital requirements; and

¹⁵ Includes goodwill and intangibles attributable to investments in subsidiaries, joint ventures and associates. For the purposes of this Prudential Standard, a joint operation~~†~~ (as defined under Australian Accounting Standard AASB 11 Joint Arrangements) is to be treated as a joint venture.

¹⁶ ~~For the purposes of this Prudential Standard, a joint operation as defined under Australian Accounting Standard AASB 11 Joint Arrangements is to be treated as a joint venture.~~

- (d) does not undertake **insurance business** or business related to insurance business¹⁷

does not have its intangible assets (including the intangible component that could arise after or outside of acquisition) deducted under paragraph 15 of this Attachment.

Superannuation funds

~~12.18.~~ A regulated institution must deduct any surplus in a defined benefit superannuation fund, of which the regulated institution is an employer-sponsor, unless otherwise approved in writing by APRA. The surplus must be net of any associated deferred tax liability that would be extinguished if the assets involved become impaired or derecognised under Australian Accounting Standards. A regulated institution may apply to APRA to include a surplus as an asset for capital adequacy purposes where the regulated institution is able to demonstrate unrestricted and unfettered access to a fund surplus in a timely manner. Subject to APRA approval, the regulated institution may include the surplus in its capital base. This surplus will no longer be required to be deducted from Common Equity Tier 1 Capital.

~~13.19.~~ A regulated institution must deduct any deficit in a defined benefit superannuation fund of which the regulated institution is an employer-sponsor and that is not already reflected in Common Equity Tier 1 Capital.

Reinsurance assets

~~14.20.~~ A regulated institution must deduct all reinsurance assets¹⁸ reported in relation to each reinsurance arrangement that does not meet the reinsurance documentation test in *Prudential Standard GPS 230 Reinsurance Management* (GPS 230).

~~15.21.~~ A regulated institution must deduct all reinsurance assets reported in relation to each reinsurance contract entered into by the regulated institution inception on or after 31 December 2008 that does not meet the governing law requirements in GPS 230.

Investments in subsidiaries, joint ventures and associates

~~16.22.~~ A regulated institution must make a deduction for investments in subsidiaries, joint ventures and associates that are subject to regulatory capital requirements. The amount of the deduction is the lesser of the regulated institution's share of the regulatory capital requirements¹⁹ and the value of the investment that is

¹⁷ Entities that undertake business related to insurance business include entities that provide a financing role to insurance business, insurance intermediaries and service companies.

¹⁸ For the purposes of this Prudential Standard, 'reinsurance assets' refers to reinsurance assets as defined in GPS 001, net of doubtful debts.

¹⁹ The regulated institution's share of the regulatory capital requirements is determined by applying the ownership percentage of the subsidiary, joint venture or associate (as relevant) to the total regulatory capital requirement of the investment.

recorded on the regulated institution's balance sheet after adjustment for any intangible component in accordance with paragraphs 15 and 17 of this Attachment. This deduction must be applied after any deduction for intangibles in the investment in accordance with paragraphs 15 and 17 of this Attachment.

~~17.23.~~ For the purposes of the deduction in paragraph 22 of this Attachment, the regulatory capital requirement of the investment is:

- (a) the prescribed capital amount if the investment is in an insurer as defined under the Act; or
- (b) the equivalent amount to the prescribed capital amount if the investment is an entity carrying on insurance business in a foreign jurisdiction; or
- (c) a comparable regulatory capital requirement as agreed with APRA.²⁰

Unless agreed otherwise with APRA, the regulatory capital requirement must be the amount determined at the **reporting date** or within a period of three months prior to the reporting date.

~~18.24.~~ If the investment subject to the deduction in paragraph 22 of this Attachment is a **non-operating holding company** (NOHC), the regulated institution must 'look-through' the investment to the value and regulatory capital requirements of the entity/entities owned by the NOHC.

Assets under a fixed or floating charge

~~19.25.~~ Subject to paragraph 26 of this Attachment, a regulated institution must deduct all assets of the regulated institution that are under a fixed or floating charge²¹, mortgage or other security to the extent of the indebtedness secured on those assets. This deduction may be reduced by the amount of any liability for the charge that is recognised on the regulated institution's balance sheet.

~~20.26.~~ Where the security referred to in paragraph 25 of this Attachment exclusively supports a regulated institution's insurance liabilities, the deduction only applies to the amount by which the fair value of the charged assets exceeds the regulated institution's supported insurance liabilities. These insurance liabilities are to be valued in accordance with GPS 340.

Fair value adjustments

27. A regulated institution must deduct the difference between fair value and the reported value of each asset. This deduction can be a negative amount (that is, an addition to Common Equity Tier 1 Capital) if fair value exceeds reported value. any amount required by APRA in writing where APRA considers that fair values on the balance sheet are not prudent or reliable.

²⁰ Examples of the entities that are subject to a comparable regulatory capital requirement are authorised deposit-taking institutions, life companies and health insurers.

²¹ Charge as defined in the Act.

28. A regulated institution may measure its non-financial assets, short-term receivables, and intercompany receivables and payables using the requirements in Australian Accounting Standards for fair value.

~~21.~~29. A regulated institution must make any other deduction required by APRA in writing where APRA considers that fair values are not prudent or reliable.

Other adjustments

30. A regulated institution must make any other deductions required under any other Prudential Standard.

Attachment C

Criteria for inclusion in Additional Tier 1 Capital

1. To ~~qualify be classified~~ Additional Tier 1 Capital, an instrument must satisfy ~~the following minimum criteria~~ all the criteria in this Attachment.
2. The instrument must be paid-up and the amount must be irrevocably received by the issuer.
- ~~2. The instrument represents, prior to any conversion to Common Equity Tier 1 Capital (refer to Attachment ~~GE~~), the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 Capital instruments²². Where an issuer is a holding company, any claim in relation to the instrument must be subordinate to the claims of general creditors of the holding company.~~
3.
- ~~3. The paid-up amount of the instrument, or any future payments related to the instrument, is neither secured nor covered by a guarantee of the issuer or related entity, or other arrangement that legally or economically enhances the seniority of the holder's claim.²³ The instrument may not be secured or otherwise subject to netting or offset claims on behalf of the holder or the issuer of the instrument.~~
4.
- ~~4. The principal amount of the instrument is perpetual (i.e. it has no maturity date).²⁴~~
5.
- ~~5. The instrument contains no step-ups or other incentives to redeem. The issuer and any other member of a group to which the issuer belongs must not create an expectation at issuance that the instrument will be bought back, redeemed or cancelled. The contractual terms of the instrument must not provide any feature that might give rise to such an expectation.²⁵~~
6.

²² ~~Where an issuer is a holding company, the subordination applicable must apply to all general creditors of the holding company.~~

²³ ~~This would preclude any provision of support (including contribution of reserves) to any SPV used to issue capital instruments that form part of a regulated institution's issue of Additional Tier 1 and Tier 2 Capital instruments.~~

²⁴ An instrument may be treated as perpetual if it will mandatorily convert to ordinary shares at a pre-defined date after 5 years from issue. Instruments with maturity dates and automatic roll-over features do not qualify as perpetual instruments.

²⁵ Conversion from a fixed rate to a floating rate (or vice versa) in combination with a call option without any increase in the credit spread is not considered an incentive to redeem. However, the regulated institution must not otherwise do anything to create an expectation that the call will be exercised.

~~6.7.~~ The instrument may only be callable at the initiative of the issuer and only after a minimum of five years from the date on which the issuer irrevocably receives the proceeds of payment for the instrument. The issuer:

- (a) must receive prior written approval from APRA to exercise a call option;
~~For instruments issued by subsidiaries not regulated by APRA included in a Level 2 insurance group, prior written approval from APRA must also be obtained;~~
- (b) must not do anything that creates an expectation that a call will be exercised; and
- (c) must not exercise a call unless:
 - (i) the issuer, prior to or concurrent with the exercise of the call, replaces the instrument with a capital instrument of the same or better quality, and the replacement of the instrument is done under conditions that are sustainable for the income capacity of the issuer; or
 - (ii) the regulated institution meets the requirements relating to reductions in capital in GPS 110.

~~7.8. An~~ The instrument may provide for multiple call dates after five years. However, the specification of multiple call dates must not act to create an expectation that the instrument will be redeemed upon any call date;

~~8. issuers must not assume, or create market expectations, that supervisory approval will be forthcoming for the issuer to redeem, call or purchase an instrument;~~

~~9. a~~ An issuer must:

~~9.~~

- (a) have full discretion at all times to cancel distributions/payments on the instrument.²⁶ Any waived distributions are non-cumulative (i.e. are not required to be made up by the issuer at a later date, or are otherwise not made up by the issuer). The instrument must not provide for payment of a higher dividend or interest rate if dividend or interest payments are not made on time, or a reduced dividend or interest rate if such payments are made on time;
- (b) ensure that cancellation of discretionary distributions/payments is not an event of default. Holders of the instruments must have no right to apply for the winding-up or administration of the issuer, or cause a receiver, or

²⁶ An instrument may not provide for investors upon non-payment of a distribution to convert an Additional Tier 1 Capital instrument, and the amount of any unpaid dividend or interest, into ordinary shares or mutual equity interests.

receiver and manager, to be appointed in respect of the issuer on the grounds that the issuer fails to make, or is or may become unable to make, a distribution on the instruments;

(c) have full access to cancelled distributions/payments to meet obligations as they fall due; and

(d) ensure that cancellation of distributions/payments do not impose restrictions on the issuer, or any other member of the group to which the issuer belongs, except in relation to distributions/payments or redemptions/buybacks on Common Equity Tier 1 Capital instruments.

~~10. have full discretion at all times to cancel distributions/payments on the instrument. Any waived distributions are non-cumulative (i.e. are not required to be made up by the issuer at a later date). The instrument must not provide for payment of a higher dividend or interest rate if dividend or interest payments are not made on time, or a reduced dividend or interest rate if such payments are made on time;~~

~~11. ensure that cancellation of discretionary distributions/payments is not an event of default. Holders of the instruments must have no right to apply for the winding-up or administration of the issuer, or cause a receiver, or receiver and manager, to be appointed in respect of the issuer on the grounds that the issuer fails to make, or is or may become unable to make, a distribution on the instruments;~~

~~12. have full access to cancelled distributions/payments to meet obligations as they fall due; and~~

~~13. ensure that cancellation of distributions/payments do not impose restrictions on the issuer, or any other member of the group to which the issuer belongs, except in relation to distributions/payments or redemptions/buybacks on Common Equity Tier 1 Capital instruments;~~

~~14. d~~Distributions on the instrument are paid out of distributable items of the issuer, and the instrument must not provide for payments to investors other than in the form of a cash payment. The level of distributions must not be tied or linked to the credit standing of the issuer.;

10.

