



## Prudential Standard LPS 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 life company and the various regulatory adjustments to be made to determine the capital base for each statutory fund, the general fund and the life company as a whole.

The ultimate responsibility for ensuring that the capital base of a life company and the capital bases of all of its funds meet the requirements of this Prudential Standard rests with its Board of directors.

The key requirements of this Prudential Standard are that a life company must:

- comply with minimum requirements regarding the size and composition of the capital base for the life company as a whole and for each of its funds;
- 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.

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## Authority

1. This Prudential Standard is made under paragraph 230A(1)(a) of the Life Insurance Act 1995 (the Act).

## Application and commencement

2. This Prudential Standard applies to all life companies including **friendly societies** (together referred to as **life companies**) registered under the Act<sup>1</sup>, except where expressly noted otherwise.
3. A life company must apply this Prudential Standard separately:
  - (a) for a life company other than a friendly society: to each of its statutory funds, its shareholders' fund and the life company as a whole; and
  - (b) for a friendly society: to each of its approved benefit funds, its management fund and the friendly society as a whole.
4. This Prudential Standard only applies to the business of an **Eligible Foreign Life Insurance Company** which is carried on through its Australian statutory funds but not otherwise.<sup>2</sup>
5. This Prudential Standard applies to life companies from 1 July 2023.

## Adjustments and exclusions

6. APRA may adjust or exclude a specific requirement in this Prudential Standard in relation to a life company.<sup>3</sup>

## Previous exercise of discretion

7. A life company 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.

## Interpretation

8. Terms that are defined in Prudential Standard LPS 001 Definitions appear in bold the first time they are used in this Prudential Standard.
9. 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.

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<sup>1</sup> Refer to subsection 21(1) of the Act.

<sup>2</sup> Refer to section 16ZD of the Act.

<sup>3</sup> Refer to subsection ~~S~~-230A(4) of the Act.

10. Unless otherwise indicated:

- (a) the term **statutory fund** will be used to refer to a statutory fund of a life company other than a friendly society, or an approved benefit fund of a friendly society, as relevant;
- (b) the term **general fund** will be used to refer to the shareholders' fund of a life company other than a friendly society, or the management fund of a friendly society, as relevant;
- (c) the term 'fund' will be used to refer to a statutory fund or a general fund, as relevant;
- (d) the term 'insurance policy receivables' will be used to refer to premiums and other accounts receivable including loans on policies that have been recognised within the **net life contract liabilities** derived from the insurance and reinsurance contract liabilities and assets reported on the balance sheet under *AASB 17 Insurance Contracts*; and
- (e) the term 'insurance policy payables' will be used to refer to claims and other accounts payable that have been recognised within the net life contract liabilities derived from the insurance and reinsurance contract liabilities and assets reported on the balance sheet under *AASB 17 Insurance Contracts*.

11. 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;
- (b) a 'category of capital' is a group of components of capital; and
- (c) the 'net assets' of a statutory fund, ~~or~~ general fund, or life company is a reference to the net assets of the fund or life company determined under the life company's prudential reporting to APRA under the *Financial Sector (Collection of Data) Act 2001* (Collection of Data Act). It includes shareholders' capital and retained profits, unallocated benefit fund reserves<sup>4</sup>, other reserves and foreign currency translation reserves.

## Definitions

12. 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**;

<sup>4</sup> This item only applies to friendly society benefit funds providing defined benefits. It includes unallocated surplus that must be transferred to the management fund and unallocated surplus that may either be transferred to the management fund or used for benefit enhancement under the benefit fund rules.

- (b) distributable items – means items which are permitted to be distributed to holders of capital instruments in accordance with relevant statutory and regulatory requirements applicable to distributions by the issuer;
- (c) mutual equity interests – capital instruments issued by mutually owned life companies that meet the criteria in Attachment G to this Prudential Standard;
- (d) mutually-owned life company – means a life company 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; and
- (g) related entity – means an entity over which a life company or parent entity of the life company exercises control or significant influence and can include a parent company, a sister company, a subsidiary or any other affiliate.~~;~~

### Capital base of a life company

13. The capital base must be assessed for the life company as a whole and for each of its funds. The requirements for statutory funds are specified in paragraphs ~~51~~~~52~~ to ~~54~~~~55~~. The requirements for general funds are specified in paragraphs ~~55~~~~56~~ to ~~57~~~~57~~. Paragraphs 14 to ~~50~~~~51~~ set out the requirements for the life company as a whole.
14. The capital base of a life company consists of the following categories:
  - (a) Tier 1 Capital, which comprises:
    - (i) Common Equity Tier 1 Capital;
    - (ii) Additional Tier 1 Capital; and
    - (iii) Paid-up mutual equity interests issued by a mutually-owned life company 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.

15. A life company must ensure that at all times<sup>5</sup>:

- (a) the Common Equity Tier 1 Capital for the life company exceeds 60 per cent of the **prescribed capital amount** of the life company;

- (b) the Tier 1 Capital for the life company exceeds 80 per cent of the prescribed capital amount of the life company; ~~and~~

- (c) the capital base for the life company exceeds the **Prudential Capital Requirement** (PCR) of the life company;

- (d) 120 per cent of the net assets for the life company exceeds 60 per cent of the prescribed capital amount of the life company;

- (e) the sum of 120 per cent of the net assets and the Additional Tier 1 Capital for the life company exceeds 80 per cent of the prescribed capital amount of the life company; and

- ~~(e)~~(f) the sum of 120 per cent of the net assets, the Additional Tier 1 Capital and the Tier 2 Capital for the life company exceeds the PCR of the life company.

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

17. A life company must ensure that any item of capital that the life company includes in a particular category of 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.

18. A life company must not include an item of capital in a particular category of its capital base if that 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.

- ~~19. A life company must ensure that funds raised by a related entity, and invested in the life company, are not upgraded to a higher category of capital when measured in a life company's capital base. Any such component of capital must be reclassified to the appropriate lower category of capital when included in the life company's capital base.~~

<sup>5</sup> The net assets of the life company referred to in subparagraphs 15(d), 15(e) and 15(f) is as defined in subparagraph 11(c) but excludes equity components that are classified as Additional Tier 1 Capital.

