



Prudential Standard APS 111

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 as Regulatory Capital for an authorised deposit-taking institution (ADI) and the various regulatory adjustments to be made to determine total Regulatory Capital on both a Level 1 and Level 2 basis.

The ultimate responsibility for ensuring that an ADI's Regulatory Capital meets the requirements of this Prudential Standard rests with its Board of directors.

The key requirements of this Prudential Standard are that an authorised deposit-taking institution must:

- include in the appropriate category of Regulatory 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 Regulatory Capital instruments are capable of bearing loss on either a 'going-concern' basis (Tier 1 Capital) or a 'gone-concern' basis (Tier 2 Capital); and
- make certain regulatory adjustments to capital, mainly from Common Equity Tier 1 Capital, to determine total Regulatory Capital.

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Authority

1. This Prudential Standard is made under section 11AF of the Banking Act 1959 (~~the Banking Act~~).

Application

2. This Prudential Standard applies to all authorised deposit-taking institutions (ADIs), subject to paragraph 3 of this Prudential Standard.
3. This Prudential Standard does not apply to:
 - (a) a **foreign ADI** that is subject to comparable capital adequacy standards in its home country; or
 - (b) a **purchased payment facility provider (PPF provider)**.
4. A reference to an ADI in this Prudential Standard, unless otherwise indicated, is a reference to:
 - (a) an ADI on a **Level 1** basis; and
 - (b) a group of which an ADI is a member on a **Level 2** basis.
5. If an ADI to which this Prudential Standard applies is:
 - (a) the holding company for a group ~~of bodies corporate~~, the ADI must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable; or
 - (b) a **subsidiary** of an authorised **non-operating holding company (authorised NOHC)**, the authorised NOHC must ensure that the requirements in this Prudential Standard are met on a Level 2 basis, where applicable.
6. This Prudential Standard commences on 1 January ~~2018~~2021.

Adjustments and exclusions

7. APRA may adjust or exclude a specific requirement in this Prudential Standard in relation to an ADI.¹

Interpretation

- ~~7.8.~~ Terms that are defined in *Prudential Standard APS 001 Definitions* appear in bold the first time they are used in this Prudential Standard. 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

¹ Refer to subsection 11AF(2) of the Banking Act.

Standard, **Australian Accounting Standard** or **Australian Auditing and Assurance Standard** is a reference to the instrument as in force from time to time.

Regulatory Capital

~~8.9.~~ For the purposes of this Prudential Standard:

- (a) a component of capital is any form of capital ~~defined~~ specified in this Prudential Standard as eligible for inclusion in Regulatory Capital; and
- (b) a category of capital is a group of components of capital.

~~9.10.~~ Regulatory Capital (~~Total Capital~~) consists of the following categories:

- (a) Tier 1 Capital (going-concern capital²), 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 ADI³ that meet the criteria in paragraph 1 of Attachment ~~K-I~~ of this Prudential Standard ~~that and~~ are above the limit specified in paragraph 4 of Attachment ~~K-I~~; and

~~(b)~~ Tier 2 Capital (gone-concern capital)⁴;

that satisfy the criteria set out in this Prudential Standard.

11. Total Capital is the sum of the components of Tier 1 Capital and Tier 2 Capital.

~~10.12.~~ An ADI must ensure that any component of ~~Regulatory Capital~~ capital that the ADI included ~~includes~~ in a particular category of its Total Regulatory Capital satisfies, in both form and substance, all requirements in this Prudential Standard for the particular category of Regulatory Capital in which it is included.

~~11.13.~~ An ADI must not include a component of ~~Regulatory Capital~~ capital in a particular category of Regulatory Capital if that component, 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 Regulatory Capital.

² 'Going-concern capital' refers to capital against which losses can be written off while an ADI continues to operate. Going-concern capital will also absorb losses should the ADI ultimately fail.

³ For the purposes of this Prudential Standard, a 'mutually-owned ADI' is a 'mutual entity' as defined in the Corporations Act.

⁴ 'Gone-concern capital' refers to capital that would not absorb losses until such time as an ADI is wound up or the capital is otherwise written off or converted into ordinary shares or mutual equity interests.

~~12.14.~~ An ADI must ensure that the category of Regulatory Capital in which a component of capital is included, when measured at ~~an individual group member level~~ (Level 1 or equivalent), is not upgraded to a higher category of Regulatory Capital when measured in an ADI's Regulatory Capital at Level 2. Any such component of capital must be reclassified to the appropriate lower category of Regulatory Capital when measured at Level 2.

~~13.15.~~ An ADI must not include a capital instrument in a category of Regulatory Capital based on a future event⁵, ~~such as the future sale or issuance of a higher quality capital instrument~~, until such time as:

- (a) the future event occurs; and
- (b) the proceeds have been irrevocably received by the ADI.

~~14.16.~~ APRA may require an ADI to:

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

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

18. An ADI 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.

~~15.19.~~ An ADI must provide APRA, as soon as practicable, with copies of documentation, ~~which if not a final set must be well-developed draft versions~~, associated with the issue of Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital instruments.

~~16.20.~~ Where the terms of ~~an a capital~~ instrument depart from established precedent, an ADI must consult with APRA on the eligibility of the ~~capital~~ instrument for inclusion as a category ~~in of~~ the ADI's Regulatory Capital in advance of the issuance of the ~~capital~~ instrument, and provide APRA with all information it requires to assess the eligibility of the ~~capital~~ instrument.

⁵ This includes, but is not limited to, the future sale or issuance of a capital instrument and the future conversion of an instrument or debt into ordinary shares or mutual equity interests.

21. As part of the documentation provided for the purposes of paragraphs 19 and 20 of this Prudential Standard, an ADI must include a statement of compliance of the capital instrument signed by a senior manager of an ADI issuer, and in the case of a capital instrument issued by a non-ADI member of the Level 2 group, signed by a senior manager of the ADI or authorised NOHC with group responsibility. The statement must:
- (a) address how the issuer is satisfied that each required capital eligibility criterion set out in this Prudential Standard is met and will continue to be met in the future; and
 - (b) clearly set out references to supporting documents and opinions that establish the criteria are met.
22. An ADI must obtain APRA's ~~consent~~ approval before the terms or conditions of an instrument are amended in a way that may affect its eligibility as Regulatory Capital.
23. Paid-up instrument in this Prudential Standard refers to a capital instrument where:
- (a) the payment of the capital has been received with finality by the issuer;
 - (b) the capital is reliably valued;
 - (c) the capital is fully under the issuer's control; and
 - (d) the instrument does not, directly or indirectly, expose the issuer to the credit risk of an investor.