~~15.~~11. The instrument cannot have a credit sensitive distribution/payment feature (i.e. a distribution/payment that is reset based in whole or part on the credit standing of the issuer or the group or any other member of the group to which it belongs). AHowever, an instrument may utilise a broad index as a reference rate for distribution or payments calculation purposes. Where an issuer is a reference entity in the determination of the reference rate, the reference rate must not exhibit any significant correlation with the issuer's credit standing. APRA ~~will~~may require a regulated institution to exclude~~not allow inclusion of~~ an instrument from as part of Additional Tier 1 Capital where

it considers that the reference rate is sensitive to the credit standing of the issuer.²⁷;

- ~~16. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of any national insolvency law applying in the jurisdiction of issue. In such cases, the issue documentation must specify that the insolvency law that applies is the law of the place of incorporation of the issuer.²⁷;~~

~~12.~~

- ~~17.13.~~ The instrument is directly issued by the issuer, and, except where otherwise permitted in this Prudential Standard, the issuer, any other member of a group to which the issuer belongs, or any related entity²⁸ cannot have purchased or directly or indirectly²⁹ funded the purchase of the instrument.²⁷;

- ~~18. the instrument has no features that hinder recapitalisation of the issuer, or any other members of the group to which the issuer belongs. This includes features that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified timeframe;~~

- ~~19. Where the terms of the instrument provide the ability (even in contingent circumstances) to substitute the issuer of the Additional Tier 1 Capital instruments, or the issuer of ordinary shares into which they convert (i.e. to replace the regulated institution with another party), the relevant documentation must set out the mechanism to ensure that there will be a simultaneous capital injection into the regulated institution to replace the transferred capital instrument. The Any replacement capital injection must occur at least simultaneously with the substitution and must be unconditional. The capital injection must be of equal or better quality capital and at least the same amount as the original issue, unless otherwise approved by APRA in writing;~~

~~14.~~

- ~~20. the instrument does not contain any terms, covenants or restrictions that could inhibit the issuer's ability to be managed in a sound and prudent manner, particularly in times of financial difficulty, or restrict APRA's ability to resolve any problems encountered by the issuer;~~

²⁷ ~~If an overseas branch of a regulated institution issues in a foreign jurisdiction where insolvency law is different from the jurisdiction where the parent entity is based, issue documentation must specify that the insolvency law in the parent's jurisdiction will apply. This includes where the issue is made in a different jurisdiction.~~

²⁸ ~~This does not preclude a parent entity of the regulated institution from holding the instrument where the instrument is directly issued by the regulated institution to the parent.~~

²⁹ ~~Indirect exposures represent exposures that will result in a loss to the regulated institution substantially equivalent to any loss in the direct holding.~~

~~21. The rate of dividend or interest on the instrument, or the formulae for calculating dividend or interest payments, must be predetermined and set out in the issue documentation.~~³⁰

~~15.~~

~~22. where an issue of an instrument involves the use of an SPV, the issue of the instrument is subject to Attachment F;~~

~~23. The instrument includes provisions addressing which comply with the loss absorption requirements at the point of non-viability as required by Attachment GE to this Prudential Standard.~~

~~16.~~

~~17. The instrument is clearly and separately disclosed in the issuer's financial statements and, for a Level 2 insurance group, in any consolidated financial statements.~~³⁰ ~~and~~

~~18. The instrument must not include the following clauses:~~

~~(a) a cross-default clause linking the issuer's obligations under any debt instrument or other capital instrument to default by the issuer, or default by another party (related or otherwise), under the instrument itself; or~~

~~(b) an event of default clause specifying an event relating to any debt instrument or other capital instrument of the issuer, that brings the issuer into default under the instrument itself.~~

~~For the purposes of paragraph 18(b) an event of default clause includes a clause specifying the following events:~~

~~(i) the exercise or non-exercise of discretions within the debt instrument or other capital instrument;~~

~~(ii) the adverse event or change, however so described or determined, occurring in respect of the debt instrument or other capital instrument; and~~

~~(iii) any consequence arising from, or any action taken or intended to prevent³⁰, the above events or default by the issuer under the debt instrument or other capital instrument,~~

~~but does not include a clause specifying the irrevocable winding-up (that is, either by way of an effective resolution by shareholders or members for winding-up, or a court order has been made and the time for the appeal of the decision has passed) of the issuer.~~

³⁰ For example, by way of a scheme of arrangement.

~~24.19.~~ The issue documentation must clearly and prominently state indicates:

(a) the instrument is perpetual;

~~(a) —~~

~~(b) —~~

(b) the instrument is unsecured;

(c) the subordinated nature of the instrument and that neither the issuer nor the holder of the instrument is allowed to exercise any contractual rights of set-off;

(d) the instrument is not subject to netting;

~~(e) — the issuer cannot buy back, repurchase or redeem the instrument other than in terms permitted under this Prudential Standard; and~~

~~(e) —~~

(f) if relevant, the application of requirements for loss absorption at the point of non-viability under Attachment ~~GE~~ to this Prudential Standard; and

(g) the instrument is neither covered by the Financial Claims Scheme nor guaranteed by the Australian Government; and

~~(d)(h) where the issuer has full discretion over the timing and amount of any distributions paid on the instrument, including not paying a distribution.;~~

20. For the purposes of In accordance with paragraph 9 of this Attachment, failure to make a distribution or payment must not trigger any restrictions³¹ on the issuer other than its ability to pay a distribution on Common Equity Tier 1 Capital instruments³² or to redeem such instruments. Such ‘stopper’ provisions must not:

(a) impede the full discretion of the issuer at all times to cancel distributions/payments on the instrument or act in a way that could hinder the recapitalisation of the issuer;

(b) prevent payment on another instrument where such payment was not fully discretionary;

³¹ No restrictions on payment of distributions, or any restrictions on redemptions or buyback of Common Equity Tier 1 Capital instruments may be applied to: i) any existing holding company of the issuer or ii) any potential future holding company of the issuer, where the holding company does not undertake the role of the issuer of the instrument. This includes situations where a future holding company may be substituted as the issuer of ordinary shares on conversion, but not substituted as the issuer of the instrument.

³² —Any reference to Common Equity Tier 1 Capital instruments in this paragraph includes a reference to mutual equity interests issued in accordance with Attachment G.

- (c) prevent distribution to holders of Common Equity Tier 1 Capital instruments for a period that extends beyond the point in time the distributions/payments on the Additional Tier 1 Capital instruments are resumed; ~~or~~

(d) impede the normal operation of the issuer or any restructuring activity (including acquisitions or disposals); ~~or~~

~~(d)~~(e) hinder any recapitalisation of the issuer.

A ‘stopper’ provision may, however, act to prohibit actions that are equivalent to payment of dividend or interest, such as a regulated institution undertaking discretionary buybacks of ordinary shares.

21. An instrument must not include any provision that permits an additional optional distribution or payment to be made. Any structuring of a distribution or payment as a bonus payment, or any arrangement to ~~make-up~~compensate for unpaid distributions or payments is also prohibited. An instrument cannot provide for investors to convert an instrument into ordinary shares or mutual equity instruments upon non-payment of a distribution.
22. For the purposes of paragraph 6 of this Attachment, an incentive or expectation to call or otherwise redeem an Additional Tier 1 Capital instrument includes, but is not limited to:
 - (a) a call option combined with a requirement, or an investor option, to convert the instrument into ordinary shares if the call is not exercised; ~~or~~
 - (b) a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate less the swap rate (i.e. the fixed rate paid to the call date to receive the second reference rate);
 - (c) a call option combined with an increase in redemption amount in the future;
 - (d) automatic redemption or an option to redeem following a change of control event;
 - (e) mandatory conversion within the first five years of issue, except conversions arising from change of control, regulatory or tax events;
 - (f) any arrangement whereby an investor will become subject to: (i) known tax or charges, or to (ii) known higher tax or charges than they would have had to pay before, following a call date and the issuer is required to compensate an investor for any payment of the additional tax or charges (refer to paragraph 26 of this Attachment); and
 - ~~(b)~~(g) application of maximum or minimum rates on distributions.
23. A call option and a provision to convert into ordinary shares will not constitute an incentive to redeem provided there is at least two years from the date upon

which the regulated institution may have an option to call the instrument to the nearest subsequent date upon which that conversion option may be exercised.

24. Calling an instrument and replacing it with an instrument with a higher credit spread or that is otherwise more expensive ~~may~~ is deemed to create the expectation that the issuer will exercise a call option on other outstanding Additional Tier 1 Capital instruments or Tier 2 Capital instruments with call options, unless the issuer can satisfy APRA as to the economic and prudential rationale and that such an action will not create an expectation that other instruments will be called in similar circumstances.

25. An instrument must provide for the immediate, automatic and permanent revocation of a call notice upon a non-viability event. A call option cannot be exercised in anticipation of a non-viability event.

26. An instrument may only provide for a call within the first five years of issuance as a result of a tax or regulatory event. A tax or regulatory event is confined to:

- a) changes in statute and regulations (and judicial and administrative actions pertaining to the application of a statute or regulations) which impact a specific capital instrument;
- b) changes related only to the jurisdictions relevant to an instrument;
- c) changes that have occurred, or will occur, as opposed to changes that may occur; and
- d) changes which impact the issuer of an affected capital instrument. Changes in tax or regulation impacting the holder of a capital instrument will not constitute a tax or regulatory event for the purposes of this Attachment.

25.27. APRA may require a regulated institution not to exercise a call where it relates to a tax or regulatory event if APRA ~~will not permit such a call if it~~ forms the view that the regulated institution was in a position to anticipate the tax or regulatory event when the instrument was issued. In order for a call to be exercised the issuer must comply with the provisions in paragraph 7 of this Attachment.

26.28. Where an Additional Tier 1 Capital instrument provides for conversion into ordinary shares³³, the issue documentation must:

- (a) specify the number of ordinary shares to be received upon conversion, or specify the conversion formula for determining the number of ordinary shares received;

³³ Conversion must be into the ordinary shares of the insurer or its parent ~~entity~~, which must be listed at the time of issue. For an unlisted insurer with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into the unlisted ordinary shares of the insurer. Where an unlisted insurer issues the instrument to its listed parent ~~entity~~, conversion may be into unlisted ordinary shares of the insurer.

- (b) provide for the number of ordinary shares to be received under the conversion formula specified in (a) of this paragraph ~~to be fixed to be capable of being ascertained immediately and objectively; and~~
 - (c) set the maximum number of ordinary shares received so as not to exceed the price of the Additional Tier 1 Capital instrument at the time of its issue divided by 20 per cent of the regulated institution's³⁴ ordinary share price³⁵ at the same time. However, this cap does not apply if the only holder of the converting capital instrument is a listed parent which wholly-owns the issuer of the capital instruments. In calculating the ordinary share price at time of issue, adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations. In calculating the ordinary share price at the time of issue, adjustments may only be made for transactions that change the number of shares on issue without involving an exchange of value and which have no impact on capital.³⁶ Adjustments must exclude transactions involving cash payments or other compensation to, or by, holders of the ordinary shares or the issuer of the capital instrument. The method of calculation of adjustments must be fixed in issue documentation and adjustments must be capable of being ascertained immediately and objectively; and
 - (d) where a capital instrument is denominated in foreign currency, provide a clear method for determining: (i) the exchange rate to be used in calculating the number of ordinary shares to be issued upon conversion (e.g. the prevailing exchange rate); and (ii) the exchange rate to be used in calculating the maximum number of ordinary shares which could be issued on conversion (issue date exchange rate). Documentation must include how exchange rates would be determined, if at a time of conversion, foreign exchange markets were to be closed at the intended time of conversion.
29. For mutually owned regulated institutions, where an Additional Tier 1 Capital instrument provides for conversion into mutual equity interests, the issue documentation must:
- (a) Specify the number of mutual equity interests to be received upon conversion, or specify the conversion formula for determining the number of mutual equity interests received;
 - (b) Provide for the number of mutual equity interests to be received under the formula specified in (a) of this paragraph to be capable of being ascertained immediately and objectively; and
 - (a)(c) Set the maximum number of mutual equity interests received such that the aggregate nominal value of the interests received cannot exceed, at the

³⁴ Reference to regulated institution captures any entity whose ordinary shares are issued as a result of conversion provisions.

³⁵ For an unlisted regulated institution that has no listed parent ~~entity~~ at the time of issue, the ordinary share price is based on the book value per share at the time of issue.