~~20.~~19. A life company must not include a capital instrument in a category of the capital base based on a future event<sup>6</sup>, until such time as:

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

~~21.~~20. APRA may require a life company to:

- (a) exclude from its capital base any item included as a component of capital that in APRA's opinion is not a genuine contribution to the financial strength of the life company; 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.

~~22.~~21. 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.

~~23.~~22. A life company 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.

~~24.~~23. A life company must not include a capital instrument in its capital base if the capital instrument has features that hinder recapitalisation of the life company, or a related entity of the life company. This includes features that require the life company or a related entity of the life company, to compensate investors if a new instrument is issued at a lower price during a specified timeframe.

~~25.~~24. A capital instrument is not eligible for inclusion in the capital base if it contains any terms that could inhibit the life company'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 life company.

~~26.~~25. 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 level of capital raised.<sup>7</sup>

~~27.~~26. A life company or a related entity of the life company, must not create an expectation at issuance that a capital instrument will be bought back, redeemed

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<sup>6</sup> 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 instruments.

<sup>7</sup> 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.

or cancelled prior to maturity, and the statutory or contractual terms of the instrument must not include any feature that may give rise to such an expectation prior to maturity. A life company or a related entity of the life company, must not assume, or create market expectations, that supervisory approval will be forthcoming for the life company or a related entity of the life company, to buy back, redeem or cancel an instrument prior to maturity.

~~28.27.~~ A life company 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.

~~29.28.~~ A life company 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.

~~30.29.~~ Where the terms of a capital instrument depart from established precedent, a life company must consult with APRA on the eligibility of the instrument for inclusion in a category of the life company's capital base in advance of the issuance of the instrument, and provide APRA with all information it requires to assess the eligibility of the instrument.

~~31.30.~~ As part of the documentation provided for the purposes of paragraphs ~~28.29~~ and ~~29.30~~ of this Prudential Standard, a life company must include a statement of compliance of the capital instrument signed by a **senior manager** of the life company. 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
- (b) clearly set out references to supporting documents and opinions that demonstrate that the criteria are met.

~~32.31.~~ A life company must obtain APRA's written approval before the terms of an instrument are altered in a way that may affect its eligibility as a component of the capital base.

### Common Equity Tier 1 Capital

~~33.32.~~ 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 policy owners and other creditors in the event of winding-up of the issuer.



~~34.33.~~ Common Equity Tier 1 Capital consists of the sum of:

- (a) paid-up ordinary shares issued by a life company (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 life company that meet the criteria in paragraph 1 of Attachment G to this Prudential Standard ~~and are above up to~~ the limit specified in paragraph 4 of Attachment G;
- (c) retained earnings;
- (d) undistributed current year earnings (refer to paragraph 34~~35~~ of this Prudential Standard);
- (e) accumulated other comprehensive income and other disclosed reserves (refer to paragraph 38~~39~~ to this Prudential Standard); and
- (f) regulatory adjustments applied in the calculation of Common Equity Tier 1 Capital required under Attachment B to this Prudential Standard.

~~35.34.~~ Current year earnings must take into account:

- (a) negative goodwill;
- (b) expected tax expenses; and
- (c) dividends when declared in accordance with Australian Accounting Standards.

~~36.35.~~ Declared dividends for the purpose of paragraph 34(c)~~35(e)~~ 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 life company. A life company 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 life company 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 approval to a new amount by which declared dividends may be reduced for regulatory capital purposes.

~~37.36.~~ Current year earnings include the full value of fee income not sourced from life policies provided that:

- (a) the fee income has either been received in cash or has been debited by the life company to an account to be paid by the provider of the fees or otherwise forms part of the upfront fees owed to the life company;
- (b) outstanding amounts of fee income debited by the life company 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 life company to the account cannot be cancelled by the provider of the fee income where the fees were otherwise 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.

~~38.37.~~ Fee income not sourced from life policies may include net positive amounts arising from the netting of deferred or future income and capitalised expenses associated with a product class (not comprising life policies) provided the conditions in paragraph 36~~37~~ of this Prudential Standard are satisfied. Any deferred income or future income that do not satisfy the conditions in paragraph 36~~37~~, if not already excluded from current year or retained earnings, must be deducted from Common Equity Tier 1 Capital.

~~39.38.~~ 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 life company;
  - (ii) the ordinary shares comprise only new ordinary shares to be issued by the life company, or new ordinary shares to be issued by the life company to employees, or new ordinary shares already issued by the life company 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).
- (c) foreign currency translation reserve;
- (d) general reserves;
- (e) cumulative unrealised gains or losses on hedges<sup>8</sup> 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

<sup>8</sup> This includes cumulative unrealised gains or losses on effective cash flow hedges as defined in Australian Accounting Standards.

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 purpose of paragraph 38(b)~~39(b)~~ any other reserves associated with share-based payments must be excluded from the capital base.

~~40.39.~~ 39. Revaluation of property holdings on the balance sheet may be included as part of other disclosed reserves only if:

- (a) the property is owned by the life company;
- (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 life company;
- (e) the revaluations are reliable, in accordance with Australian Accounting Standards, and subject to audit or review consistent with Australian **Auditing and Assurance Standards**. A 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**

~~41.40.~~ 40. 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 policy owners and other more senior creditors in the event of winding up of the issuer; and
- (d) provide for fully discretionary capital distributions.

~~42.41.~~ 41. Additional Tier 1 Capital consists of:

- (a) instruments issued by a life company 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 absorbency at the point of non-viability set out in Attachment E 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.

## **Tier 2 Capital**

~~43.42.~~ 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 life company and its capacity to absorb losses.

~~44.43.~~ Tier 2 Capital consists of:

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

## **Additional Tier 1 or Tier 2 Capital issued overseas by the life company**

~~45.44.~~ Additional Tier 1 Capital instruments and Tier 2 Capital instruments may be issued by a life company, either in its country of incorporation or through a branch in another country, provided the instrument:

- (a) constitutes an obligation of the life company at all times;
- (b) is freely available to absorb losses across all of the operations of the life company; 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**

~~46.45.~~ The matters APRA may consider in assessing whether an item included by a life company 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 sourced, directly or indirectly, from the life company; 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 life company failing to meet any servicing obligations.