Application of fair values

17.24. Where ~~An an~~ ADI ~~may~~ measures its financial instruments at fair value for capital adequacy purposes, and where permitted, for other prudential purposes, it ~~must provided it complies~~ comply with the requirements ~~of in~~ Attachment A ~~of to~~ this Prudential Standard.

Common Equity Tier 1 Capital

- 18.25. 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 depositors and other creditors in the event of winding-up of the issuer.
- 19.26. Common Equity Tier 1 Capital consists of the sum of:

- (a) paid-up ordinary shares issued by an ADI (where listed on an exchange or unlisted) that meet the criteria in Attachment B ~~of to~~ this Prudential Standard;
- (b) paid-up mutual equity interests issued by a mutually owned ADI that meet the criteria in paragraph 1 ~~of to~~ Attachment ~~K-I~~ ~~of to~~ this Prudential Standard up to the limit specified in paragraph 4 ~~of to~~ Attachment ~~KI~~;
- (c) retained earnings;
- (d) undistributed current year earnings (refer to paragraphs ~~2127~~ to ~~2531~~ of this Prudential Standard);
- (e) accumulated other comprehensive income and other disclosed reserves (refer to paragraphs ~~2632~~ and ~~2733~~ of this Prudential Standard);
- (f) minority interests (calculated in accordance with Attachment C ~~of to~~ this Prudential Standard) arising from the issue of ordinary shares to **third parties** by a fully consolidated subsidiary⁶ or a fully consolidated holding company that heads a Level 2 group, included in the Level 2 group where:
 - (i) the shares giving rise to the minority interest would, if issued by the ADI, meet the criteria in Attachment B ~~of to~~ this Prudential Standard; and
 - (ii) the subsidiary issuing the shares is itself an ADI or an overseas deposit-taking institution that is subject to equivalent minimum prudential requirements and level of supervision as an ADI; and
- (g) regulatory adjustments applied in the calculation of Common Equity Tier 1 Capital in accordance with Attachment D ~~of to~~ this Prudential Standard.

~~20.27.~~ Current year earnings must take into account:

- (a) negative goodwill;
- (b) the unwinding of any discount on credit loss provisions (refer to Attachment A ~~of to~~ *Prudential Standard APS 220 Credit Quality* (APS 220));
- (c) expected tax expenses; and
- (d) dividends when declared in accordance with Australian Accounting Standards.

~~21.28.~~ Declared dividends for the purpose of paragraph ~~2127~~(d) to this Prudential Standard may be reduced by the expected proceeds, as agreed by APRA, of a Dividend Reinvestment Plan (DRP) to the extent that dividends are used to

⁶~~This must also be read to refer to any holding company that heads the Level 2 group and is fully consolidated in the Level 2 group.~~

purchase new ordinary shares issued by the ADI. An ADI 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 an ADI identifies any material change in the expected level of future subscription for new ordinary shares under its DRP, it must notify APRA and obtain APRA's [agreement-approval](#) to a new amount by which declared dividends may be reduced for Regulatory Capital purposes.

~~22.29.~~ Current year earnings also include the full value of ~~upfront~~ fee income provided that:

- (a) the fee income has either been received in cash or has been debited to a customer's account or otherwise forms part of the upfront fees owed by a customer;
- (b) outstanding amounts of fee income debited to customer accounts are claimable in full in the event of default by the customer, 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 customer cannot cancel any fees debited to the customer's account for which they were otherwise obliged to pay upfront; and
- (e) there is no requirement for the provision of continuing additional services or products associated with the fee income concerned.

~~23.30.~~ Fee income may include net positive amounts arising from the netting of deferred [or future](#) income and capitalised expenses associated with a product class provided the conditions in paragraph ~~23.29~~ ~~of to~~ this Prudential Standard are satisfied. [Any deferred income or future income that do not satisfy the conditions in paragraph 29 to this Prudential Standard, if not already excluded from current year or retained earnings, must be deducted from Common Equity Tier 1 Capital.](#)

~~24.31.~~ Current year earnings and retained earnings may include fair value adjustments provided these adjustments satisfy the requirements for the recognition of fair values set out in Attachment A and Attachment D ~~of to~~ this Prudential Standard.

~~25.32.~~ 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 ADI;

- (ii) the ordinary shares comprise only new ordinary shares to be issued by the ADI ~~to employees~~, or new ordinary shares ~~already~~ issued by the ADI ~~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); ~~and-~~
- ~~(iii)~~(iv) the amount of a reserve is matched by an equivalent charge to profit or loss of the ADI for expensing the future issue of, or funding of the acquisition of ordinary shares by employees.

~~Any other reserves associated with share based payments must be excluded from Regulatory Capital;~~

- (c) foreign currency translation reserve;
- (d) cumulative unrealised gains or losses on hedges⁷ offsetting gains or losses included in Common Equity Tier 1 Capital (such as movements in the currency value of foreign-currency-denominated hedging instruments that offset movements in foreign-currency-denominated items recognised in the foreign currency translation reserve). This includes fair value gains or losses on derivatives representing effective economic hedges of assets; and
- (e) any other gains and losses in accumulated other comprehensive income and other disclosed reserves that may be specified by APRA.

For the purposes of paragraph (b), any other reserves associated with share-based payments must be excluded from Regulatory Capital.

26.33. Revaluation of property holdings may be included as part of other disclosed reserves only if:

- (a) the property is owned by the ADI, or a member of the Level 2 group at Level 2;
- (b) the property comprises only land and buildings;
- (c) the property is readily available to be sold. A property need not be scheduled for sale, nor need a sale be intended. However, such a property must be capable of being readily sold within six months were a decision made to sell the property;
- (d) the reserves are shown as a component of equity in the audited published financial accounts of the ADI (and the group that it heads);
- (e) the revaluations are reliable, in accordance with Australian Accounting Standards, and subject to audit or review consistent with Australian Auditing and Assurance Standards. ~~An investment~~A property must be

⁷ This includes cumulative unrealised gains or losses on effective cash flow hedges as defined in Australian Accounting Standards.

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 (~~owner occupied property and investment property~~) included in the reserves.

Additional Tier 1 Capital

~~27.34.~~ 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 depositors and other more senior creditors in the event of winding up of the issuer; and
- (d) provide for fully discretionary capital distributions.