³⁶ This may include subsequent ordinary share splits, bonus issues and share consolidations.

date of conversion, the nominal value of the Additional Tier 1 Capital instrument converted.

30. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the regulated institution under Australian Accounting Standards.
31. In issuing Additional Tier 1 Capital instruments a regulated institution may, within the category of Additional Tier 1 Capital:
- (a) differentiate between instruments as to whether an instrument is required to convert or be written-off in the first instance;
 - (b) provide for a ranking under which Additional Tier 1 Capital instruments will be converted or written off; and
 - (c) where conversion or write-off of capital instruments is required at Level 2, the Level 2 insurance group may provide for a ranking under which Additional Tier 1 Capital instruments issued by individual members of the group may need to be converted or written off. This would be subject to any requirements for conversion or write-off of Additional Tier 1 Capital instruments required to be undertaken on a Level 1 basis.
32. Where an Additional Tier 1 Capital instrument provides for a write-off mechanism, this mechanism must be structured so that:
- (a) the claim of the holder of the instrument on liquidation of the issuer is reduced to, or below, the value of the written-off instrument;
 - (b) the amount of the instrument that may be paid if a call is exercised is irrevocably reduced to the value of the instrument after write-off;
 - (c) there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the regulated institution; and
 - (a)(d) the distribution or payments payable on the instrument must be permanently reduced (i.e. distributions or payments must be calculated at no more than the rate set for the written-off value of the instrument).
- 27.33. The instrument must not include a mechanism that would require a holder to sell the instrument to the issuer or a related entity of the issuer other than as part of a call option or redemption of the instrument. A mechanism that requires a holder to sell the instrument to a nominated party other than the issuer or a related entity of the issuer will not constitute an incentive to redeem provided there is at least two years from the date upon which the holder is required to sell the instrument to the nearest subsequent date upon which conversion may be exercised.
- 28.34. Where an instrument is drawn down in a series of tranches, it must meet the requirements in this Prudential Standard as if each tranche is a separate Additional Tier 1 Capital instrument in its own right.

~~35. There must be no cross-default clauses in the~~ The documentation of any debt instrument or other capital instrument of the issuer of an Additional Tier 1 Capital instrument must not include any of the following clauses: linking the issuer's obligations under the instrument to default by the issuer under any of its other obligations, or default by another party, related or otherwise.

(a) a cross-default clause linking the issuer's obligations under the Additional Tier 1 Capital instrument to default by the issuer under any of its other obligations, or default by another party (related or otherwise) under the debt or other capital instrument; or

(b) an event of default clause specifying an event relating to the Additional Tier 1 Capital instrument that brings the issuer into default under the debt or other capital instrument.

~~36. For the purposes of paragraph 35(b) of this Attachment, an event of default clause includes a clause specifying the following events:~~

(a) the exercise or non-exercise of discretions within the Additional Tier 1 Capital instrument;

(b) an adverse event or change, however so described or determined, occurring in respect of the Additional Tier 1 Capital instrument; and

(c) any consequence arising from, or any action taken to prevent³⁷, the above events or a default by the issuer under the Additional Tier 1 Capital instrument,

but does not include a clause specifying the irrevocable winding-up (that is, either by or an effective resolution by shareholders or members for winding-up, or a court order has been made, and the time for the appeal of the decision has passed) of the issuer.

~~29.37. The instrument must be marketed in accordance with its prudential treatment and must not include any 'repackaging' arrangements that have the effect of compromising the quality of the capital raised. Where issue If a prospectus or other offer documentation, or marketing of anthe instrument, or any ongoing dealings with investors in the instrument, could be reasonably held to suggest to investors that the instrument has attributes not consistent with the eligibility requirements in this Attachment, of a lower level of capital than claimed by the issuer (or its corporate group) for prudential purposes, the instrument will be ineligible to be included in the regulated institution's Additional Tier 1 Capital.~~

~~30.38. The instrument, whether issued by the regulated institution or another member of the Level 2 insurance group to which the regulated institution belongs (including overseas subsidiaries) may be subject to the laws of a foreign country jurisdiction other than Australia or its territories, except that the terms and~~

³⁷ For example, by way of a scheme of arrangement.

conditions of the instrument that relate to non-viability conversion or write-off must be subject to the laws of an Australian jurisdiction.

~~31.39.~~ Where the instrument, whether issued by the regulated institution or another member of the Level 2 insurance group to which the regulated institution belongs (including overseas subsidiaries) is subject to the laws of a foreign country jurisdiction other than Australia or its territories, the regulated institution must also ensure that the instrument satisfies all relevant qualifying eligibility criteria applicable to the instrument under this Attachment are enforceable for Additional Tier 1 Capital under the laws of that jurisdiction.

~~32.40.~~ APRA may require the regulated institution to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the regulated institution's expense, confirming that the instrument meets satisfies all applicable criteria for an Additional Tier 1 Capital instrument under this Prudential Standard~~the requirements in paragraphs 14 and 15 of this Attachment.~~

~~Attachment D~~

~~Additional Tier 1 Capital: Stapled security structure~~

~~A stapled security structure consisting of the issue of a preference share and a stapled instrument of another form may be included in Additional Tier 1 Capital, subject to satisfying the following additional minimum criteria:~~

~~the preference share is issued directly by a regulated institution and is 'stapled' to securities issued directly by an overseas branch of the regulated institution. The stapled structure must not involve use of SPVs and must be simple and transparent;~~

~~at least one of the preference share and the security to which it is stapled must be fully paid-up. Any partly paid preference share or stapled security is eligible only to the extent that it has been paid-up;~~

~~the preference share and the instrument to which it is stapled must each individually satisfy the criteria in this Prudential Standard for an Additional Tier 1 Capital instrument;~~

~~the terms and conditions of the stapled security must substantially mirror those of the preference share such that the stapled security operates effectively as if it was a preference share;~~

~~the preference share and the instrument to which it is stapled must not be traded separately and are to remain stapled together until an 'unstapling event' occurs;~~

~~'unstapling' at the option of the issuer is permitted. The instrument documentation must clearly stipulate the events that will cause the preference share to be 'unstapled' resulting in the stapled security being extinguished, leaving the holder of the stapled security holding the preference share instead. 'Unstapling' must take place if:~~

~~a non-viability trigger event occurs in accordance with Attachment G;~~

~~proceedings for the liquidation of the regulated institution have commenced;~~

~~APRA issues a recapitalisation direction to the regulated institution in accordance with sub-section 103B(1) of the Act; or~~

~~a judicial manager is appointed to the regulated institution pursuant to sub-section 62L of the Act;~~

~~to reduce the inherent legal risk associated with 'unstapling' of the structure, the issue documentation must ensure the clarity, consistency and certainty with which the contractual terms and conditions are specified, and specifically that:~~

~~all entities involved in the stapled structure have the capacity and power to issue the instruments and perform obligations under them;~~

~~the rights and obligations created by the preference share and the stapled security are legally valid, binding and enforceable on all parties in all jurisdictions where they are issued;~~

~~the stapled security will be extinguished and holders of the stapled security will hold the underlying preference share upon the occurrence of an ‘unstapling event’; and~~

~~the ‘unstapling’ mechanism will take effect as contemplated in the issue documentation even if the regulated institution or another entity has become, or is likely to become, insolvent, including where it is in administration, receivership, winding up or where a judicial manager has been appointed under the Act.~~

~~Where necessary, APRA may require a regulated institution to obtain independent legal opinion confirming the above; and~~

~~adequate internal policies and controls must be in place such that the ‘unstapling’ procedures are correctly followed.~~

~~A preference share and instrument to which it is stapled must be issued by the same issuer but they need not be issued in the same jurisdiction.~~

Attachment **DE****Criteria for inclusion in Tier 2 Capital**

1. ~~To be classified~~ ~~qualify~~ as Tier 2 Capital, an instrument must satisfy all of the criteria in this Attachment ~~the following minimum criteria~~:

1. ~~_____~~

2. ~~The~~ instrument must be paid-up and the amount must be irrevocably received by the issuer.

2. ~~t~~

3. ~~The~~ instrument represents, prior to any conversion to Common Equity Tier 1 Capital (refer to Attachment ~~GE to this Prudential Standard~~), the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 Capital instruments and Additional Tier 1 Capital instruments. Where an issuer is a holding company, any claim in relation to the instrument must be subordinate to the claims of general creditors of the holding company³⁸.

3. ~~_____~~

4. ~~The~~ paid-up amount of the instrument, or any future payments related to the instrument, is neither secured nor covered by a guarantee of the issuer or related entity, or other arrangement that legally or economically enhances the seniority of the claim.³⁹ The instrument may not be secured or otherwise subject to netting or offset of claims on behalf of the holder or the issuer of the instrument.

4. ~~T~~

5. ~~the~~ principal amount of the instrument:

(a) has a minimum maturity of at least five years⁴⁰; and

(b) is only recognised in Tier 2 Capital (and so in the capital base) in the five years prior to maturity on a straight-line amortised basis (refer to paragraph ~~21212 of to~~ this Attachment).

6. ~~The~~ instrument contains no step-ups or other incentives to redeem. The issuer and any other member of a group to which the issuer belongs must not create an expectation at issuance that the instrument will be bought back, redeemed or cancelled before its contractual maturity. The contractual terms of the

³⁸ ~~Where an issuer is a holding company the subordination applicable must apply to all general creditors of the holding company.~~

³⁹ ~~This would preclude any provision of support (including contribution of reserves) to any SPV used to issue capital instruments that form part of the regulated institution's issue of Additional Tier 1 and Tier 2 Capital instruments.~~

⁴⁰ Where an instrument has a defined maturity and provides for a mandatory roll-over the maturity of the instrument is deemed to only extend to the date upon which any roll-over may take effect.

instrument must not provide any feature that might give rise to such an expectation.⁴¹;

6.

7. ~~†~~The instrument may only be callable at the initiative of the issuer and only after a minimum of five years from the date on which the issuer irrevocably receives the proceeds of payment for the instrument. The issuer:

- (a) must receive prior written approval from APRA to exercise a call option-
~~For instruments issued by subsidiaries not regulated by APRA included in a Level 2 insurance group, prior written approval from APRA must also be obtained;~~
- (b) must not do anything that creates an expectation that a call will be exercised; and
- (c) must not exercise a call unless:
 - (i) the issuer, prior to or concurrent with the exercise of the call, replaces the instrument with a capital instrument of the same or better quality, and the replacement of the instrument is done at conditions that are sustainable for the income capacity of the issuer; or
 - (ii) the regulated institution meets the requirements relating to reductions in capital in GPS 110.

8. ~~An~~The instrument may provide for multiple call dates after five years. However, the specification of multiple call dates must not act to create an expectation that the instrument will be redeemed upon any call date.;

~~9. issuers must not assume, or create market expectations, that supervisory approval will be forthcoming for the issuer to redeem, call or purchase an instrument†;~~

~~10.9. †~~The instrument must confer no rights on holders to accelerate the repayment of future scheduled payments (coupon or principal) except in bankruptcy (including wind~~ing~~-up) and liquidation. Wind~~ing~~-up of the regulated institution must be irrevocable (that is, either by way of ~~a court order or~~ an effective resolution by shareholders or members for a wind-up, or a court order has been made, and the time for appeal of the decision has passed). The making of an application ~~for~~ wind~~ing~~-up or the appointment of a receiver, administrator, or official with similar powers, including the exercise of APRA's powers under Part V of the Act, must not be sufficient to accelerate repayment of the instrument.;

⁴¹ Conversion from a fixed rate to a floating rate (or vice versa) in combination with a call option without any increase in the credit spread is not considered an incentive to redeem. However, the regulated institution must not otherwise do anything to create an expectation that the call will be exercised.