**47.46.** In assessing the overall strength of the capital adequacy of a life company APRA will have regard to the level of capital adequacy of individual group members of a group to which the life company 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 life company.

**48.47.** In assessing the overall capital strength of a life company, APRA may request that the parent entity provide APRA with details of relevant 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 life company to other members of the group. APRA may also request details of material exposures between other members of the group to which it belongs.

### **Holding of capital instruments in group members by other group members**

**49.48.** Capital instruments of a life company that are held as direct investments by a vehicle<sup>9</sup> subject to consolidation within the financial statements of the group to which it belongs in accordance with Australian Accounting Standards, may be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital, or the capital base of a statutory fund, only if:

- (a) the life company (or relevant vehicle, other than a parent company of the life company, 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 policy owners or other third-party investors);
- (b) the risk and rewards associated with the investments are borne primarily by third parties;
- (c) the life company 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 employee share-based remuneration scheme.

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<sup>9</sup> These vehicles exclude any SPV, such as a trust, involved with employee share-based remuneration schemes.

~~50.49.~~ Direct investments in shares of a life company by an SPV (e.g. a trust) established under a share-based employee remuneration scheme may be included in the life company's Common Equity Tier 1 Capital only if:

- (a) the shares issued to the SPV represent ordinary shares of the life company;
- (b) the amount included in Common Equity Tier 1 Capital is matched by an equivalent charge to profit or loss of the life company for expensing the issue of ordinary shares to, 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).

~~51.50.~~ If the requirements in paragraph 48~~50~~ and 49 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, Additional Tier 1 Capital and Tier 2 Capital, as appropriate.

### Capital base of a statutory fund

~~52.51.~~ The capital base of a statutory fund is:

- (a) the net assets of the fund; less
- (b) all regulatory adjustments to the net assets of the statutory fund required under Attachment B; plus
- (c) Tier 2 Capital as defined in paragraph ~~52~~~~53~~.

~~53.52.~~ The Tier 2 Capital of a statutory fund consists of:

- (a) instruments that are a liability of that fund and meet the criteria for inclusion in Tier 2 Capital as set out in Attachment D; less
- (b) all holdings by the fund of the life company's own Tier 2 Capital instruments.

~~54.53.~~ A life company must ensure that, at all times<sup>10</sup>:

- (a) the capital base less the Tier 2 Capital in accordance with paragraph ~~52~~~~53~~ of each statutory fund exceeds 80 per cent of the prescribed capital amount of the fund; ~~and~~
- ~~(b)~~ the capital base of each statutory fund exceeds the PCR of the fund~~;~~

<sup>10</sup> The net assets of each statutory fund referred to in subparagraphs 53(c) and 53(d) is as defined in subparagraph 11(c) but includes seed capital transferred to the statutory fund from the general fund.

(c) 120 per cent of the net assets of each statutory fund exceeds 80 per cent of the prescribed capital amount of the fund; and

~~(b)~~(d)the sum of 120 per cent of the net assets and the Tier 2 Capital in accordance with paragraph 52 of each statutory fund exceeds the PCR of the fund.

~~55.~~54. APRA may, by notice in writing to a life company, set a higher percentage for the capital base, net of Tier 2 Capital, for one or more statutory funds of the life company.

### **Capital base of a general fund**

~~56.~~55. The capital base of a general fund is:

- (a) the net assets of the fund; less
- (b) all regulatory adjustments to the net assets of the general fund required under Attachment B.

56. A life company must ensure that, at all times, the capital base of the general fund exceeds the PCR of the fund.

57. A friendly society must ensure that, at all times, 120 per cent of the net assets of the general fund exceeds the PCR of the fund.<sup>11</sup>

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<sup>11</sup> The net assets of the general fund referred to in paragraph 57 is as defined in subparagraph 11(c) but excludes seed capital that is a receivable from a statutory fund.

## 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;
  - (b) the instrument represents the most subordinated claim in liquidation of the issuer;
  - (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);
  - (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);
  - (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. 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 *Prudential Standard LPS 110 Capital Adequacy* (LPS 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.<sup>12</sup> Within Common Equity Tier 1 Capital, each

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<sup>12</sup> In cases where capital instruments have a permanent write-off feature, this criterion is still deemed to be met by ordinary shares.



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 standards;
  - (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~~<sup>13</sup>, cannot have purchased or directly or indirectly<sup>14</sup> funded 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 life company 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 instrument will be ineligible to be included in the life company's Common Equity Tier 1 Capital.
  3. Where an instrument issued by the life company is subject to the laws of a foreign jurisdiction, the life company 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.
  4. APRA may require the life company to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the expense

<sup>13</sup> This does not preclude the parent entity of the life company holding the instrument where the instrument is directly issued by the life company to the parent.

<sup>14</sup> Indirect exposures represent exposures that will result in a loss to the life company substantially equivalent to any loss in the direct holding.

of the life company, confirming that the instrument meets all or any criteria applied to Common Equity Tier 1 Capital instruments in this Prudential Standard.

5. For the purpose 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 life company's capital base, items must be valued on the same basis as a life company's accounts prepared in accordance with the ~~Financial Sector (Collection of Data) Act-2001~~.
2. For the purposes of 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 deduction must be made from Common Equity Tier 1 Capital. A life company 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 life company 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 life company must not recognise, for the purpose of measuring its capital adequacy, any transactions (or dealings) which have the aim of offsetting required deductions.

### *Exception for assets with values linked to the value of liabilities*

6. If policy benefits can be reduced in response to a fall in the value of an asset listed in this Attachment, the asset does not have to be deducted. However, the asset will be subject to a 100 per cent capital charge when applying the default risk stress under Prudential Standard LPS 114 Capital Adequacy: Asset Risk Charge. This treatment can only be applied if:
  - (a) the benefits under the policy are contractually linked to the performance of the asset;
  - (b) the extent of the exposure to the asset is consistent with the stated investment objectives; and

- (c) there has been appropriate disclosure to policy owners of the risks to which they are exposed.