~~28.35.~~ Additional Tier 1 Capital consists of:

- (a) instruments issued by an ADI 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 E ~~of to~~ this Prudential Standard;
 - (ii) for instruments classified as liabilities under Australian Accounting Standards, the loss absorption requirements set out in Attachment F ~~of to~~ this Prudential Standard; and
 - (iii) the requirements for loss absorption at the point of non-viability set out in Attachment ~~JH~~ ~~of to~~ this Prudential Standard;
- (b) instruments issued by a fully consolidated subsidiary⁸ of the Level 2 group or a fully consolidated holding company that heads a Level 2 group, and held by third parties (calculated in accordance with Attachment C ~~of to~~ this Prudential Standard) where:
 - (i) the instruments would, if issued by the ADI, meet the criteria in Attachment E ~~of to~~ this Prudential Standard;
 - (ii) instruments classified as liabilities under Australian Accounting Standards meet the loss absorption requirements set out in Attachment F ~~of to~~ this Prudential Standard; and

⁸ ~~Refer to footnote 3.~~

- (iii) the instruments meet the requirements for loss absorption at the point of non-viability set out in Attachment ~~JH~~ of to this Prudential Standard; and
- (c) regulatory adjustments applied in the calculation of Additional Tier 1 Capital in accordance with Attachment D of to this Prudential Standard.

Instruments may also be included in Additional Tier 1 Capital in accordance with Attachment ~~L-J~~ of to this Prudential Standard.

~~29. An Additional Tier 1 Capital instrument may be a stapled security structure provided the structure meets the criteria in Attachment G of this Prudential Standard.~~

Tier 2 Capital

~~30.36.~~ 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 an ADI and its capacity to absorb losses.

~~31.37.~~ Tier 2 Capital consists of:

- (a) instruments issued by the ADI at Level 1 that meet:
 - (i) the criteria for inclusion in Tier 2 Capital set out in Attachment ~~H-G~~ of to this Prudential Standard; and
 - (ii) the requirements for loss absorption at the point of non-viability set out in Attachment ~~J-H~~ of to this Prudential Standard;
- (b) instruments issued by a fully consolidated subsidiary⁹ of the Level 2 group or a fully consolidated holding company that heads a Level 2 group, and held by third parties (calculated in accordance with Attachment C of to this Prudential Standard) where:
 - (i) the instruments would, if issued by the ADI, meet the criteria in Attachment ~~H-G~~ of to this Prudential Standard;
 - (ii) the instruments meet the requirements for loss absorption at the point of non-viability set out in Attachment ~~J-H~~ of to this Prudential Standard;
- (c) a General Reserve for Credit Losses (GRCL) (refer to APS 220), unless APRA determines otherwise; and
- (d) regulatory adjustments applied in the calculation of Tier 2 Capital in accordance with Attachment D of to this Prudential Standard.

⁹~~Refer to footnote 3.~~

Instruments may also be included in Tier 2 Capital in accordance with Attachment ~~L-J~~ of to this Prudential Standard.

~~32.38.~~ 32.38. The GRCL may be included in Tier 2 Capital gross of tax effects up to the following limits:

- (a) for an ADI using the **Standardised Approach to credit risk**: a maximum of 1.25 per cent of total credit risk-weighted on-balance sheet and off-balance sheet assets¹⁰ calculated under *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (APS 112)*;
- (b) for an ADI using the **Internal ratings-based (IRB) approach to credit risk**: a maximum of 0.6 per cent of total credit risk-weighted assets¹¹ for non-defaulted exposures, to the extent that total eligible provisions exceed total expected losses;
- (c) for an ADI using a partial IRB approach to credit risk: the sum of reserves proportionately based on the limits in (a) and (b) of this paragraph; ~~or~~ and
- (d) where it is not possible for the ADI to determine whether the GRCL relates to assets under the standardised or IRB approaches to credit risk: allocation on a basis that is reasonable and consistent.

~~33.39.~~ 33.39. If a GRCL has not already resulted in a charge to profit or loss (e.g. by way of establishment of a general reserve or provision in audited published financial accounts), a GRCL reported for capital adequacy purposes must be matched by a corresponding reduction in an ADI's Common Equity Tier 1 Capital.

Additional Tier 1 Capital or Tier 2 Capital issued overseas by ADIs or subsidiaries

~~34.40.~~ 34.40. Additional Tier 1 Capital instruments and Tier 2 Capital instruments may be issued by an ADI, or a consolidated subsidiary in the Level 2 group, either in its country of incorporation or through a branch in another country, provided the instrument:

- (a) constitutes an obligation of the ADI or of the consolidated subsidiary itself at all times;
- (b) is freely available to absorb losses on a going concern (Additional Tier 1 Capital only) and gone concern basis across all of the operations of the ADI, or the consolidated subsidiary that issued the instrument; and

¹⁰ Total credit-risk weighted assets include any assets forming part of a securitisation scheme which do not meet the operational requirements for regulatory capital relief under *Prudential Standard APS 120 Securitisation (APS 120)* or where the securitisation scheme is synthetic or has been undertaken on a funding-only basis.

¹¹ Refer to footnote 10.

- (c) meets all of the requirements of this Prudential Standard for inclusion in Additional Tier 1 Capital or Tier 2 Capital.

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

~~35. Capital instruments issued through a Special Purpose Vehicle (SPV) must satisfy the requirements of Attachment I of this Prudential Standard to be eligible Additional Tier 1 Capital or Tier 2 Capital.~~

Intra-group capital transactions

~~36.41.~~ The matters APRA may consider in assessing whether an item included by an ADI as a component of capital resulting from intra-group transactions does not represent a genuine contribution to financial strength include, but are not limited to, whether a component of capital:

- (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 ADI itself; ~~or~~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 ADI failing to meet any servicing obligations.