~~11.10.~~ ~~†~~The instrument must not provide for payment to investors other than in the form of a cash payment.;

~~12.11.~~ ~~†~~The instrument cannot have a credit sensitive distribution/payment feature (i.e. a distribution/payment that is reset based in whole or part on the credit standing of the issuer or the group or any other member of the group to which it belongs). ~~The~~~~However, an~~ instrument may utilise a broad index as a reference rate for distribution or payments calculation purposes. Where an issuer is a reference entity in the determination of the reference rate, the reference rate must not exhibit any significant correlation with the issuer's credit standing. APRA ~~may require a regulated institution to exclude~~~~will not allow inclusion of~~ an instrument ~~from treatment~~ as ~~part of~~ Tier 2 Capital where APRA ~~it~~ considers that the reference rate is sensitive to the credit standing of the issuer.;

~~13.12.~~ ~~†~~The instrument is directly issued by the issuer, and, except where otherwise permitted in this Prudential Standard, the issuer, any other member of a group to which the issuer belongs, or any other related entity⁴² cannot have purchased or directly or indirectly⁴³ funded the purchase of the ~~instrument~~instrument or be funding the purchase of the instrument.;

~~the instrument has no features that hinder recapitalisation of the issuer, or any other members of the group to which the issuer belongs. This includes features that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified timeframe;~~

~~14.13.~~ ~~where~~If the terms of the instrument provide the ability (even in contingent circumstances) to substitute the issuer of the Tier 2 Capital instruments or the issuer of the ordinary shares into which they may convert (i.e. to replace the regulated institution with another party), the relevant documentation must set out the mechanism to ensure that there will be a ~~simultaneous~~ capital injection into the regulated institution to replace the transferred capital instrument. ~~Any~~ The replacement capital injection must occur at least simultaneously with the substitution and must be unconditional. The capital injection must be of equal or ~~better quality~~better quality capital and at least the same amount as the original issue, unless otherwise approved by APRA ~~in writing~~.;

~~15.~~ ~~the instrument does not contain any terms, covenants or restrictions that could inhibit the issuer's ability to be managed in a sound and prudent manner, particularly in times of financial difficulty, or restrict APRA's ability to resolve any problems encountered by the issuer;~~

~~16.14.~~ ~~†~~The rate of dividend or interest on the instrument, or the formulae for calculating dividend or interest payments, must be predetermined and set out in the issue documentation.;

⁴² This does not preclude a parent of the regulated institution from holding the instrument where the instrument is directly issued by the regulated institution to the parent.

⁴³ Indirect exposures represent exposures that will result in a loss to the regulated institution substantially equivalent to any loss in the direct holding.

~~17.15. where~~ If an issuer defaults under the terms of the instrument, ~~the~~ remedies available to the holders must be limited to actions for specific performance, recovery of amounts currently outstanding or the winding-up of the issuer. The amounts that may be claimed in the event that the issuer defaults may include any accrued unpaid dividends and interest, including payment of market interest on these unpaid amounts. Any claim against the issuer. All such for unpaid dividends and interest must be the most subordinated to the claims in liquidation of the issuer after Common Equity Tier 1 Capital instruments and Additional Tier 1 Capital instruments of policyholders and other creditors of the issuer.;

~~18.16. t~~The instrument must not provide for payment of a higher dividend or interest rate if dividend or interest payments are not made on time, or a reduced dividend or interest rate if such payments are made on time.;

~~19. where an issue of an instrument involves the use of an SPV, the issue of the instrument is subject to Attachment F;~~

~~20.17. t~~The instrument includes provisions which comply with the addressing loss absorption requirements at the point of non-viability in accordance with Attachment EG to this Prudential Standard.;

18. The instrument is clearly and separately disclosed in the issuer's financial statements and, ~~for at~~ Level 2 ~~insurance group~~, in any consolidated financial statements.;

19. The instrument must not include any of the following clauses:

- (a) a cross-default clause linking the issuer's obligations under any debt instrument or other capital instrument to default by the issuer, or default by another party (related or otherwise), under the instrument itself; or
- (b) an event of default clause specifying an event relating to any debt instrument or other capital instrument (other than the instrument itself) of the issuer, that brings the issuer into default under the instrument itself.

For the purposes of paragraph 19(b), an event of default includes a clause specifying the following events:

- (i) the exercise or non-exercise of discretions within the debt instrument or other capital instrument;
- (ii) an adverse event or change, however so described or determined, occurring in respect of the debt instrument or other capital instrument;
and

(iii) any consequence arising from, or any action taken or intended to prevent⁴⁴, the above events or a default by the issuer under the debt instrument or other capital instrument,

but does not include a clause specifying the irrevocable winding-up (that is, either by way of an effective resolution by shareholders or members for winding-up, or a court order has been made, and the time for the appeal of the decision has passed) of the issuer;

21.—

~~22.20.~~ Issue documentation **must** clearly **and prominently state** ~~indicates~~:

(a) the maturity date of the instrument at which time the issuer is required to redeem the instrument;

(b) the **unsecured and** subordinated nature of the instrument, and that neither the issuer nor the holder of the instrument is allowed to exercise any contractual rights of set-off;

(c) the instrument is not subject to netting;~~and~~

~~(a)~~ that the issuer cannot buy back, repurchase or redeem the instrument other than in terms permitted under this Prudential Standard;

~~(d)~~

(e) that the instrument is neither covered by the Financial Claims Scheme nor guaranteed by the Australian Government; and

~~(b)(f)~~ the application of requirements relating to loss absorption at the point of non-viability under Attachment **GE to this Prudential Standard**.

~~23.21.~~ The amount of ~~the~~ **an** instrument eligible for inclusion in Tier 2 Capital is to be amortised on a straight-line basis at a rate of 20 per cent per annum over the last four years to maturity as follows:

Years to Maturity	Amount Eligible for Inclusion in Tier 2 Capital
More than 4	100 per cent
Less than and including 4 but more than 3	80 per cent
Less than and including 3 but more than 2	60 per cent
Less than and including 2 but more than 1	40 per cent

⁴⁴ For example, by way of a scheme of arrangement.

Less than and including 1	20 per cent
---------------------------	-------------

~~Where an instrument is drawn down in a series of tranches, it must meet the requirements in this Prudential Standard as if each tranche is a separate Tier 2 Capital instrument in its own right and the minimum original maturity of each tranche must be five years from the time proceeds of the issue are irrevocably received by the issuer.~~

~~24.22.~~ For the purposes of paragraph ~~64(e)~~ of this Attachment, an incentive or expectation to call or otherwise redeem a Tier 2 Capital instrument includes, but is not limited to:

- (a) a call option combined with a requirement, or an investor option, to convert the instrument into ordinary shares if the call is not exercised; ~~or~~
- ~~(b)~~ a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate less the swap rate (i.e. the fixed rate paid to the call date to receive the second reference rate);~~:-~~
- ~~(c)~~ a call option combined with an increase in redemption amount in the future;
- ~~(d)~~ automatic redemption or an option to redeem following a change of control event;
- ~~(e)~~ mandatory conversion within the first five years of issue, except conversions arising from change of control, regulatory or tax events;
- ~~(f)~~ any arrangement whereby an investor will become subject to: (i) known tax or charges; or to (ii) known higher tax or charges than they would have had to pay before, following a call date and the issuer is required to compensate an investor for any payment of the additional tax or charges (refer to paragraph 26 of this Attachment); and
- ~~(b)(g)~~ application of maximum or minimum rates on distributions.

~~25.23.~~ A call option and a provision to convert into ordinary shares will not constitute an incentive to redeem provided there is at least two years from the date upon which the regulated institution may have an option to call the instrument to the nearest subsequent date upon which that conversion option may be exercised.

~~24.~~ Calling an instrument and replacing it with an instrument with a higher credit spread or that is otherwise more expensive ~~is deemed to~~~~may~~ create the expectation that the issuer will exercise a call option on other outstanding Tier 2 Capital instruments and Additional Tier 1 Capital instruments with call options, unless the issuer can satisfy APRA as to the economic and prudential rationale and that such an action will not create an expectation that other instruments will be called in similar circumstances.

- ~~26-25.~~ A Tier 2 capital instrument must provide for the immediate, automatic and permanent revocation of a call notice upon a non-viability event (refer to Attachment E to this Prudential Standard). A call option cannot be exercised in anticipation of a non-viability event.
26. ~~A Tier 2 Capital~~ instrument may only provide for a call within the first five years of issuance as a result of a tax or regulatory event. A tax or regulatory event is confined to:
- (a) changes in statute and regulations (and judicial and administrative actions pertaining to the application of a statute or regulations) which impact the specific capital instrument;
 - (b) changes related only to the jurisdictions relevant to the instrument;
 - (c) changes that have occurred, or will occur, as opposed to changes that may occur; or
 - (d) changes which impact the issuer of the affected capital instrument. Changes in tax or regulation impacting the holder of the capital instrument will not constitute a tax or regulatory event for the purposes of this Attachment.
27. ~~APRA may require a regulated institution not to exercise a call where it relates to a tax or regulatory event if APRA will not permit such a call if it~~ forms the view that the regulated institution was in a position to anticipate the tax or regulatory event when the instrument was issued. In order for a call to be exercised the issuer must comply with the provisions in paragraph ~~7 of 1(f)(i) to (iii) of~~ this Attachment.
28. Where a Tier 2 Capital instrument provides for conversion into ordinary shares⁴⁵, the issue document must:
- (a) specify the number of ordinary shares to be received upon conversion or specify the conversion formulae for determining the number of ordinary shares received;
 - (b) provide for the number of ordinary shares to be received under the conversion formula specified in (a) of this paragraph to be capable of being ascertained immediately and objectively; and
 - a) — set the maximum number of ordinary shares received so as not to exceed the price to the Tier 2 Capital instrument at the time of its issue divided by 20 per cent of the regulated institution's⁴⁶ ordinary share price⁴⁷ at the

⁴⁵ Conversion must be into the ordinary shares of the insurer or its parent ~~entity~~, which must be listed at the time of issue. For an unlisted insurer with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into the unlisted ordinary shares of the insurer. Where an unlisted insurer issues the instrument to its listed parent ~~entity~~, conversion may be into unlisted ordinary shares of the insurer.

⁴⁶ Reference to regulated institution in this context captures any entity whose ordinary shares are issued as a result of conversion provisions.

same time. However, this cap does not apply if the only holder of the converting capital instrument is a listed parent which wholly-owns the issuer of the capital instrument. In calculating the ordinary share price at time of issue:

- ~~b) specify the number of ordinary shares to be received upon conversion or specify the conversion formulae for determining the number of ordinary shares received~~
- ~~e) provide for the number of ordinary shares to be received under the formula specified in (a) to be fixed; and~~
- ~~(c) set the maximum number of ordinary shares received so as not to exceed the price of the Tier 2 Capital instrument at the time of its issue divided by 20 per cent of the regulated institution's⁴⁸ ordinary share price⁴⁹ at the same time. In calculating the ordinary share price at time of issue, adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations.~~
 - ~~(i) adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations;~~
 - ~~(ii) adjustments may only be made for transactions that change the number of shares on issue without involving an exchange of value and which have no impact on capital;⁵⁰~~
 - ~~(iii) adjustments must exclude transactions involving cash payments or other compensation to, or by, holder of the ordinary shares or the issuer of the capital instrument; and~~
 - ~~(iv) the method of calculation of adjustments must be fixed in issue documentation and adjustments must be capable of being ascertained immediately and objectively; and~~
- ~~(d) where the capital instrument is denominated in foreign currency, provide a clear method for determining: (i) the exchange rate to be used in calculating the number of ordinary shares to be issued upon conversion (e.g. the prevailing exchange rate); and (ii) the exchange rate to be used in calculating the maximum number of ordinary shares which could be issued on conversion (issue date exchange rate). Documentation must include how exchange rates would be determined, if at a time of conversion, foreign exchange markets were to be closed at the intended time of conversion.~~

⁴⁷ For an unlisted regulated institution that has no listed parent at the time of issue, the ordinary share price is based on the book value per share at the time of issue.