### **Holdings of own capital instruments**

7. Unless otherwise indicated, a life company must deduct from the corresponding category of capital holdings of the life company's own capital instruments, whether held directly or indirectly<sup>15</sup>, unless otherwise 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 life company could be contractually obliged to purchase and also all of the unused portion of any limit agreed with APRA under paragraph ~~27~~<sup>28</sup> of this Prudential Standard;

### **Regulatory adjustments to Common Equity Tier 1 Capital**

8. A life company must make the following deductions to determine Common Equity Tier 1 Capital.

#### *Deferred tax assets and deferred tax liabilities*

9. Subject to paragraphs 10, 11 and 12 of this Attachment, a life company must deduct deferred tax assets net of deferred tax liabilities.<sup>16</sup>
10. 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 cannot 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 liability adjustment calculated in accordance with paragraph 25 of this Attachment.
11. The netting of deferred tax assets and deferred tax liabilities must only be applied where the life company 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 life company 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
  - (b) defined benefit superannuation assets.
13. In order to apply the treatment in paragraph 9 of this Attachment, a life company must:

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<sup>15</sup> Indirect exposures represent exposures that will result in a loss to the life company substantially equivalent to any loss in the direct holding.

<sup>16</sup> Excluding any deferred tax liabilities that have already been netted off elsewhere in accordance with this Prudential Standard.

- (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.

*Gains and losses arising from changes in own creditworthiness*

14. A life company must eliminate all unrealised gains and losses that have resulted from changes in the value of liabilities (including capital instruments) and any associated embedded derivatives, due to changes in the life company'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*

15. Subject to paragraph 17~~16~~ of this Attachment, a life company must deduct the following net of any associated deferred assets and deferred tax liabilities that would be extinguished if the assets involved become impaired or derecognised under Australian Accounting Standards:
- (a) goodwill and any other intangible assets<sup>17</sup> 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 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

<sup>17</sup> 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.

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 from sources other than life policies over deferred costs may be included in Common Equity Tier 1 Capital provided the fee income received satisfies the criteria in paragraph ~~37~~<sup>36</sup> of this Prudential Standard. Otherwise, up-front fee income received from sources other than life policies must not be added to capital.
17. An investment in a subsidiary, joint venture<sup>18</sup> or **associate** that:
  - (a) is operationally independent;
  - (b) represents a genuine arm's length investment;
  - (c) is not subject to prudential capital requirements; and
  - (d) does not undertake 'life insurance business' or business related to insurance business<sup>19</sup>

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*

18. A life company must deduct any surplus in a defined benefit superannuation fund, of which the life company 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 life company may apply to APRA to include a surplus as an asset for capital adequacy purposes where the life company is able to demonstrate unrestricted and unfettered access to a fund surplus in a timely manner. Subject to APRA approval the life company may include the surplus in its capital base. This surplus will no longer be required to be deducted from Common Equity Tier 1 Capital.
19. A life company must deduct any deficit in a defined benefit superannuation fund of which a life company is an employer-sponsor and that is not already reflected in Common Equity Tier 1 Capital.

<sup>18</sup> 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.

<sup>19</sup> Entities that undertake business related to life insurance business include entities that provide a financing role to life insurance business, life insurance intermediaries and service companies.

*Reinsurance assets*

20. A life company must deduct all reinsurance assets<sup>20</sup> (if positive) reported in relation to each reinsurance arrangement that, subject to a six month grace period from risk inception, does not comprise an executed and legally binding contract.

*Investments in subsidiaries, joint ventures and associates*

21. A life company 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 life company's share of the regulatory capital requirements<sup>21</sup> and the value of the investment that is recorded on the life company's balance sheet after adjustment for any intangible component in accordance with paragraphs 15 and 17~~16~~ of this Attachment. This deduction must be applied after any deduction for intangibles in the investment in accordance with paragraphs 15 and 17~~16~~ of this Attachment.
22. For the purposes of the deduction in paragraph 21 of this Attachment, the regulatory capital requirement of the investment is:
- (a) the prescribed capital amount if the investment is in a life company as defined under the Act; or
  - (b) the equivalent amount to the prescribed capital amount if the investment is an entity carrying on life insurance business in a foreign jurisdiction; or
  - (c) a comparable regulatory capital requirement as agreed with APRA.<sup>22</sup>
23. If the investment subject to the deduction in paragraph 21 of this Attachment is a **non-operating holding company** (NOHC), the life company 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*

24. A life company must deduct all assets of the life company that are under a fixed or floating charge<sup>23</sup>, 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 life company's balance sheet.

<sup>20</sup> For the purposes of this Prudential Standard, 'reinsurance assets' refers to reinsurance assets net of doubtful debts.

<sup>21</sup> The life company's share of the regulatory capital requirements is determined by applying the ownership of the subsidiary, joint venture or associate (as relevant) to the total regulatory capital requirement of the investment.

<sup>22</sup> Examples of the entities that are subject to a comparable regulatory capital requirement are **authorised deposit-taking institutions**, general insurers and health insurers.

<sup>23</sup> 'Charge' means a charge created in any way and includes a mortgage or an agreement to give or execute a charge or mortgage, whether upon demand or otherwise.

*Liability adjustment*

25. A life company must deduct the liability adjustment. This is calculated as the difference between:
- (a) the sum of **adjusted policy liabilities** and insurance policy payables; and
  - (b) the sum of net life contract liabilities and insurance policy receivables;
- together with any tax effects that would result from these adjustments, where:
- (c) 'net life contract liabilities' equals the sum of the insurance, reinsurance and investment contract liabilities (net of insurance and reinsurance assets) disclosed in the **statutory accounts**.
26. The liability adjustment can be positive or negative. The method of determining the adjusted policy liabilities is specified in Attachment F.

*Fair value adjustments*

27. A life company may measure its non-financial assets, short term receivables, and intercompany receivables and payables using the requirements in Australian Accounting Standards ~~for~~ rather than fair value.
28. A life company 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.
29. A life company 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 life company must make any other deductions required under any other Prudential Standard.