~~42.~~ In assessing the overall strength of ~~an ADI on a~~ Level 1 and Level 2 capital adequacy basis, APRA will have regard to:

~~(e)(a) the level of capital adequacy of individual group members of a group to which the ADI belongs, including any limitations in the amount of capital that may be ability of the ADI to readily extracted capital from individual group members to provide support, if required, of the Level 2 group should the need arise to recapitalise the ADI or other group members of the group. APRA may require an ADI to adjust its Level 2 Regulatory Capital ratios to reflect any inability to readily extract capital and any limitations on the amount of capital that may be extracted.~~

~~37.43.~~ In measuring Regulatory Capital at Level 2, an ADI must exclude any capital instrument issued by a member of the Level 2 group where the obligations under that instrument are secured, guaranteed, or subject to any other arrangement provided by a ~~by another group member of the group that legally and economically enhances the seniority of claims of investors.~~

Holding of capital instruments in group members by other group members

~~38.44.~~ Capital instruments¹² of an ADI, a member of a group headed by an ADI, or a NOHC at Level 2 that are held as direct investments by a vehicle⁴³, subject to consolidation within the ADI's financial statements in accordance with Australian Accounting Standards, may be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital (on both a Level 1 and Level 2 basis, as appropriate) only if:

- (a) the ADI (or relevant vehicle) did not fund the acquisition of the capital instruments (i.e. acquisition of capital instruments is funded by third parties such as life insurance policyholders or other third-party investors);
- (b) the risk and rewards associated with the investments are borne primarily by third parties; ~~and~~
- (c) the ADI 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-~~

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

~~39.45.~~ Direct investments in shares of an ADI by an SPV (e.g. a trust) established under a share-based employee remuneration scheme may be included in the ADI's Common Equity Tier 1 Capital (on a Level 1 and Level 2 basis, as appropriate) only if:

- (a) the shares issued to the SPV represent ordinary shares of the ADI;
- (b) the amount included in Common Equity Tier 1 Capital is matched by an equivalent charge to profit ~~and-or~~ loss of the ADI for expensing the issue or funding the acquisition of ordinary shares by the vehicle; and
- (c) the ordinary shares issued cannot be converted to payment in another form (e.g. cash).

For the purposes of measuring Regulatory Capital at Level 2, the SPV holding such shares must be excluded from the consolidated group. As a consequence, any associated change in the fair value of the shares held by an SPV must be excluded from Regulatory Capital and risk-weighted assets at Level 2.

~~40.46.~~ If the requirements in paragraphs ~~4044~~ and ~~4145~~ of this Prudential Standard are not satisfied, the relevant capital instruments must be treated as holdings of

¹² Capital instruments include all capital instruments eligible to be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital.

⁴³ ~~These vehicles exclude any SPV, such as a trust, involved with employee share-based remuneration schemes.~~

own capital instruments and deducted from Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital, as appropriate.

Adjustments and exclusions

~~41. APRA may adjust or exclude a specific requirement in this Prudential Standard in relation to an ADI.⁴⁴~~

Previous exercise of discretion and transitional arrangements

~~42.47. The transitional arrangements at Attachment J to this Prudential Standard apply to non-Common Equity Tier 1 Capital and Tier 2 Capital instruments (including instruments issued by fully consolidated subsidiaries that are held by third parties) that do not fully meet the criteria at Attachment E and Attachment G to this Prudential Standard if the ADI had obtained APRA’s approval prior to 1 January 2013 under a previous version of this Prudential Standard for those arrangements to apply.~~

~~⁴⁴ Refer to subsection 11AF(2) of the Banking Act.~~

Attachment A - Use of Fair Values

1. An ADI may measure its financial instruments at fair value for capital adequacy ~~(both banking book and trading book)~~ and, where permitted, for other stated prudential purposes referred to in other Prudential Standards, provided:
 - (a) the ADI complies with the requirements of Australian Accounting Standards relating to the use of fair values;
 - (b) valuations are reliable, including use of reasonable estimates of values;
 - (c) the use of fair values and associated valuations are covered by the ADI's risk management systems, including related risk management policies, procedures and controls;
 - (d) the ADI notifies APRA promptly whenever there is a material:
 - (i) reclassification by the ADI of financial assets and liabilities from amortised cost to fair values or from fair values to amortised cost;
~~and/or~~
 - (ii) change in
 - (A) the systems and controls used for valuation purposes;
 - (B) the valuation methodologies; or
 - ~~(A)~~(C) the valuation adjustments employed to produce fair values of financial instruments; and
 - (e) the ADI meets all requirements set out below, as applicable, with respect to measurement of financial instruments at fair values.
2. For the purposes of paragraph 1(c) of this Attachment, an ADI must:
 - (a) have clear and robust governance structures for the production, assignment, verification and oversight of the valuation of financial instruments;
 - (b) have adequate capacity, including during periods of stress, to establish and verify valuations. This capacity must be commensurate with the importance, risk and size of exposures being valued in the context of the business profile of the ADI;
 - (c) for exposures that represent a material risk, have a capacity to produce valuations using alternative methods in the event that primary valuation inputs and valuation approaches become unreliable, unavailable or not relevant due to market discontinuities or illiquidity;
 - (d) test and review on a regular basis the performance of its valuations, including under stress conditions, so that it understands the limitations of

its valuations. This is of particular significance where an ADI makes use of models for valuation purposes; and

- (e) ensure the application of fair values is specifically addressed as part of the adequate internal or external audit review of the ADI's risk management framework under Prudential Standard CPS 220 Risk Management (CPS 220), including in the internal review of the implementation of policies and procedures for producing fair values and their application.
3. An ADI must advise APRA, if requested, of details of:
 - (a) the ADI's use of fair values of financial instruments and the ADI's valuation policies and procedures;
 - (b) the relationship between the ADI's use of fair values and its risk management policies and procedures; and
 - (c) the ADI's assessment of the impact of the application of fair values on the value of financial instruments for capital adequacy purposes.
 4. If APRA considers that an ADI's policies and procedures for the application of fair values, or the fair values recognised by an ADI, are inadequate, not reliable, or adversely affect the ADI's safety and soundness, APRA may require ~~it~~the ADI, at Level 1 and Level 2, to:
 - (a) to amend its policies and procedures;
 - (b) make adjustments to fair values of financial instruments included in Regulatory Capital, and for other stated prudential purposes;
 - (c) discontinue using fair value measures for regulatory reporting; or
 - (d) hold higher levels of capital.

Systems and controls

- 4.5. An ADI's systems and controls used for valuation purposes must:
 - (a) include documented policies and procedures for the process of valuation. This must incorporate clearly defined responsibilities of the various areas involved in this process;
 - (b) ensure clear and independent reporting lines for the areas responsible for the valuation process;
 - (c) provide for the Board to receive reports from senior management on the valuation oversight and valuation performance issues that are notified to senior management for resolution, as well as all significant changes in valuation policies, methodologies and adjustments;
 - (d) be integrated with other risk management systems within the ADI;

- (e) outline assets and liabilities and other positions to be recognised at fair value and the processes for approving use of fair values for new items, products and transactions. New product approval processes must include all internal stakeholders relevant to risk measurement, risk control and the assignment and verification of valuations of financial instruments involved;
- (f) enable the ADI to make choices regarding the alternative treatments for categorising financial instruments using fair value measures under Australian ~~accounting~~ Accounting practice Standards⁴⁵ in a fully informed and disciplined manner. If Australian Accounting Standards do not provide relevant guidance, a generally used accounting treatment must be utilised;
- (g) specify the relationship between the application of fair value measures and the ADI's risk management framework;
- (h) detail the processes for ensuring that the use of fair values is applied consistently across the ADI for capital adequacy, reporting and risk management purposes, including across similar instruments (risks) and business lines (books). This must include the frequency at which fair values will be calculated and reported; and
- (i) explicitly assess valuation uncertainties and ensure that assessments of material valuation uncertainties are included in the information provided to the Board and senior management.