⁴⁸ ~~Reference to regulated institution in this context captures any entity whose ordinary shares are issued as a result of conversion provisions.~~

⁴⁹ ~~For an unlisted regulated institution that has no listed parent entity at the time of issue, the ordinary share price is based on the book value per share at the time of issue.~~

⁵⁰ ~~—This may include subsequent ordinary share splits, bonus issues and share consolidation.~~

29. For mutually owned regulated institutions, where a Tier 2 Capital instrument provides for conversion into mutual equity interests, the issue documentation must:
- (a) specify the number of mutual equity interests to be received upon conversion, or specify the conversion formula for determining the number of mutual equity interests received;
 - (b) provide for the number of mutual equity interests to be received under the formula specified in (a) of this paragraph to be capable of being ascertained immediately, objectively, and without further steps; and
 - (c) set the maximum number of mutual equity interests received such that the aggregate nominal value of the interests received cannot exceed, at the date of conversion, the nominal value of the Tier 2 Capital instrument converted.
30. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the regulated institution under Australian Accounting Standards.
31. In issuing Tier 2 Capital instruments, a regulated institution may, within the category of Tier 2 capital:
- (a) differentiate between instruments as to whether an instrument is required to convert or be written-off in the first instance;
 - (b) provide for a ranking under which Tier 2 Capital instruments will be converted or written off; and
 - (c) where conversion or write-off of capital instruments is required at Level 2, the Level 2 insurance group may provide for a ranking under which Tier 2 Capital instruments issued by individual members of the group may need to be converted or written off. This would be subject to any requirements for conversion or write-off of Tier 2 Capital instruments required to be undertaken on a Level 1 basis.
32. Where a Tier 2 Capital instrument provides for a write-off mechanism, this mechanism must be structured so that:
- (a) the claim of the instrument on liquidation of the issuer is reduced to, or below, the value of the written-off instrument;
 - (b) the amount of the instrument that may be paid if a call is exercised is irrevocably reduced to the value of the instrument after write-off;
 - (c) there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the regulated institution; and
 - (d) the distribution/payments payable on the instrument must be permanently reduced (i.e. distributions/payments must be calculated at no more than the rate set for the written-off value of the instrument).

~~(a)~~

~~28.33.~~ The instrument must not include a mechanism that would require a holder to sell the instrument to the issuer or a related entity of the issuer other than as part of a call option or redemption of the instrument. A mechanism that requires a holder to sell the instrument to a nominated party other than the issuer or related entity of the issuer will not constitute an incentive to redeem provided there is at least two years from the date upon which the holder is required to sell the instrument to the nearest subsequent date upon which conversion may be exercised.

~~34.~~ Where an instrument is drawn down in a series of tranches, it must meet the requirements in this Prudential Standard as if each tranche is a separate Tier 2 Capital instrument in its own right and the minimum original maturity of each tranche must be give years from the time proceeds of the issue are irrevocably received by the issuer.

~~35.~~ There must be no cross default clauses in the~~The~~ documentation of any debt instrument or any other capital instrument of the issuer of a Tier 2 Capital instrument must not include any of the following clauses: linking the issuer's obligations under the instrument to default by the issuer under any of its other obligations, or default by another party, related or otherwise.

(a) a cross-default clause linking the issuer's obligations under the Tier 2 Capital instrument to default by the issuer under any of its obligations, or default by another party (related or otherwise) under the debt instrument or other capital instrument; or

(b) an event of default clause specifying an event relating to the Tier 2 Capital instrument that brings the issuer into default under the debt instrument or other capital instrument.

~~36.~~ For the purposes of paragraph 35(b), an event of default clause includes a clause specifying the following events:

(a) the exercise or non-exercise of discretions within the Tier 2 Capital instrument;

(b) an adverse event or change, however so described or determined, occurring in respect of the Tier 2 Capital instrument; and

(c) any consequence arising from, or any action taken or intended to prevent⁵¹, the above events or a default by the issuer under the Tier 2 Capital instrument.

but does not include a clause specifying the irrevocable winding up (that is, either by way of an effective resolution by shareholders or members for winding up, or a court order has been made, and the time for appeal of the decision has passed) of the issuer.

⁵¹ For example, by way of a scheme of arrangement.

~~29.37.~~ Where ~~issue~~The instrument must be marketed in accordance with its prudential treatment and must not include any ‘repackaging’ arrangements that have the effect of compromising the quality of the capital raised. If a prospectus or other offer documentation, or marketing of the an instrument, or any ongoing dealings with investors could be reasonably held to suggest to investors that the instrument has attributes not consistent with the eligibility requirements in this Attachment for Tier 2 Capital instruments, other than those claimed by the issuer (or its corporate group) for prudential purposes, the instrument is ineligible to be included in ~~the regulated institution’s~~ Tier 2 Capital.

~~30.38.~~ The instrument, whether issued by the regulated institution or another member of the Level 2 insurance group to which the regulated institution belongs (including any overseas subsidiaries) may be subject to the laws of a foreign country jurisdiction other than Australia or its territories, except that the terms ~~and conditions~~ of the instrument that relate to non-viability conversion or write-off (refer to Attachment E to this Prudential Standard) must be subject to the laws of an Australian jurisdiction.

~~31.39.~~ Where the instrument, whether issued by the regulated institution or another member of a Level 2 insurance group to which the regulated institution belongs (including any overseas subsidiaries), is subject to the laws of a foreign country jurisdiction other than Australia or its territories, the ~~regulated institution~~regulated institution must also ensure all relevant eligibility criteria applicable to the instrument under this Attachment ~~isare enforceable that the instrument satisfies all relevant qualifying criteria for Tier 2 Capital~~ under the laws of that jurisdiction.

~~32.40.~~ APRA may require the regulated institution to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA’s choice and at the regulated institution’s expense, confirming that the instrument meets the requirements ~~in paragraphs 13 and 14 of this Attachment~~of this Prudential Standard.

~~Attachment F~~~~Criteria for capital issues involving Special Purpose Vehicles~~

~~The following requirements must be met for capital instruments issued through an SPV to qualify as capital:~~

~~the SPV issuing the instrument is a single purpose non-operating entity established for the sole purpose of raising capital for the ‘relevant institution’⁵²;~~

~~capital instruments issued by the relevant institution to the SPV, and capital instruments issued by the SPV to investors, must meet the requirements of this Prudential Standard for Additional Tier 1 and Tier 2 Capital set out in Attachment C and Attachment E, as appropriate;~~

~~capital instruments issued by the SPV must not be funded, directly or indirectly, by the relevant institution or any other member of a corporate group to which the relevant institution belongs. Similarly, the regulated institution or other member of a corporate group to which it belongs may not provide any funding to the SPV itself, other than to cover its administrative operating expenses;~~

~~the only asset⁵³ of the SPV is its investment in capital instruments issued by the relevant institution for which it raises capital. The SPV must have no material liabilities other than its issued capital instruments;~~

~~instruments issued by the relevant institution to the SPV, and by the SPV to ‘third party’⁵⁴ investors, must:~~

~~be of the same category of capital (e.g. both Additional Tier 1 Capital instruments, or both Tier 2 Capital instruments);~~

~~if Tier 2 Capital instruments, have the same maturity; and~~

~~have terms and conditions that mirror each other;~~

~~the proceeds from the issue of a capital instrument by the SPV must be immediately and directly invested in, and available without limitation to the relevant institution;~~

~~where a non-viability trigger event occurs (Attachment G), the instruments issued to the SPV, and by the SPV to investors, must be subject to conversion or write-off into ordinary shares in accordance~~

⁵² In this Attachment, reference to ‘relevant institution’ includes an insurer, an ultimate holding company or an operating subsidiary included in the Level 2 insurance group.

⁵³ Assets that relate to the operation of the SPV may be excluded from this assessment if they are *de minimis*.

⁵⁴ For the purposes of this Prudential Standard, a ‘third party’ is defined as an entity that is not the regulated institution or a ~~related body corporate~~ of the regulated institution.

~~with the requirements in Attachment G. In such circumstances, investors in instruments issued by the SPV irrevocably cease to have any claims on the SPV or the relevant institution;~~

~~where capital instruments issued by an SPV are converted into ordinary shares of the relevant institution, such conversions are subject to the requirements (including limits) covering conversion set out in Attachments C, E and G; and~~

~~the main features of the instrument issued by the SPV and the structure of the issue are transparent and capable of being understood by investors. An issue is not eligible for inclusion in a regulated institution's Additional Tier 1 Capital or Tier 2 Capital where the complexity of its structure raises doubt over the legal and regulatory risk associated with it.~~

~~An SPV may be established to issue tranches of one instrument where the only change in the terms and conditions of the tranches is a variation in distribution or payments to be made on the instrument. An SPV may not issue different forms of an instrument even if they belong to the same category of capital instruments.~~

Attachment **EG****Loss absorption at the point of non-viability: Additional Tier 1 and Tier 2 Capital instruments**

1. An Additional Tier 1 Capital or Tier 2 Capital instrument must include a provision whereby upon the earliest ~~under which, on the~~ occurrence of a non-viability trigger event, ~~(as defined in paragraphs 3 and 4 of this Attachment),~~ it will be immediately and irrevocably:

~~(a) be~~ converted into the ordinary shares of the regulated institution or its ultimate parent ~~entity~~, which must be listed⁵⁵ at the time the instrument is issued.⁵⁶; ~~or For an unlisted regulated institution with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into the unlisted ordinary shares of the regulated institution. Where an unlisted regulated institution issues the instrument to its listed parent, conversion may be into the unlisted ordinary shares of the regulated institution;~~

~~(a)(b)~~ converted into mutual equity interests; or

~~(b)(c)~~ written off.