**Regulatory adjustments to the net assets of a statutory fund or general fund**

31. The amount of net assets to be included in the capital base of a statutory fund or general fund of a life company must be calculated after making the following deductions:
- (a) all regulatory adjustments to Common Equity Tier 1 Capital required under this Attachment; and
  - (b) for a friendly society management fund, seed capital that is a receivable from an approved benefit fund.
32. In determining the deduction for deferred tax assets net of deferred tax liabilities, a life company may assume that tax benefits in one fund can be offset against



deferred tax liabilities in another statutory fund or the general fund, subject to the offset only being used once in the calculation of the capital base for both funds.

33. For a friendly society approved benefit fund, 'seed capital' may be added to the net assets of the fund.

## Attachment C - Criteria for inclusion in Additional Tier 1 Capital

1. To be classified as Additional Tier 1 Capital, an instrument must satisfy all the criteria in this Attachment.<sup>24</sup>
2. The instrument must be paid-up and the amount must be, irrevocably received by the issuer.
3. The instrument represents, prior to any conversion to Common Equity Tier 1 Capital (refer to Attachment E), the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 Capital instruments.
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 holder's claim. 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.
5. The principal amount of the instrument is perpetual (i.e. it has no maturity date).<sup>24</sup>
6. The instrument contains no step-ups or other incentives to redeem. The issuer and any related entity of the life company -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.<sup>25</sup>
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;
  - (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

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

<sup>25</sup> 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 life company must not otherwise do anything to create an expectation that the call will be exercised.

- (ii) the life company meets the requirements relating to reductions in capital in LPS 110.

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.<sup>26</sup>

8. An issuer must:

- (a) have full discretion at all times to cancel distributions/payments on the instrument.<sup>26</sup> 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 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.<sup>27</sup>

9. 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.<sup>28</sup>

10. 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). 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 life company to exclude an instrument from Additional Tier 1 Capital where it considers that the reference rate is sensitive to the credit standing of the issuer.

<sup>26</sup> 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.

11. 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. The issue documentation must specify that the insolvency law that applies is the law of the place of incorporation of the issuer.<sup>27</sup>
12. The paid-up amount of the instrument is classified as equity under relevant accounting standards.<sup>28</sup>
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 entity<sup>28</sup> cannot have purchased or directly or indirectly<sup>29</sup> funded the purchase of the instrument.
14. Where the terms of the instrument provide the ability (even in contingent circumstances) to substitute the issuer of the Additional Tier 1 Capital instrument, or the issuer of ordinary shares into which they convert (i.e. to replace the life company with another party), the relevant documentation must set out the mechanism to ensure that there will be a capital injection into the life company to replace the transferred capital instrument. The 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.
15. 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.
16. The instrument includes provisions which comply with loss absorption requirements at the point of non-viability as required by Attachment E to this Prudential Standard.
17. The instrument is clearly and separately disclosed in the issuer's financial statements and in any consolidated financial statements.
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.

<sup>27</sup> If an overseas branch of a life company 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.

<sup>28</sup> This does not preclude a parent entity of the life company from holding the instrument where the instrument is directly issued by the life company to the parent entity.

<sup>29</sup> Indirect exposures represent exposures that will result in a loss to the life company substantially equivalent to any loss in the direct holding.

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 prevent<sup>30</sup>, 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 the members of a friendly society for winding-up, or a court order has been made and the time for the appeal of the decision has passed) of the issuer.

19. The issue documentation must clearly and prominently state:

- (a) the instrument is perpetual;
- (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 of 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;
- (f) if relevant, the application of requirements for loss absorption at the point of non-viability under Attachment E to this Prudential Standard; and
- (g) that 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 purpose of paragraph 8 of this Attachment, failure to make a distribution or payment must not trigger any restrictions<sup>31</sup> on the issuer other than its ability

<sup>30</sup> For example, by way of a scheme of arrangement.

<sup>31</sup> 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.

to pay a distribution on Common Equity Tier 1 Capital instruments<sup>32</sup> 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;
- (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;
- (d) impede the normal operation of the issuer or any restructuring activity (including acquisitions or disposals); or
- (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 life company 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 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 interests 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;
  - (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;

<sup>32</sup> 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.

- (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
  - (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 life company 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 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.
27. APRA may require a life company not to exercise a call where it relates to a tax or regulatory event if APRA forms the view that the life company 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(a) to 7(c) of this Attachment.

28. Where an Additional Tier 1 Capital instrument provides for conversion into ordinary shares<sup>33</sup>, 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;
  - (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;
  - (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 life company's<sup>34</sup> ordinary share price<sup>35</sup> at the same time. However, this cap does not apply if the only holder of the converting capital instrument is a listed parent entity 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 similar transactions. 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. 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 life companies, where an Additional Tier 1 Capital instrument provides for conversion into mutual equity interests, the issue documentation must:

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

<sup>34</sup> Reference to life company captures any entity whose ordinary shares are issued as a result of conversion provisions.

<sup>35</sup> For an unlisted life company 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.



- (a) ~~S~~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) ~~P~~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
  - (c) ~~S~~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 Additional Tier 1 Capital instrument converted.
30. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the life company under Australian Accounting Standards.
31. In issuing Additional Tier 1 Capital instruments a life company 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; and
  - (b) provide for a ranking under which Additional Tier 1 Capital instruments will be converted or written off.
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 life company; and
  - (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).
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.
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. 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:
- (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 prevent,<sup>36</sup> 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 the members of a friendly society for winding-up, or a court order has been made, and the time for appeal of the decision has passed) of the issuer.
37. Where issue documentation, or 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 instrument will be ineligible to be included in the life company's Additional Tier 1 Capital.
38. The instrument may be subject to the laws of a foreign country except that the terms and conditions of the instrument that relate to non-viability conversion or write-off must be subject to the laws of an Australian jurisdiction.
39. Where the instrument is subject to the laws of a foreign country, the life company must also ensure that the instrument satisfies all relevant eligibility criteria applicable to the instrument under this Attachment are enforceable under the laws of that jurisdiction.
40. APRA may require the life company to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the life company's expense, confirming that the instrument satisfies all applicable criteria for an Additional Tier 1 Capital instrument under this Prudential Standard.