Valuation methodologies

5.6. An ADI's policies and procedures governing the use of fair value measurement must:

- (a) outline the methods used for the selection and validation of valuation processes used in calculating and reporting fair values including, where appropriate, independent review, analysis of model stability and performance under a variety of conditions, use of back-testing and frequency of validation. The ADI must retain data and supporting documentation for these purposes;
- (b) include rigorous and independent validation and control processes in relation to the design and validation of methodologies used to produce valuations. These valuations must maximise the use of relevant and reliable inputs in a controlled and disciplined manner and incorporate all other important information so that fair value estimates are as reliable as possible;
- (c) maximise the use of relevant observable inputs, and minimise the use of unobservable inputs, when estimating fair values using a valuation technique; and

⁴⁵ ~~'Accounting practice' means Australian Accounting Standards or, if these do not provide relevant guidance, a generally used accounting treatment.~~

- (d) only mark-to-model where mark-to-market is not possible. The ADI must be able to demonstrate that any use of mark-to-model is prudent.

6.7. The relevance and reliability of valuations that an ADI makes are directly related to the quality and reliability of the inputs used in the valuation methodology applied. In determining whether a source of market prices or values used in the methodology applied is reliable, an ADI must consider, amongst other things:

- (a) accounting guidance provided in Australian Accounting Standards applicable to the determination of relevant market information and other factors likely to have a material effect on a financial instrument's fair value;
- (b) the frequency and availability of the prices/quotes utilised;
- (c) whether those prices/quotes represent, or are supported by, actual regularly occurring transactions on an arm's-length basis;
- (d) the breadth of the distribution of the price or value data and whether it is generally available to relevant participants in the market;
- (e) the timeliness of the information relative to the frequency of valuations required to be undertaken;
- (f) the number of independent sources that produce the prices/quotes; and
- (g) the similarity between a financial instrument sold in a transaction and the actual instrument held by the ADI.

Mark-to-market valuation methodologies

7.8. An ADI must mark-to-market at least daily utilising readily available close-out prices in orderly transactions.

8.9. An ADI must ensure that prices utilised for mark-to-market valuation purposes are:

- (a) Are sourced independently; and
- (b) use the more prudent side of the bid/offer close-out prices unless the ADI can demonstrate it is a significant market maker in a particular position type and can close out at mid-market closing prices.

9.10. Observable inputs must be considered but need not be determinative in valuation processes where an ADI has reasonable grounds to believe that:

- (a) observable inputs or transactions may not be relevant, such as in forced liquidation or distressed sale scenarios; and
- (b) inputs or transactions may not be observable such as where markets are inactive.

Mark-to-model valuation methodologies

~~10.11.~~ Mark-to-model means any valuation that has to be benchmarked, extrapolated or otherwise calculated from a market input, other than valuations calculated from market inputs using market-convention pricing formulae (where such inputs are generally considered to be mark-to-market equivalents).

~~11.12.~~ An ADI may only use mark-to-model if:

- (a) marking-to-market is not possible;
- (b) use of mark-to-model valuation can be demonstrated to be prudent; and
- (c) the valuation procedure applies an extra degree of conservatism.

~~12.13.~~ In order for a mark-to-model valuation process to be reliable:

- (a) senior management of the ADI must be aware of the elements of fair valued positions that are subject to mark-to-model and understand the materiality of the uncertainty this creates in the reporting of risk/reward of the business undertaken;
- (b) market inputs in the model process must be sourced, to the extent possible, in line with market prices. The ADI must regularly review the appropriateness of market inputs used for the particular position being valued;
- (c) where available, generally accepted valuation methodologies for particular products must be used as far as possible;
- (d) where a model is developed by the ADI itself, it must be:
 - (i) based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process;
 - (ii) developed or approved independently of the area within the ADI that will be utilising the model for its business activities; and
 - (iii) tested independently, including validating the mathematics, the assumptions and the software implementation;
- (e) there must be formal change control procedures in place and a secure copy of the model must be held and periodically used to check valuations;
- (f) the ADI's risk management function must be aware of the weaknesses in the model and how best to address such weaknesses in the valuation output;
- (g) the model must be subject to periodic review by the ADI to determine the accuracy of its performance, including:
 - (i) assessment of the appropriateness of assumptions utilised; and

- (ii) analysis of profit and loss versus risk factors;
- (h) comparison must be made between actual close-out values to model outputs; and
- (i) valuation adjustments must be made, as appropriate, including to cover the uncertainty of model valuations (refer to paragraphs 14 to 21 of this Attachment).

Valuation adjustments

~~13.14.~~ 14.14. If an ADI uses fair value measurement, it may need to adjust the values produced by its mark-to-market and mark-to-model valuation methodologies. If an ADI seeks to make such adjustments it must:

- (a) apply a rigorous and consistent process to determine valuation adjustments as appropriate;
- (b) consider whether any valuation adjustments are necessary where third-party valuations are used in mark-to-market or mark-to-model; and
- (c) take into account, at a minimum, the following matters:
 - (i) close-out costs;
 - (ii) unearned credit spreads;
 - (iii) operational risks;
 - (iv) early termination;
 - (v) investing and funding costs;
 - (vi) any future administrative costs; and
 - (vii) as appropriate, model risk.

~~14.15.~~ 14.15. Valuation adjustments that need to be made must, unless otherwise provided for in this Prudential Standard, impact on Common Equity Tier 1 Capital and may exceed those made under Australian Accounting Standards.

Illiquid positions

~~15.16.~~ 15.16. An ADI must have procedures in place, if needed:

- (a) to adjust current fair value measurements to account for any illiquidity of positions;
- (b) to calculate the necessary adjustments where positions are judged to be illiquid; and

- (c) to review the appropriateness of those adjustments, or lack thereof, on a regular (at least monthly) basis.

This applies whether or not a position is marked-to-market using market prices, observable inputs or third-party valuations, or is marked-to-model.