- ~~2. The amount of an instrument that may be recognised in the regulated institution's Tier 1 Capital and capital base on the occurrence of a non-viability trigger event is the minimum level of Common Equity Tier 1 Capital that would be generated by a full conversion or write-off of the instrument. Where an instrument provides for write-off as the primary loss absorption mechanism, the amount recognised must account for potential taxation liabilities or other potential offsets at the time of issuance. Adjustments must be updated over time to reflect the best estimates of the offset value.~~

- ~~3.2. A non-viability trigger event in relation to a regulated institution (including Category B insurers) is the earlier of is:~~

~~(a) in relation to the issuance of a notice in writing by APRA to the regulated institution that conversion or write-off of capital instruments is necessary because, without it, when APRA considers notified that the regulated institution that APRA considers; would become non-viable; or~~

~~i) conversion or write-off of capital instruments is necessary because, without it, the regulated institution would become non-viable; or~~

⁵⁵ ~~For the purposes of this paragraph, 'listed' refers to an institution admitted to, and not removed from, a stock exchange.~~

⁵⁶ ~~For an unlisted regulated institution with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into unlisted ordinary shares of the regulated institution. Where an unlisted regulated institution issues the instrument to its listed parent entity, conversion may be into unlisted ordinary shares of the regulated institution.~~

- ii) without a public sector injection of capital or equivalent support, the regulated institution would become non-viable;
- (b) subject to paragraph 6 of this Attachment, in relation to a fully-consolidated subsidiary in the Level 2 insurance group; a determination by APRA, notified to the regulated institution in writing, that without a public sector injection of capital, or equivalent support, the regulated institution would become non-viable.
 - i) a non-viability event in relation to its parent regulated institution under this Attachment; or
 - ii) the application of non-viability requirements imposed by a host regulator of the subsidiary or under statute; and
- (c) subject to paragraphs 7 and 8 of this Attachment, where the regulated institution is a locally-incorporated regulated institution that is a subsidiary of a foreign entity, notification by the home regulator of the foreign entity to the foreign entity or the regulated institution that the home regulator considers that:
 - (i) conversion or write-off of capital instruments is necessary because, without it, the foreign entity or the regulated institution would become non-viable; or
 - (ii) without a public sector injection of capital, or equivalent support, the foreign entity or the regulated institution would become non-viable.
- (b) —
- 4. ~~In addition to paragraph 3 of this Attachment, a non-viability trigger event in relation to a Category B insurer is the earlier of:~~
- 5. ~~the issuance of a notice by the home regulator of the Category B insurer's parent to the Category B insurer's parent that conversion or write-off of capital instruments issued by a Category B insurer is necessary because, without it, the Category B insurer's parent or the Category B insurer itself would become non-viable; or~~
- 6. ~~a determination by the home regulator of the Category B insurer's parent, that without a public sector injection of capital, or equivalent support, the Category B insurer's parent or the Category B insurer itself would become non-viable.~~
- 3. Conversion or write-off of an Additional Tier 1 or Tier 2 Capital instrument must generate an unequivocal addition to the regulated institution's Level 1 or Level 2 Common Equity Tier 1 Capital under Australian Accounting Standards. need only occur to the extent necessary to enable APRA to conclude that the regulated institution is viable without further conversion or write-off. In such circumstances, conversion or write-off would need to fully exhaust Additional Tier 1 Capital instruments before involving Tier 2 Capital instruments. APRA

~~will not approve partial conversion or partial write-off in those exceptional circumstances where a public sector injection of funds is deemed necessary.~~

- ~~4. For the purposes of conversion or write-off, in whole or in part, of an Additional Tier 1 Capital or Tier 2 Capital instrument as a result of a non-viability event, the amount to be converted must be the face value of the instrument or relevant part thereof. Dividends and interest associated with the instrument which have been converted or written off, but which are not yet due and payable must also be extinguished.~~
- ~~5. In order to comply with the immediate conversion or write-off in paragraph 1 to this Attachment, the instrument must be capable of conversion or write-off taking place at any time of day:

(a) during a business day; or

(b) on a day that is not a business day.~~
- ~~6. To qualify as Additional Tier 1 Capital or Tier 2 Capital, an instrument issued by a fully consolidated subsidiary included in the Level 2 insurance group must satisfy the requirements in this Attachment. As a result, a non-viability event applicable to a parent regulated institution must function as a non-viability event for the subsidiary itself for the instrument if the instrument is to be eligible for inclusion in the capital of the Level 2 insurance group. A fully consolidated subsidiary incorporated overseas may, however, also be subject to non-viability requirements imposed by a host or home regulator or under statute provided that the requirements are disclosed by the regulator, and issue documentation for the instrument discloses that the instrument is subject to a potential loss as a result of the requirements. The implementation of such non-viability requirements upon the overseas subsidiary must not be a non-viability event for instruments issued by the parent regulated institution under paragraph 1 of this Attachment.~~
- ~~7. To qualify as eligible Additional Tier 1 or Tier 2 Capital, an instrument issued by a locally-incorporated regulated institution that is a subsidiary of a foreign regulated institution must satisfy the requirements in this Attachment. A non-viability event of the regulated institution, however, need not trigger any loss absorption requirement upon the foreign parent.~~
- ~~8. A locally-incorporated regulated institution that is a subsidiary of a foreign entity may, either individually or as part of a group, also be subject to non-viability requirements applied by the authorities in the overseas country of incorporation of the foreign parent, provided that the requirements are disclosed by the authorities, and issue documentation for the instrument discloses that the instrument is subject to potential loss as a result of the requirements. A locally-incorporated regulated institution that is a subsidiary of a foreign parent, is permitted to, but not required to, provide for the application of a non-viability event based on non-viability requirements⁵⁷ applied to the foreign parent. As a result, a non-viability requirement applicable to the foreign parent may function~~

⁵⁷ Requirements may be applied by the home regulator or under statute.

as a non-viability event for the regulated itself in relation to Additional Tier 1 Capital or Tier 2 Capital instruments issued by the regulated institution.

9. Where a non-viability event occurs in accordance with this Attachment, the amount of conversion or write off of Additional Tier 1 or Tier 2 Capital instruments is to be determined in accordance with paragraphs 11 and 12 of this Attachment. If a non-viability event occurs as a result of only host or home regulator or statutory non-viability requirements (refer to paragraphs 2(c)(i) and 2(c)(ii) of this Attachment), then the amount of conversion or write-off of Additional Tier 1 or Tier 2 Capital instruments issued by a locally incorporated regulated institution that is a subsidiary of a foreign parent will be determined by the relevant host or home regulator or statutory requirements.
10. The amount of an instrument that may be recognised in the regulated institution's Tier 1 and capital base, is the minimum level of Common Equity Tier 1 Capital that would be generated by full conversion or write-off of the instrument on the occurrence of a non-viability event. In determining, at any point in time, the minimum level of Common Equity Tier 1 Capital that would be generated by conversion or write-off, the regulated institution must take into account any tax or other potential offsets which might impact the minimum level if conversion or write-off were to take place. Adjustments to the amount of an instrument included in Tier 1 Capital or capital base must be updated over time to reflect any change in the best estimates of the offset value. Where an instrument's primary loss absorption mechanism is conversion into ordinary shares, a regulated institution is not required to take into account any taxation effect resulting from write-off of the instrument in the event conversion was not achievable.
11. The aggregate amount of full or partial conversion or write-off of Additional Tier 1 Capital or Tier 2 Capital instruments must, at a minimum, be no less than the lower of:
 - (a) the amount required to ensure the non-viability event no longer applies⁵⁸;
 - and
 - (b) the principal amounts of all instruments.
12. A regulated institution must carry out full conversion or write-off of its Additional Tier 1 Capital and Tier 2 Capital instruments unless APRA is satisfied that the aggregate amount of a partial conversion or partial write-off is sufficient to meet the requirements of paragraph 11 of this Attachment and a public sector injection of funds into the regulated institution would not be necessary. If a non-viability event no longer applies, unless otherwise required by APRA, further conversion or write-off of Additional Tier 1 Capital or Tier 2 Capital instruments need not be undertaken.

7. —

⁵⁸ Such a declaration would typically be provided, as appropriate, by APRA or another regulator, or by way of statutory provisions.

- ~~8. The amount of conversion or write-off of capital instruments undertaken in accordance with this Attachment will be subject to the requirements applied by the relevant regulator.~~
- ~~9. A regulated institution may provide for Additional Tier 1 Capital instruments to be converted or written off prior to any conversion or write-off of Tier 2 Capital instruments. In these circumstances, conversion or write-off of Tier 2 Capital instruments will only be necessary to the extent that conversion of Additional Tier 1 Capital instruments has not resulted in APRA withdrawing the notice issued to the regulated institution under paragraph 3 or paragraph 4 of this Attachment, as appropriate.~~
- ~~10. Conversion or write-off must generate an unequivocal addition to Common Equity Tier 1 Capital of the regulated institution under Australian Accounting Standards.~~
- ~~11.13. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares (or mutual equity interests), the regulated institution must ensure that, at the time of issue and on a continuing basis, there are no legal or other impediments to issuing the relevant number of shares (or mutual equity instruments) and all necessary authorisations approvals have been obtained to effect conversion.~~
- ~~12.14. An Additional Tier 1 Capital or Tier 2 Capital instrument must unequivocally provide for the amount of the instrument to be immediately and irrevocably written-off (including termination of the right to receive ordinary shares, mutual equity interests, principal, dividends or interest) in the accounts of the regulated institution and result in an unequivocal addition to Common Equity Tier 1 Capital ifWhere, following a non-viability trigger event, conversion of a capitalthe instrument:~~
- ~~(a) is not capable of being undertaken;~~
- ~~(a)(b)has not been fully effected for any reason within five business days;~~
- ~~(b)(c)is not irrevocable; or~~
- ~~(e)(d)will not result in an immediate and unequivocal increase in Common Equity Tier 1 Capital of the regulated institution, at Level 1 and Level 2, as applicable.~~
- ~~13. the amount of the instrument must immediately and irrevocably be written-off in the accounts of the regulated institution and result in an unequivocal addition to Common Equity Tier 1 Capital.~~
- ~~14. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares when a non-viability trigger event occurs, the issue documentation must:~~
- ~~15. specify the number of ordinary shares to be received upon conversion, or specify the conversion formula for determining the number of ordinary shares received;~~

- ~~16. provide for the number of ordinary shares to be received under the formula specified in (a) to be fixed; and~~
- ~~17. set the maximum number of ordinary shares received so as not to exceed the price of the Additional Tier 1 or Tier 2 Capital instrument at the time of its issue divided by 20 per cent of the regulated institution's⁵⁹ ordinary share price⁶⁰ at the same time. In calculating the ordinary share price at time of issue, adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations.~~
- ~~15. Where issue documentation may provides for a ranking hierarchy of conversion or write-off under which instruments may be converted or written-off upon a non-viability event, provided that the terms of the issue documentation do not, the terms attached to such a hierarchy must not impede the ability of the capital instrument to be immediately converted or written-off. Any ranking must provide for all Additional Tier 1 Capital instruments to be fully converted or written-off before any Tier 2 Capital instruments are required to be converted or written-off. Any conversion or write-off of the Tier 2 Capital instruments will only be necessary to the extent that conversion or write-off of the Additional Tier 1 Capital instruments is insufficient to permit a declaration that a non-viability event no longer applies.~~
- ~~16. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares or mutual equity interests when a non-viability event occurs, the conversion provisions in issue documentation must satisfy in the case of Additional Tier 1 Capital instruments the requirements of paragraphs 28 of Attachment C to this Prudential Standard, and, in the case of Tier 2 Capital instruments, the requirements in paragraph 28 of Attachment D to this Prudential Standard.~~
- ~~17. Where an Additional Tier 1 Capital or Tier 2 Capital instrument provides for a write-off of the instrument, upon a non-viability event, the write-off provisions in the issue documentation must satisfy the requirements in paragraph 32 of Attachment C to this Prudential Standard for an Additional Tier 1 Capital instrument, and the write-off provisions must satisfy paragraph 32 of Attachment D to this Prudential Standard for a Tier 2 Capital instrument.~~
- ~~18.~~
- ~~19. Issuing Additional Tier 1 or Tier 2 Capital instruments may, within each category of capital:~~
- ~~20. differentiate between instruments as to whether an instrument is required to convert or be written off in the first instance;~~

⁵⁹ ~~Reference to regulated institution captures any entity whose ordinary shares are issued as a result of conversion provisions.~~

⁶⁰ ~~For an unlisted regulated institution that has no listed parent entity at the time of issue, the ordinary share price is based on the book value per share at the time of issue.~~