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<sup>36</sup> For example, by way of a scheme of arrangement.

## Attachment D - Criteria for inclusion in Tier 2 Capital

1. To be classified as Tier 2 Capital, an instrument must satisfy all of the criteria in this Attachment.
2. The instrument must clearly indicate that it is subordinate to the interests of policy owners of a particular statutory fund in the liquidation of the life company.
3. The instrument must be paid-up and the amount must be irrevocably received by the relevant statutory fund.
4. The paid-up amount of the instrument must be classified as a liability of the relevant statutory fund under the relevant accounting standards.
5. The instrument represents, prior to any conversion to Common Equity Tier 1 Capital (refer to Attachment E 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.
6. 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. 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.~~;~~
7. The principal amount of the instrument:
  - (a) has a minimum maturity of at least five years<sup>37</sup>; 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 23 to this Attachment).~~;~~
8. The instrument contains no step-ups or other incentives to redeem. The issuer and any related entity of the life company 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 instrument must not provide any feature that might give rise to such an expectation.<sup>38</sup>
9. 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;

<sup>37</sup> 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.

<sup>38</sup> 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 life company must not otherwise do anything to create an expectation that the call will be exercised.

- (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 life company meets the requirements relating to reductions in capital in LPS 110.
10. 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.
  11. The instrument must confer no rights on holders to accelerate the repayment of future scheduled payments (coupon or principal) except in bankruptcy (including winding-up) and liquidation. Winding-up of the life company must be irrevocable (that is, either by way of an effective resolution by the members of a friendly society for winding-up, or a court order has been made, and the time for appeal of the decision has passed). The making of an application for winding-up or the appointment of a judicial manager, liquidator or other external administrator including the exercise of APRA's powers under Part 8 of the Act, must not be sufficient to accelerate repayment of the instrument.
  12. The instrument must not provide for payment to investors other than in the form of a cash payment.
  13. 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 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 life company to exclude an instrument from treatment as Tier 2 Capital where APRA considers that the reference rate is sensitive to the credit standing of the issuer.
  14. 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 entity<sup>39</sup> cannot have purchased or directly or indirectly<sup>40</sup> funded the purchase of the instrument or be funding the purchase of the instrument.

<sup>39</sup> This does not preclude a parent entity of the life company from holding the instrument where the instrument is directly issued by the life company to the parent entity.

<sup>40</sup> Indirect exposures represent exposures that will result in a loss to the life company substantially equivalent to any loss in the direct holding.

15. 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 life company with another party), the relevant documentation must set out the mechanism to ensure that there will be a capital injection into the life company and the relevant statutory fund to replace the transferred capital instrument. 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 capital and at least the same amount as the original issue, unless otherwise approved by APRA.
16. 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.
17. If an issuer defaults under the terms of the instrument, 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 for unpaid dividends and interest must be the most subordinated claims in liquidation of the issuer after Common Equity Tier 1 Capital instruments and Additional Tier 1 Capital instruments.
18. 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. The instrument includes provisions which comply with the loss absorption requirements at the point of non-viability in accordance with Attachment E to this Prudential Standard.
20. The instrument is clearly and separately disclosed in the issuer's financial statements.
21. 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 21(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 prevent<sup>41</sup>, 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 the members of a friendly society for winding-up, or a court order has been made, and the time for the appeal of the decision has passed) of the issuer.

22. Issue documentation must clearly and prominently state:

- (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;
- (d) that the issuer cannot buy back, repurchase or redeem the instrument other than in terms permitted under this Prudential Standard; and
- (e) the application of requirements relating to loss absorption at the point of non-viability under Attachment E to this Prudential Standard.

23. The amount of 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:

<b>Years to <del>m</del>Maturity</b>	<b>Amount <del>e</del>Eligible for <del>i</del>Inclusion in Tier 2 Capital</b>
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
Less than and including 1	20 per cent

<sup>41</sup> For example, by way of a scheme of arrangement.

24. For the purposes of paragraph 8 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;
  - (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 28 of this Attachment); and
  - (g) application of maximum or minimum rates on distributions.
25. 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 life company may have an option to call the instrument to the nearest subsequent date upon which that conversion option may be exercised.
26. Calling an instrument and replacing it with an instrument with a higher credit spread or that is otherwise more expensive is deemed -to 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.
27. 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.
28. 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 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.
29. APRA may require a life company not to exercise a call where it relates to a tax or regulatory event if APRA forms the view that the life company 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 9(a) to 9(c) of this Attachment.
30. Where a Tier 2 Capital instrument provides for conversion into ordinary shares<sup>42</sup>, 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 formula specified in (a) of this paragraph 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 Tier 2 Capital instrument at the time of its issue divided by 20 per cent of the life company's<sup>43</sup> ordinary share price<sup>44</sup> at the same time. However, this cap does not apply if the only holder of the converting capital instrument is a listed parent entity which wholly-owns the issuer of the capital instrument. In calculating the ordinary share price at time of issue:
    - (i) adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations;

<sup>42</sup> Conversion must be into the ordinary shares of the life company or its parent entity, which must be listed at the time of issue. For an unlisted life company with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into unlisted ordinary shares of the life company. Where an unlisted life company issues the instrument to its listed parent entity, conversion may be into unlisted ordinary shares of the life company.

<sup>43</sup> Reference to life company in this context captures any entity whose ordinary shares are issued as a result of conversion provisions.

<sup>44</sup> For an unlisted life company 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.



- (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;
  - (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.
31. For mutually owned life companies, 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.
32. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the life company under Australian Accounting Standards.
33. In issuing Tier 2 Capital instruments, a life company 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; and
  - (b) provide for a ranking under which Tier 2 Capital instruments will be converted or written off.
34. 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 life company; 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).
35. 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.
36. 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.
37. The documentation of any debt instrument or other capital instrument of the issuer of a Tier 2 Capital instrument must not include any of the following clauses:
- (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.
38. For the purposes of paragraph 37(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 prevent<sup>45</sup>, 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 the members of a friendly society for winding up, or a court order has been made, and the time for appeal of the decision has passed) of the issuer.