~~16.17.~~ Relevant factors an ADI must consider in determining valuation adjustments for illiquidity include, but are not limited to:

- (a) the average volatility of bid/offer spreads;
- (b) the availability of independent market quotes (number and identity of market makers);
- (c) the average volatility (under normal market conditions and in periods of market stress) of trading volumes and volumes of assets and liabilities that are exchanged;
- (d) market concentrations;
- (e) ageing of positions;
- (f) the amount of time it would take to hedge the position/risks within the position or to otherwise dispose of an asset or liability or other position;
- (g) the extent to which the valuation relies on mark-to-model; and
- (h) the impact of other model risks.

~~17.18.~~ For complex products, including but not limited to securitisation exposures and nth-to-default credit derivatives, an ADI must explicitly assess the need for valuation adjustments to reflect model risk associated with using:

- (a) a possibly incorrect valuation methodology; and
- (b) unobservable (and possibly incorrect) calibrations in the valuation model.

~~18.19.~~ An adjustment to the current valuation of less liquid positions must, unless otherwise provided for in this Prudential Standard, impact on Common Equity Tier 1 Capital and may exceed valuation adjustments made under Australian Accounting Standards and those other adjustments required to be made (refer to paragraph ~~14~~15 of this Attachment).

Independent price verification

~~19.20.~~ An ADI must arrange independent price verification to be performed at regular intervals so that market prices or model inputs used in valuation processes are verified for accuracy. Such verification must be performed by parties independent of dealing, trading or asset or liability origination areas.

~~20.21.~~ Independent price verification entails a higher standard of accuracy than market prices or model inputs used for daily marking-to-market purposes. For

independent price verification where pricing sources are more subjective, an ADI must consider whether prudent measures such as valuation adjustments (see above) may be appropriate and make such adjustments as necessary.

Own creditworthiness

21.22. An ADI's policies and procedures must set out how it determines the fair value gains and losses arising from changes in the ADI's own creditworthiness and that of other group members at Level 2.

Attachment B - Criteria for classification as paid-up ordinary shares

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

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

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

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

~~(c)~~(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's approval);

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

~~(e)~~(f) distributions on the instrument are paid out of distributable items¹⁶ (retained earnings included) of the issuer, and the terms of the instrument do not provide for payment to investors other than in the form of a cash payment. The level of distributions must not be tied or linked to the amount paid up at issuance, or to the credit standing of the issuer, and must not be subject to a contractual cap, except to the extent that restrictions applied to the payment of distributions are in accordance with *Prudential Standard APS 110 Capital Adequacy* (APS 110);

~~(f)~~(g) 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;

¹⁶ For the purposes of this Prudential Standard, 'distributable items' refer to those items which are permitted to be distributed in accordance with relevant statutory and regulatory requirements applicable to distributions by an issuer.

- ~~(g)~~(h) 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)~~(i) the instruments take the first and proportionately greatest share of any losses as they occur.¹⁷ Within Common Equity Tier 1 Capital, each instrument absorbs losses on a going concern basis proportionately, and *pari passu*, with all the other instruments included in Common Equity Tier 1 Capital;
- ~~(i)~~(j) 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)~~(k) the paid-up amount of the instrument is classified as equity under Australian Accounting Standards;
- (l) 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 entity¹⁸, cannot have purchased or directly or indirectly¹⁹ funded the purchase of the instrument, or be funding the instrument;
- ~~(k)~~(m) the instrument has no features that hinder recapitalisation of the issuer, or any other members of the group to which the issuer belongs;
- ~~(l)~~(n) 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 entity²⁰, 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)~~(o) 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)~~(p) the instrument is clearly and separately disclosed on the issuer's financial statements and, in any consolidated financial statements. Disclosure must

¹⁷ In cases where other capital instruments have a permanent write-off feature, this criterion is still deemed to be met by ordinary shares.

¹⁸ A related entity is one over which an ADI or parent entity of the ADI exercises control or significant influence and can include a parent company, a sister company, a subsidiary or any other affiliate. This does not preclude a parent entity of the ADI from holding the instrument where the instrument is directly issued by the ADI to the parent entity.

¹⁹ ~~This excludes full recourse lending~~ Lending to a borrower on a non-recourse basis secured against any capital instruments of the ADI or members of the group is to be treated as an indirect funding of ~~fund the purchase of a well diversified and well collateralised portfolio that may include~~ the capital instruments forming part of the security against the loan.

²⁰ Refer to footnote 4218.

be in line with the frequency with which an ADI, or group of which it is a member, publishes its financial results.

2. Where issue documentation, marketing of an instrument, or any ongoing dealings with investors in the instrument, suggest the instrument has attributes not consistent with the eligibility requirements in this Attachment, the instrument will be ineligible to be included in Common Equity Tier 1 Capital.
- ~~2.3.~~ Where an instrument, whether issued by the ADI or another member of the Level 2 group to which the ADI belongs, is subject to the laws of a foreign jurisdiction ~~other than Australia or its territories~~, the ADI must also ensure that the instrument satisfies all relevant qualifying criteria for Common Equity Tier 1 Capital under this Attachment and under the laws of ~~that the foreign country do not override the provisions within the instrument designed to meet these criteria~~ jurisdiction.
- ~~3.4.~~ APRA may require the ADI to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the expense of the ADI, confirming that the instrument meets all or any of the criteria applied to Common Equity Tier 1 Capital instruments in this Prudential Standard.
- ~~4.5.~~ For the purposes of Attachment ~~K-I~~ of this Prudential Standard, a reference in this Attachment (except in paragraphs 1(~~ab~~), (~~bc~~), (~~ef~~) and (~~hi~~) of this Attachment) to 'paid up ordinary shares' is to be read as a reference to 'paid up mutual equity interests'.

Attachment C - Minority interest and other capital issued out of fully consolidated subsidiaries and is held by third parties

1. The requirements in this Attachment do not apply on a Level 2 basis to capital instruments issued by an ADI that is a subsidiary of an authorised NOHC where the authorised NOHC owns 100 per cent of, and has a sole direct investment in, the ADI. Where the authorised NOHC holds investments in other entities (whether in the Level 2 group or a wider group), the capital instruments issued by the ADI subsidiary to third parties are subject, at Level 2, to the provisions of this Attachment.

1.2. Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital issued to third parties by fully consolidated subsidiaries ~~of~~ in a Level 2 group may be included in the appropriate category of Total Regulatory Capital at Level 2 to the extent set out in this Attachment and paragraphs ~~2026~~(f), ~~2935~~(b) and ~~3237~~(b) ~~of~~ to this Prudential Standard.