- ~~21. provide for a ranking under which Additional Tier 1 and Tier 2 Capital instruments will be converted or written off; and~~
- ~~22. where conversion or write-off of capital instruments is required at Level 2, the Level 2 insurance group may provide for a ranking under which Additional Tier 1 and Tier 2 Capital instruments issued by individual members of the group may need to be converted or written off. This would be subject to any requirements for conversion or write-off of capital instruments required to be undertaken on a Level 1 basis.~~
- ~~23. For the purposes of conversion or write-off of an Additional Tier 1 or Tier 2 Capital instrument, the amount to be converted or written off will be the face value of the instrument recorded in the books of the regulated institution, where relevant.~~
- ~~24. Where an Additional Tier 1 or Tier 2 Capital instrument provides for a write-off mechanism, this mechanism must be structured so that:~~
- ~~25. the claim of the instrument on liquidation of the issuer is reduced to, or below, the value of the written off instrument;~~
- ~~26. the amount of the instrument that may be paid if a call is exercised is irrevocably reduced to the written off amount of the instrument;~~
- ~~27. there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the regulated institution; and~~
- ~~28. the distribution/payments payable on the instrument must be permanently reduced (i.e. distributions/payments must be calculated at no more than the rate set for the written off value of the instrument).~~
18. The contractual terms and conditions of an Additional Tier 1 Capital or Tier 2 Capital instrument must provide that, on conversion or write-off of the instrument upon a non-viability event, any residual claims associated with the portion of the instrument converted or written off, the issue of an instrument must not provide for any residual claims on the issuer that are not senior to claims associated with ordinary shares or mutual equity interests of the regulated institution and not senior to claims associated with ordinary shares or mutual equity interests of the parent entity, or the parent entity, in the event that a conversion or write-off is undertaken.
19. A regulated institution must notify APRA, if the regulated institution anticipates that:
 - (a) the regulated institution may be exposed to the occurrence of a non-viability event;
 - (b) a fully consolidated subsidiary in the Level 2 insurance group may be exposed to the occurrence of a non-viability event contained in non-viability requirements imposed on it by a host regulator or by statute; or

- (c) the regulated institution may be subject to a non-viability event contained in non-viability requirements imposed by a home regulator or statute upon the regulated institution's foreign parent; or
- (d) a non-viability event may occur in relation to a fully consolidated subsidiary in the regulated institution's Level 2 insurance group or in relation to the regulated institution's foreign parent.

~~Attachment H~~

~~Transitional arrangements for capital instruments~~

~~Instruments eligible for transition~~

~~Non-common equity Tier 1 and Tier 2 Capital instruments, including instruments issued by fully consolidated subsidiaries that are held by third parties, that do not fully meet the criteria in Attachments C and E, respectively, may be eligible for transition in accordance with this Attachment.~~

~~Capital instruments issued before 9 April 2010 that complied with APRA's prudential capital requirements in force at the time of issue may be eligible for the transitional arrangements provided in this Attachment. However, if the instrument had a call and a step-up (or other incentive to be redeemed) after 22 September 2010 and before 1 January 2013, it must be fully derecognised in the relevant category of capital.~~

~~Instruments issued after 9 April 2010 and before 1 January 2013 that do not include a step-up or other incentive to redeem, but otherwise complied with APRA's prudential capital requirements in force at the time of issue, may be eligible for the transitional arrangements outlined in this Attachment.~~

~~APRA may, however, determine in writing whether an instrument is eligible for the transitional arrangements provided in this Attachment.~~

~~Transitional arrangements~~

~~Capital instruments approved by APRA for transitional arrangements under this Attachment (transitional instruments) will be phased out from inclusion in the capital base from 1 January 2013. Such instruments may be included in the relevant category of capital until their first available call date (if any), or as determined in writing by APRA.~~

~~The amount of transitional instruments that may be included in the capital base is determined by reference to the 'base amount' of Additional Tier 1 or Tier 2 Capital (refer to paragraphs 7 to 11 of this Attachment). The proportion of the base amount that may be included in the capital base is amortised over nine years, commencing at 90 per cent of the base amount on 1 January 2013, with the cap reducing by 10 percentage points on 1 January of each of the following years. Table 1 sets out the amortisation schedule for the phase-out of transitional instruments.~~

~~Table 1: Transitional arrangements for capital instruments~~

Year commencing	Percentage of base amount of transitional instruments that may be included in Additional Tier 1 and Tier 2 Capital under the phase-out arrangements.
1 January 2013	90
1 January 2014	80
1 January 2015	70
1 January 2016	60
1 January 2017	50
1 January 2018	40
1 January 2019	30
1 January 2020	20
1 January 2021	10
1 January 2022	0

~~Base amount~~

~~The base amount is calculated for each category of capital and is the sum of the nominal amounts of transitional instruments within that class that are outstanding on 31 December 2012.~~

~~The base amount must not include existing Tier 1 and Tier 2 Capital instruments ineligible for recognition under the June 2010 version of GPS 112 because of the limits for recognition or the amortisation requirements of that Prudential Standard.~~

~~Where a Tier 2 Capital instrument has started to amortise prior to 1 January 2013 in accordance with the June 2010 version of GPS 112:~~

~~only the amortised amount of that capital instrument as at 1 January 2013 may be included in the base amount; and~~

~~the amount of the instrument eligible to be included in Tier 2 Capital will continue to be amortised at 20 per cent per annum.~~

~~In calculating the base amount, a regulated institution must use the value of Additional Tier 1 Capital instruments and Tier 2 Capital instruments in the regulated institution's balance sheet as at 1 January 2013. In calculating the amount of foreign currency denominated Additional Tier 1 Capital and Tier 2 Capital instruments eligible to be included under the relevant cap, the amount of the capital instruments reported would be the amount of such instruments that would be reported by the regulated institution as outstanding in its financial statements (adjusted for any amortisation arrangement applicable to Tier 2 Capital instruments) as at 31 December 2012.~~

~~The base amount remains unchanged even where an instrument:~~

~~is redeemed;~~

~~meets its first call date; or~~

~~is included in Tier 2 Capital and its recognition in the capital base is amortised in accordance with this Prudential Standard.~~

~~A regulated institution may replace such an instrument with the amounts of other transitional instruments not already included in the capital base, up to the capped amount applying to the year in which the instrument is redeemed or derecognised.~~

Attachment ~~F~~

Level 2 insurance groups

1. This Attachment applies adjustments to the prudential requirements outlined in this Prudential Standard including Attachments A, B, C, ~~ED~~, and ~~FE and G~~ for Level 2 insurance groups. A Level 2 insurance group must comply with all the prudential requirements in this Prudential Standard, unless a contrary prudential requirement is set out in this Attachment.

Capital base

2. The parent entity of a Level 2 insurance group must ensure that the category of capital in which a component of capital is included, when measured at an individual group member level, is not upgraded to a higher category of capital when measured in the Level 2 insurance group's capital base. Any such component of capital must be reclassified to the appropriate lower category of capital when measured for the Level 2 insurance group.

Capital issued by fully consolidated subsidiaries and held by third parties

Common Equity Tier 1 Capital

3. In addition to paragraph ~~303020~~ of this Prudential Standard, Common Equity Tier 1 Capital of a Level 2 insurance group may include a portion of the minority interest (calculated in accordance with paragraphs 4 through to 8 of this Attachment) arising from the issue of ordinary shares to third parties by a fully consolidated subsidiary included in the Level 2 insurance group where:
 - (a) the shares giving rise to the minority interest would, if issued by the parent entity of the Level 2 insurance group, meet the criteria in Attachment A; and
 - (b) the subsidiary issuing the shares is itself an insurer or an entity undertaking **insurance business** in a foreign jurisdiction⁶¹ and is subject to equivalent minimum prudential requirements and level of supervision as an insurer.
4. Where a fully-consolidated subsidiary of a Level 2 insurance group has its own subsidiaries, all calculations must be undertaken in respect of that subsidiary and its subsidiaries as a consolidated group.
5. The minority interest in Common Equity Tier 1 Capital⁶² of a fully consolidated subsidiary that is eligible to be included in the Level 2 insurance group's

⁶¹ Subject to prior consultation with APRA, the subsidiary may also be a non-operating holding company and qualify for the treatment under this paragraph.

⁶² This includes third ~~parties~~^{parties}' interest in ordinary shares issued by a subsidiary, current year and retained earnings and distributable reserves of a subsidiary.

Common Equity Tier 1 Capital in accordance with paragraph 3 of this Attachment is calculated as:

- (a) the total minority interest in Common Equity Tier 1 Capital of the subsidiary that is attributable to third parties; less
 - (b) the percentage of Common Equity Tier 1 Capital of the subsidiary that is attributable to third parties multiplied by the surplus capital of the subsidiary, where the surplus capital of the subsidiary for this purpose is defined in paragraph 6 of this Attachment.
6. The surplus capital of the subsidiary referred to in paragraph 5 of this Attachment is the lesser of the following three items:
- (a) Common Equity Tier 1 Capital of the subsidiary less 60 per cent of the prescribed capital amount of the subsidiary;
 - (b) Tier 1 Capital of the subsidiary less 80 per cent of the prescribed capital amount of the subsidiary; and
 - (c) Total Capital of the subsidiary less the prescribed capital amount of the subsidiary.
7. For the purposes of paragraph 6 of this Attachment, the calculation of the prescribed capital amount of the subsidiary must be undertaken as though the subsidiary is an insurer subject to the **capital standards**.
8. A Level 2 insurance group may elect not to recognise Common Equity Tier 1 Capital issued by a fully consolidated subsidiary to third parties in accordance with paragraph 3 of this Attachment. However, the Level 2 insurance group must continue to include all exposures of those subsidiaries when calculating its prescribed capital amount.

Additional Tier 1 Capital

9. In addition to paragraph ~~37-25~~ of this Prudential Standard, Additional Tier 1 Capital of a Level 2 insurance group includes instruments issued by a fully consolidated subsidiary of the parent entity of the Level 2 insurance group and held by third parties where:
- (a) the instruments would, if issued by the parent entity of the Level 2 insurance group, meet the criteria in Attachment C; and
 - (b) the instruments meet the requirements for loss absorption at the point of non-viability set out in Attachment ~~EG and paragraph 18 of this Attachment.~~

Tier 2 Capital

10. In addition to paragraph ~~404029~~ of this Prudential Standard, Tier 2 Capital of a Level 2 insurance group includes instruments issued by a fully consolidated subsidiary of the parent entity of the Level 2 insurance group and held by third parties where:

- (a) the instruments would, if issued by the parent entity of the Level 2 insurance group, meet the criteria in Attachment ~~ED~~; and
- (b) the instruments meet the requirements for loss absorption at the point of non-viability set out in Attachment ~~GE and paragraph 18 of this Attachment.~~

Regulatory adjustments to Common Equity Tier 1 Capital

11. In addition to the regulatory adjustments to Common Equity Tier 1 Capital in Attachment B, a Level 2 insurance group must deduct from Common Equity Tier 1 Capital:
 - (a) any surplus, net of deferred tax liabilities, in any defined benefit superannuation fund of which an insurer or other group entity is an employer-sponsor unless otherwise approved by APRA. Any excluded surplus must reverse any associated deferred tax liability from Common Equity Tier 1 Capital;
 - (b) equity exposures and other capital investments⁶³ in non-consolidated subsidiaries or controlled entities, whether regulated or unregulated, subject to the materiality of the controlled entity (to be determined in consultation with APRA).⁶⁴ This deduction does not apply to a controlled entity, where it acts as a holding company for pass-through of equity exposures and other capital investments in Level 1 insurers or equivalent overseas entities carrying on insurance business. In the event that a controlled entity holds equity exposures and other capital investments in controlled entities not eligible for consolidation, the Level 2 insurance group must deduct its equity exposures and other capital investments in the holding company net of the value of the holding company's investment in any Level 1 insurer or equivalent overseas entities carrying on insurance business; and
 - (c) goodwill and any other intangible component of the investments in non-consolidated subsidiaries (to the extent these have not been deducted under sub-paragraph (b)).
12. The deductions relating to investments in subsidiaries, joint ventures and associates (refer to Attachment B) do not apply to investments in subsidiaries of Level 2 insurance groups. Investments in subsidiaries are treated as either consolidated subsidiaries and as a result treated as part of the Level 2 insurance group or as non-consolidated subsidiaries at Level 2.
13. The deductions relating to reinsurance assets, as set out in paragraphs 20 and 21 of Attachment B, do not apply to the **international business** of a Level 2 insurance group, unless the deduction is required in the relevant jurisdiction.