39. Where issue documentation, marketing of an instrument, or any ongoing dealings with investors suggest that the instrument has attributes not consistent with the eligibility requirements in this Attachment for Tier 2 Capital instruments, the instrument is ineligible to be included in Tier 2 Capital.
40. The instrument may be subject to the laws of foreign country, except that the terms 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.
41. Where the instrument is subject to the laws of a foreign country, the life company must also ensure all relevant eligibility criteria applicable to the instrument under this Attachment is enforceable under the laws of that jurisdiction.
42. APRA may require the life company to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the life company's expense, confirming that the instrument meets the requirements of this Prudential Standard.

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<sup>45</sup> For example, by way of a scheme of arrangement.

## Attachment E - 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 -occurrence of a non-viability trigger event, it will be immediately and irrevocably:
  - (a) converted into the ordinary shares of the life company or its ultimate parent entity, which must be listed at the time the instrument is issued. For an unlisted life company 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 life company. Where an unlisted life company issues the instrument to its listed parent entity, conversion may be into the unlisted ordinary shares of the life company-;
  - (b) converted into mutual equity interests; or
  - (c) written off.
2. A non-viability event is:
  - (a) in relation to a life company when APRA notifies the life company that APRA considers;
    - (i) conversion or write-off of capital instruments is necessary because, without it, a particular fund or the life company would become non-viable; or
    - (ii) without a public sector injection of capital or equivalent support, a particular fund or the life company would become non-viable;
  - (b) subject to paragraphs 6 and 7 of this Attachment, where the life company is a locally-incorporated subsidiary life company of a foreign ~~entity-life company~~, notification by the home regulator of the foreign ~~entity life company~~ to the foreign ~~entity regulated institution~~ or the life company that the home regulator considers that:
    - (i) ~~-~~conversion or write-off of capital instruments is necessary because, without it, the foreign ~~entity regulated institution~~ or the life company would become non-viable; or
    - (ii) without a public sector injection of capital, or equivalent support, the foreign ~~entity regulated institution~~ or the life company 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 life company's Common Equity Tier 1 Capital (for Additional Tier 1 and Tier 2 Capital instruments) and the net assets

of the relevant statutory fund (for Tier 2 Capital instruments) under Australian Accounting Standards.

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 eligible Additional Tier 1 or Tier 2 Capital, an instrument issued by a locally-incorporated life company that is a subsidiary of a foreign entity ~~regulated institution~~ must satisfy the requirements in this Attachment. A non-viability event of the life company, however, need not trigger any loss absorption requirement upon the foreign parent.
7. A locally-incorporated life company that is a subsidiary of a foreign entity ~~regulated institution~~ 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 life company 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 requirements<sup>46</sup> applied to the foreign parent. As a result, a non-viability requirement applicable to the foreign parent may function as a non-viability event for the life company itself in relation to Additional Tier 1 Capital or Tier 2 Capital instruments issued ~~be~~ by the life company.
8. 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 10 and 11 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(b)(i) and 2(b)(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 life company that is a subsidiary of a foreign parent will be determined by the relevant host or home regulator or statutory requirements.
9. The amount of an instrument that may be recognised in the life company's Tier 1 and capital base is the minimum level of Common Equity Tier 1 Capital that

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<sup>46</sup> Requirements may be applied by the home regulator or under statute.

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 life company 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 life company is not required to take into account any taxation effect resulting from write-off of the instrument in the event conversion was not achievable.

10. 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 applies<sup>47</sup>; and
  - (b) the principal amounts of all instruments.
11. A life company 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 10 of this Attachment and a public sector injection of funds into the life company 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.
12. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares (or mutual equity interests), the life company 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 approvals have been obtained to effect conversion.
13. 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 instruments, principal, dividends or interest) in the accounts of the life company and result in an unequivocal additional to Common Equity Tier 1 Capital if following a non-viability event, conversion of the instrument:
  - (a) is not capable of being undertaken;
  - (b) has not been fully effected for any reason within five business days;
  - (c) is not irrevocable; or

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<sup>47</sup> Such a declaration would typically be provided, as appropriate, by APRA or another regulator, or by way of statutory provisions.

- (d) will not result in an immediate and unequivocal increase in Common Equity Tier 1 Capital of the life company.
14. Issue documentation may provide for a ranking of conversion under which instruments may be converted or written-off upon a non-viability event, provided that the terms of the issue documentation do 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.
15. 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 and 29 of Attachment C to this Prudential Standard, and, in the case of Tier 2 Capital instruments, the requirements in paragraph 30 and 31 of Attachment D to this Prudential Standard.
16. 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 34 of Attachment D to this Prudential Standard for a Tier 2 Capital instrument.
17. 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, are not senior to claims associated with ordinary shares or mutual equity interests of the life company and not senior to claims associated with ordinary shares or mutual equity interests of the parent entity.
18. A life company must notify APRA, if the life company anticipates that:
- (a) the life company may be exposed to the occurrence of a non-viability event; or
  - (b) the life company may be subject to a non-viability event contained in non-viability requirements imposed by a home regulator or statute upon the life company's foreign parent.



## Attachment F - Definition of Adjusted Policy Liabilities

### Non-participating benefits

1. For each statutory fund, the adjusted policy liabilities for **non-participating benefits** without entitlement to **discretionary additions** are the greater of:
  - (a) the total **risk-free best estimate liability** (RFBEL) for all policies; and
  - (b) the total **termination values** for all policies.
2. For each statutory fund, the adjusted policy liabilities for non-participating benefits with entitlement to discretionary additions are the greater of:
  - (a) the total RFBEL for all policies; and
  - (b) the total termination values plus, if it is greater than zero, the **investment fluctuation reserve** (IFR).

The 'greater of' must be determined at sub-group level if the policy benefits for a sub-group of policies are determined by reference to the performance of particular assets that the life company has allocated to the liabilities for that sub-group.