2.3. Where a fully consolidated subsidiary of a Level 2 group has its own subsidiaries, all calculations of eligible Regulatory Capital attributable to third parties must be undertaken in respect of that subsidiary and its subsidiaries as a consolidated group.

3.4. An ADI may elect not to recognise, at Level 2, capital issued by a fully consolidated subsidiary that is attributable to third parties. However, the ADI must continue to include all exposures of those subsidiaries when calculating its total risk-weighted assets for Level 2 capital adequacy purposes.

4.5. The amount that may be included in the relevant category of Regulatory Capital at Level 2 is the:

- (a) total amount of the category of Regulatory Capital attributable to third parties; less
- (b) any surplus capital amount above the minimum regulatory requirements.

The amounts above are to be as calculated in accordance with paragraphs ~~56~~, ~~6-7~~ and ~~7-8~~ of this Attachment.

Common Equity Tier 1 Capital (minority interest)

5.6. Minority interest in Common Equity Tier 1 Capital of a Level 2 subsidiary that is eligible to be included in the ADI's Common Equity Tier 1 Capital at Level 2 is calculated as:

- (a) the percentage of all Common Equity Tier 1 Capital of the subsidiary that is attributable to third parties; multiplied by
- (b) the amount of Common Equity Tier 1 Capital of the subsidiary that is used to satisfy the Common Equity Tier 1 **PCR** and capital conservation buffer

requirements [under APS 110](#) at Level 2 arising from exposures held by the subsidiary.²¹

Tier 1 Capital

~~6.7.~~ The amount of Tier 1 Capital instruments issued by a subsidiary to third parties that may be included in an ADI's Tier 1 Capital at Level 2 is calculated as:

- (a) the percentage of all Tier 1 Capital of the subsidiary attributable to third parties; multiplied by
- (b) the amount of Tier 1 Capital of the subsidiary that is used to satisfy the ADI's Tier 1 PCR and capital conservation buffer requirements [under APS 110](#) at Level 2 arising from exposures held by the subsidiary.²²

Total Capital

~~7.8.~~ The amounts of [the categories of Total-Regulatory Capital instruments](#) issued by a subsidiary to third parties that may be included in an ADI's Total Capital at Level 2 is calculated as:

- (a) the percentage of Total Capital of the subsidiary attributable to third parties; multiplied by
- (b) the amount of Total Capital of the subsidiary that is used to satisfy the ADI's Total Capital PCR and capital conservation buffer requirements [under APS 110](#) at Level 2 arising from exposures held by the subsidiary.²³

²¹ Refer to paragraphs 23(a) and 26 of APS 110.

²² Refer to paragraphs 23(b) and 26 of APS 110.

²³ Refer to paragraphs 23(c) and 26 of APS 110.

Attachment D - Regulatory adjustments

General rules for regulatory adjustments

1. In determining the size of [regulatory adjustments \(i.e. deductions\)](#) from a [category of an ADI's Regulatory Capital](#), items must be valued on the same basis as ~~in the~~ ADI's balance sheet valuations.
2. For the purposes of [regulatory adjustments deductions](#) to Additional Tier 1 Capital and Tier 2 Capital:
 - (a) where the amount of Additional Tier 1 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Common Equity Tier 1 Capital; and
 - (b) where the amount of Tier 2 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Additional Tier 1 Capital and, if Additional Tier 1 Capital is insufficient to cover the amount of the deductions required, the remaining amount must be deducted from Common Equity Tier 1 Capital.
3. All equity [holdings exposures](#) and other capital support provided to financial institutions, and holdings of own capital instruments must be deducted following the corresponding deduction approach i.e. the deduction is to be applied to the same ~~tier category~~ of capital for which the capital would qualify if issued by the ADI itself.²⁴ [In the case of Total Loss Absorbing Capacity \(TLAC\) exposures \(refer to paragraph 11 of this Attachment\), the deduction is to be applied to Tier 2 Capital.](#)
4. Where a capital instrument is required to be deducted and it is not possible to determine whether it should be deducted from Common Equity Tier 1 Capital, Additional Tier 1 Capital or Tier 2 Capital, the [regulatory adjustment deduction](#) must be made from Common Equity Tier 1 Capital. An ADI must consult APRA if there is uncertainty about the category of capital against which a deduction must be made.
5. An ADI that finds it operationally difficult to look through and monitor the exact exposure to equity and other capital instruments that it holds in institutions, including through holdings of indexed securities, may apply to APRA to use a proxy approach for determining the amount of exposures to deduct. APRA may allow an ADI to apply an annual estimate of the amount to be deducted where the ADI can demonstrate that it can obtain details, at least annually, of the proportion of exposures to financial and commercial institutions (such as an indexed security) comprised of equity and other exposures of a capital nature. Where an

²⁴ [For these purposes, capital instruments issued by general insurance and life insurance companies need only incorporate loss absorption at point of non-viability provisions \(refer to Attachment H to this Prudential Standard\), and need not incorporate loss absorption provisions \(refer to Attachment F to this Prudential Standard\).](#)

ADI cannot meet this requirement, it must deduct the full value of its indirect exposures from Common Equity Tier 1 Capital.

6. All amounts of assets corresponding to deductions from capital made at Level 1 and Level 2 must be excluded when calculating an ADI's total risk-weighted assets at the respective level. Notwithstanding that the changes in value of some hedges may be deducted from capital, the credit risk of these hedges must continue to be included in total risk-weighted assets in accordance with Attachment H of APS 112.
7. For the purposes of deducting from the relevant category of Regulatory Capital:
 - (a) equity exposures;
 - (b) ~~holdings of~~ Additional Tier 1 Capital and Tier 2 Capital ~~instruments exposures;~~ and
 - (c) securitisation exposures; and
 - ~~(e)~~(d) any other exposures required to be deducted under this and other Prudential Standards;

an ADI may net any specific provisions raised against the relevant exposures or holdings before making the necessary deductions from the relevant ~~categories~~ category of Regulatory Capital.

8. An ADI must not recognise, for the purpose of measuring its capital adequacy, any transactions (or dealings) which have the aim of offsetting required deductions.