⁶³ As defined in paragraphs 18 and 19 of this Attachment.

⁶⁴ Paragraph (b) requires the goodwill component of these investments to be deducted from Common Equity Tier 1 Capital. This deduction is to be performed prior to deducting the (remaining) value of the investment from Common Equity Tier 1.

14. The deduction relating to assets under a fixed or floating charge, as set out in paragraphs 25 and 26 of Attachment B, do not apply to the international business of a Level 2 insurance group.
15. APRA may require a Level 2 insurance group to deduct from Common Equity Tier 1 Capital an amount to cover undercapitalisation of a non-consolidated subsidiary (or subsidiaries). A Level 2 insurance group may be required to provide to APRA details of, amongst other things, the:
 - (a) size and scale of the operations of the non-consolidated subsidiary;
 - (b) materiality of the subsidiary's operations to group income and strategic outlook;
 - (c) level of net tangible assets of the subsidiary;
 - (d) risk profile of the subsidiary;
 - (e) level of exposure of the Level 2 insurance group to the subsidiary; and
 - ~~(f) size of any identified capital shortfall and the likelihood of such a shortfall being remedied within a reasonable period of time.~~
 - ~~(g) **Additional Tier 1 or Tier 2 Capital issued overseas by parent entities or subsidiaries**~~

~~In addition to paragraph 30 of this Prudential Standard, Additional Tier 1 Capital instruments and Tier 2 Capital instruments may be issued by the parent entity of the Level 2 insurance group, or a fully consolidated subsidiary of the group, either in its country of incorporation or through a branch in another country, provided the instrument:~~

~~represents an obligation of the parent entity or the consolidated subsidiary itself at all times;~~

~~is freely available to absorb losses across all of the operations of the parent entity or the consolidated subsidiary that issued the instrument; and~~

~~meets all of the requirements of this Prudential Standard for inclusion in Additional Tier 1 or Tier 2 Capital.~~

~~**Use of Special Purpose Vehicles to issue Additional Tier 1 or Tier 2 Capital**~~

~~The amount of capital issued by consolidated subsidiaries to third parties through an SPV that may be included in Tier 1 Capital or the capital base is to be determined in accordance with paragraphs 9 and 10 of this Attachment.~~

Loss absorption at the point of non-viability: Additional Tier 1 and Tier 2 Capital instruments

In addition to the non-viability trigger event defined in Attachment G, for a Level 2 insurance group, a non-viability trigger event in relation to instruments issued by a fully consolidated subsidiary of a Level 2 insurance group is the earlier of:

the issuance of a notice by an host regulator of an overseas subsidiary that conversion or write-off of capital instruments issued by a fully consolidated subsidiary of a regulated institution is necessary because, without it, the host regulator considers that the subsidiary would become non-viable;

a determination by the host regulator, that without a public sector injection of capital, or equivalent support, the overseas subsidiary would become non-viable; or

(h)(f) a non-viability trigger event occurs in relation to a parent entity of the Level 2 insurance group in accordance with paragraph 3 of Attachment G.

Intra-group capital transactions

16. The matters APRA may consider in assessing whether a component of capital resulting from intra-group transactions does not represent a genuine contribution to financial strength include, but are not limited to, whether a component of capital:

17. is clearly supplied from debt raised by other group members;

18. results from intra-group transactions with no economic substance;

19. is contributed by a member of the group using funding sourced, directly or indirectly, from the Level 2 insurance group; or

20. is contributed by a group member and the funding of which contains cross-default clauses that would be triggered as a result of the Level 1 insurer or Level 2 insurance group failing to meet any servicing obligations.

21. In assessing the overall strength of a Level 2 insurance group, APRA will have regard to the ability of the Level 2 insurance group to readily extract capital from members of the group should the need arise to recapitalise the parent entity or other members of the group. APRA may require a Level 2 insurance group to adjust its Prudential Capital Requirement to reflect any inability to readily extract capital and any limitations on the amount of capital that may be extracted.

22. In measuring the capital base of a Level 2 insurance group, a Level 2 insurance group must exclude any capital instrument issued by a member of the group where the obligations under that instrument are secured, guaranteed, or subject to any other arrangement provided by a by another group member of the group that legally or economically enhances the seniority of claims of investors.

16.

~~23.17.~~ In assessing the overall capital strength of a Level 1 insurer ~~and~~ a Level 2 insurance group, APRA may request that the parent ~~entity~~ provide APRA with details of the group's intra-group exposures, including capital transactions and intra-group guarantees. The information on intra-group exposures would typically include details of all intra-group exposures provided by the parent~~(s)~~ and the Level 1 insurer ~~entity~~ to the Level 2 insurance group. APRA may also request details of material exposures between the members of the group to which the insurer belongs ~~entities controlled by the parent entity~~.

~~Holdings of capital instruments in group members by other group members~~

~~24.~~ Capital instruments⁶⁵ of a parent entity of a Level 2 insurance group or of a controlled entity within the group that are held as direct investments by a vehicle⁶⁶ subject to consolidation within the Level 2 insurance group's financial statements in accordance with Australian Accounting Standards, may be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital only if:

~~(a) the parent entity (or relevant vehicle) did not fund the acquisition of the capital instruments (i.e. acquisition of capital instruments is funded by third parties such as life insurance policyholders or other third party investors)⁶⁷;~~

~~(b) the risk and rewards associated with the investments are borne primarily by third parties; and~~

~~the parent entity can demonstrate to APRA, if required, that decisions to acquire or sell such capital instruments are made independently of the issuer of the capital instruments and in the interests of the third parties who primarily bear the risks and rewards of the investments in the instruments; and~~

~~(c) the instruments are not held for the purposes of employee share-based remuneration scheme.~~

~~25.~~ Where the requirements in paragraph ~~1818~~²³ of this Attachment are not satisfied, the relevant capital instruments must be treated as holdings of own capital instruments and deducted from Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital, as appropriate in accordance with paragraph 5 of Attachment B.

~~a)~~ For the purposes of measuring a Level 2 insurance group's capital base, the SPV holding the shares referred to in paragraph 31 of this Prudential Standard must

⁶⁵ ~~Capital instruments include all capital instruments eligible to be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital.~~

⁶⁶ ~~These vehicles exclude any SPV, such as a trust, involved with employee share-based remuneration schemes.~~

⁶⁷ ~~This excludes instruments that have been issued by subsidiaries that and are owned by the foreign parent.~~

~~be excluded from the Level 2 insurance group. As a consequence, any associated change in the fair value of the shares held by an SPV must be excluded from the capital base.~~

Capital support

~~26.~~18. For the purposes of determining whether a capital instrument constitutes capital support, including a guarantee provided to a related entity, APRA will have regard to, amongst other things, whether:

- (a) the facility represents a recognised capital instrument or is otherwise accepted as standing in place of capital required to be held by a related entity; or
- (b) the provider of the facility, in terms of either repayment or maturity, ranks below other senior unsecured or unsubordinated creditors, or
- (c) the facility is provided by an insurer or other group entity and the funding provided flows through one group entity (including any SPV) to another group entity and the funding received by the second entity meets either (a) or (b).

19. If a facility covered in paragraph 18 of this Attachment represents a form of capital support, it must be considered for the purposes of this Prudential Standard to form part of the Level 2 insurance group's 'other capital investments'. Investments are not deducted from Common Equity Tier 1 Capital, must be subject to the **Asset Risk Charge** under Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge.

Attachment G

Mutual Equity Interests

1. To be classified as a mutual equity interest, an instrument must satisfy all of the criteria in this Attachment and Attachment A to this Prudential Standard, except that paragraphs 1(b), 1(c), 1(e), 1(g), and 1(h) of Attachment A are to be read as follows:
 - (b) the mutual equity interest represents a claim against the issuer in liquidation that is subordinate to all claims other than members' rights to residual assets;
 - (c) the holder of the mutual equity interest is entitled to a claim on the residual assets of the issuer after all senior claims, including the aggregate

subscription price paid for all member shares, have been repaid in liquidation and;

(i) the holder's claim ranks equally and proportionately with all other mutual equity interests directly issued or created on conversion of Additional Tier 1 Capital or Tier 2 Capital instruments in accordance with Attachment E to this Prudential Standard; and

(ii) the holder's claim cannot exceed the principal amount of the mutual equity interest, that amount being measured as:

(A) if the mutual equity interest was issued directly, the paid-up amount of the mutual equity interest; or

(B) if the mutual equity interest was created on conversion of Additional Tier 1 Capital and Tier 2 Capital instruments, the nominal dollar value of the Additional Tier 1 Capital or Tier 2 Capital instrument prior to conversion into the mutual equity interest;

(e) distributions on the mutual equity interest are paid out of distributable items (including retained earnings) of the issuer, and there are no features that require the issuer to make payments in kind. The level of distributions must not be tied or linked to the credit standing of the issuer. Distributions on all mutual equity interests on issue cannot, in aggregate, exceed 50 per cent of the issuer's net profit after tax in the financial year to which the distributions relate.⁶⁸ All distributions on mutual equity interests must be treated as dividends for the purposes of GPS 110;

(g) distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made;

(h) each mutual equity interest absorbs losses on a going concern basis proportionately, and *pari passu*, with all other mutual equity interests.

2. Issue documentation and marketing material for mutual equity interests must clearly and prominently state that:

(a) the mutual equity interest is neither covered by the Financial Claims Scheme nor guaranteed by the Australian Government;

(b) the principal amount of the mutual equity interest is perpetual and never repaired outside liquidation (other than discretionary repurchases subject to APRA's approval);

(c) the holder of the mutual equity interest may only be entitled to a claim on the issuing regulated institution's residual assets after more senior claims

⁶⁸ 'Financial year' means a period of 12 consecutive months covered by one or more sets of publicly available operating results preceding the date of the proposed payments of distributions.

(including Additional Tier 1 Capital and Tier 2 Capital instruments) have been paid;

(d) neither the issuer nor the holder of the mutual equity interest is allowed to exercise any contractual rights of set-off in relation to the mutual equity interest; and

(e) the ADI has full discretion over the timing and amount of any distributions paid on the mutual equity interest, including not paying a distribution.

3. A regulated institution must obtain APRA's approval prior to issuing mutual equity interests, or Additional Tier 1 Capital or Tier 2 Capital instruments that convert to mutual equity interests in accordance with Attachment E to this Prudential Standard.

4. The principal amounts of all mutual equity interests on issue (determined in accordance with paragraph 1(c)(ii) of this Attachment) are eligible for inclusion in Common Equity Tier 1 Capital up to a maximum limit of 25 per cent of the regulated institution's Common Equity Tier 1 Capital before applying regulatory adjustments under paragraph 303033(g) of this Prudential Standard.

~~4.5.~~ The principal amounts of all mutual equity interests on issue (determined in accordance with paragraph 1(c)(ii) of this Attachment) are eligible for inclusion in Tier 1 Capital and the capital base.