3. The adjusted policy liabilities must be increased if the amount determined using the formula above would be insufficient to meet all guarantees and obligations implied by the promotional material of the company, and policy owners' reasonable benefit expectations based on past company practice.

### *Definition of RFBEL*

4. For both **life insurance contracts** and **life investment contracts**, the RFBEL is determined by using the methods used to determine the **best estimate liability**, as specified in *Part D of Prudential Standard LPS 340 Valuation of Policy Liabilities*, but with the gross investment yield and gross discount rate set equal to the **risk-free discount rate** plus the **illiquidity premium**.
5. An illiquidity premium must only be added to the risk-free discount rate for policies that are:
  - (a) **immediate life annuities**;
  - (b) immediate **term certain annuities**;
  - (c) other types of annuities where there are no insurance risks other than longevity and servicing expenses;
  - (d) **fixed term/rate business**; and
  - (e) **funeral bond business**.



6. If an illiquidity premium is added to the risk-free discount rate for a policy, the RFBEL must not be less than the **minimum termination value** or the contractual minimum surrender value for that policy.
7. The illiquidity premium (in basis points) added to the risk-free forward rates for the first 10 years after the reporting date is:

Illiquidity premium = 33 per cent x A spread 3 year

The spread must be:

- (a) obtained from ‘Statistical Table F3 – Aggregate Measures of Australian Corporate Bond Spreads and Yields’ (Table F3) published by the RBA on its website. ‘A spread 3 year’ is the spread to Australian Commonwealth Government ~~s~~Securities (CGS) for non-financial corporate bonds with broad credit rating (as determined by Standard and Poor’s) of A and target tenor of 3 years; or
- (b) if obtaining the spread from Table F3 is impractical due to the delay between the reporting date and the date of publication of Table F3, a best estimate assumption of the spread to be published in Table F3 may be used. The assumption must be made having regard to reasonably available statistics and other information and be neither deliberately overstated nor deliberately understated.

If the RBA ceases to publish this information, an alternative method of calculating the illiquidity premium may be used with the prior written approval of APRA.

The maximum illiquidity premium is 150 basis points and the minimum is zero.

The illiquidity premium added to risk-free forward rates more than 10 years after the reporting date is 20 basis points.

The same illiquidity premium applies to both Australian and overseas liabilities.

8. For business where tax is based only on profits, the RFBEL must exclude the value of future tax payments. Business is considered to be taxed on profits if an increase in policy liabilities would result in a deduction from the company’s taxable income.
9. The RFBEL and termination values must be determined net of reinsurance.

### Participating benefits

10. For each statutory fund, the adjusted policy liabilities for **participating benefits** are the greater of:
  - (a) the total **participating policy liabilities** (PPL) for all policies, where  $PPL = RFBEL + \max\{RFVFB + PRP, 0\}$ ; and

- (b) the total termination values for all policies, increased if necessary so that, if all termination values were paid immediately, the remaining PRP<sup>48</sup> would not be greater than zero.

where:

- (i) RFBEL is defined in the same way as for non-participating benefits;
  - (ii) RFVFB is the risk-free value of future **bonuses** calculated at the bonus rates supported by the policy liabilities<sup>49</sup> using the **best estimate assumptions** but with the gross investment yield and discount rate set equal to the risk-free discount rate (plus the illiquidity premium if this is used in determining the RFBEL);
  - (iii) PRP is policy owners' retained profits (only relevant for life companies that are not friendly societies); and
  - (iv) the 'greater of' must be determined at sub-group level if the policy benefits for a sub-group of policies are determined by reference to the performance of particular assets that the life company has allocated to the liabilities for that sub-group.
11. All amounts must include allowance for bonuses declared as at the reporting date and are net of reinsurance.
12. The adjusted policy liabilities must be increased if the amount determined using the formula above would be insufficient to meet all guarantees and obligations implied by the promotional material of the company, and policy owners' reasonable benefit expectations based on past company practice.

### Liability options and asymmetries

13. The adjusted policy liabilities must not be less than the mean of the distribution of the potential liability outcomes. If the benefits being valued contain options that may potentially be exercised against the company, or the potential liability outcomes have an adverse asymmetrical distribution, then the adjusted liability must include an appropriate value in respect of those options and/or asymmetries. For this purpose, the benefits being valued must allow for the distribution of all investment fluctuation reserves and policy owners' retained profits.

### Friendly societies

14. Friendly society benefits are neither participating nor non-participating. The adjusted policy liabilities for approved benefit funds where there is a provision for distribution of unallocated surpluses to policy owners are to be valued as if they were participating. The adjusted policy liabilities for approved benefit funds

<sup>48</sup> For friendly societies, replace the reference to PRP in this subparagraph with 'unallocated surplus that must be used for benefit enhancement under the approved benefit fund rules'.

<sup>49</sup> For friendly societies, the policy liabilities referred to in this paragraph must include unallocated surpluses held within approved benefit funds if those surpluses must be used for benefit enhancement under the approved benefit fund rules.

where there is no provision for distribution of unallocated surpluses to policy owners are to be valued as if they were non-participating.

14.15. For a friendly society management fund the adjusted policy liabilities are zero.

## 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.<sup>50</sup> All distributions on mutual equity interests must be treated as dividends for the purposes of LPS 110 and the issuer is subject to the restrictions applied to the payment of distributions in accordance with LPS 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;

<sup>50</sup> '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.

- (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 principal amount of the mutual equity interest is perpetual and never repaid outside liquidation (other than discretionary repurchases subject to APRA's approval);
    - (b) the holder of the mutual equity interest may only be entitled to a claim on the issuing life company's residual assets after more senior claims (including Additional Tier 1 Capital and Tier 2 Capital instruments) have been paid;
    - (c) 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
    - (d) the life company has full discretion over the timing and amount of any distributions paid on the mutual equity interest, including not paying a distribution.
  3. A life company 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 life company's Common Equity Tier 1 Capital before applying regulatory adjustments under paragraph ~~33(f)~~<sup>34(f)</sup> of this Prudential Standard.
  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.