Equity ~~exposures holdings~~ and other capital support provided to financial institutions²⁵

9. Unless otherwise indicated, an ADI must deduct from the corresponding category of its Regulatory Capital direct, indirect²⁶ and synthetic equity exposures, guarantees and other forms of capital support, and holdings of Additional Tier 1 Capital and Tier 2 Capital instruments in ADIs and overseas deposit-taking institutions and their subsidiaries, insurance companies and other financial institutions. This includes:

²⁵ At Level 1, this includes all financial institutions that are affiliates of the ADI at Level 1. An affiliate for these purposes is defined as a company that controls, or is controlled by, or is under common control with, the ADI. Control of a company is defined as: (i) ownership, control, or holding power to vote 20 per cent or more of a class of voting securities of the company; or (ii) consolidation of the company with the ADI for financial reporting purposes.

²⁶ Indirect holdings represent exposures that will result in a loss to the ADI substantially equivalent to any loss in the direct holding. Lending to a borrower on a non-recourse basis secured against any capital instruments of the ADI or members of its group, is to be treated as an indirect funding of the capital instruments forming part of the security held against the loans. This excludes, for example, full recourse lending to a borrower to purchase a well diversified and well collateralised portfolio that may include the relevant exposures.

- (a) equity exposures, guarantees and other forms of capital support held in the banking book;
- (b) net long positions²⁷ in equity held in the trading book (refer to *Prudential Standard APS 116 Market Risk* (APS 116)); and
- (c) underwriting positions in equity held for more than five working days.

An ADI is not required to deduct:

- (d) equity exposures in ADIs and equivalent overseas deposit-taking institutions²⁸ and their subsidiaries, insurance companies and other financial institutions held under a legal agreement on behalf of a third party, even if held in the name of the ADI (or other members of the Level 2 group), where the third party derives exclusively and irrevocably all the gains and losses of such exposures and investments;
 - (e) underwriting positions in equities held for five working-business days or less. Such exposures must be risk-weighted at 300 per cent if listed and at 400 per cent if unlisted; and
 - (f) at Level 1, and individually limited to 10 per cent of the ADI's Common Equity Tier 1 Capital, equity exposures held in other ADIs or overseas deposit-taking institutions and their subsidiaries, and insurance companies that are subsidiaries of the ADI. Such exposures, after deduction of any intangibles component, must be risk-weighted at 300-250 per cent if listed and at 400 per cent if unlisted. The amount of the equity exposure in excess of 10 per cent of the ADI's Common Equity Tier 1 Capital must be deducted from the ADI's Common Equity Tier 1 Capital.
10. For the purposes of this Attachment, ~~Equity equity exposures holdings~~ include:
- (a) equity exposures (as defined in paragraphs 49 to 52 of *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk* (APS 113)) and, in the case of an APRA-regulated institution or an overseas equivalent, holdings of debt instruments issued by the entity or other facilities exposures that qualify as Regulatory Capital.²⁹ Investments include indirect holdings such as holdings of units in a trust; and
 - (b) equity exposures including any portion of current year earnings or retained earnings that represents any amount deriving from the ADI's share of

²⁷ 'Net long positions' are the gross long positions net of the short positions in the same underlying exposures where the maturity of the short positions either match the maturity of the long positions or have residual maturities of at least one year. They include netting positions in physical instruments and derivatives over the same underlying exposure (including those associated with looking through holdings of index securities).

²⁸ An 'equivalent overseas deposit-taking institution' in this Prudential Standard refers to an overseas financial institution that is subject to equivalent minimum prudential standards and level of supervision as an ADI.

²⁹ For the purposes of this Prudential Standard, the reference to 'investment' in paragraph 49 of APS 113 includes indirect holdings such as holdings of units in a trust.

undistributed profit or loss in an associate under equity accounting that is reflected in the value of equity investments in associates.

11. For the purposes of this Prudential Standard, other capital support includes, but is not limited to, any facility (other than equity exposures) recognised as a capital instrument, or otherwise accepted by regulators, financial markets and creditors as a capital instrument, or a TLAC instrument³⁰, or standing in place of capital. The amount of guarantees and other capital support is based on the maximum amount that the ADI could be required to pay under these arrangements.

~~11.~~12. For the purposes of this Prudential Standard, the amount of equity exposures ~~(as defined in paragraphs 49 to 52 of APS 113)~~ and any other capital support that must be deducted from ~~the relevant category of Regulatory capital~~ Capital is the book value of the equity exposure or other capital support, including any amount by which they have been revalued. Any intangible component (~~particularly such as~~ goodwill) included in the valuation of equity exposures or other capital support must be deducted from Common Equity Tier 1 Capital. In the case of equity, or other capital support provided to a subsidiary, this would be calculated as the excess of the book value over the net tangible assets of the subsidiary.

~~12.~~13. Where any equity ~~holdings exposures~~ and other capital support in non-consolidated subsidiaries, including minority interests, have been incorporated for accounting purposes into the ADI's consolidated group accounts, the consolidation of these entities must, unless the value of such equity ~~holdings exposures~~ and other capital support is otherwise required to be deducted from Common Equity Tier 1 Capital under this Prudential Standard, be reversed prior to the calculation of risk-based capital ratios at Level 2; that is, any retained earnings, other reserves or minority interests of these entities included in Common Equity Tier 1 Capital, and any other items impacting on any other Level 2 category of capital as a result of the accounting consolidation, must be removed from that category for capital adequacy purposes. Goodwill and any other intangible component of the investments in non-consolidated subsidiaries must be deducted from the ADI's Common Equity Tier 1 Capital at Level 2.

~~13.~~14. In considering whether a facility, including a guarantee, provided to a related entity constitutes capital support, APRA will have regard to, amongst other things, whether:

- (a) the facility represents a recognised capital instrument or is otherwise accepted as standing in place of capital required to be held by a related entity;
- (b) the provider of the facility, in terms of either repayment or maturity, ranks below other senior unsecured or unsubordinated creditors; or

³⁰ [The Financial Stability Board's \(FSB's\) TLAC Term Sheet, November 2015, sets out eligibility criteria for TLAC-eligible instruments. For the purpose of this Attachment, relevant TLAC holdings includes: all direct, indirect and synthetic holdings of external TLAC; all instruments ranking pari passu with subordinated forms of TLAC; and excludes all holdings of instruments or other claims listed in the "Excluded Liabilities" section of the FSB TLAC Term Sheet.](#)

- (c) the facility is provided by an ADI or other member of a Level 2 group and the funding provided flows through one member of the group (including any SPV) to another member of the group and the funding received by the second entity meets either (a) or (b) of this paragraph.

~~14.15.~~ In considering whether a facility (including a guarantee) provided to an unrelated entity³¹ ~~represents~~ constitutes capital support, APRA will have regard to, amongst other things, whether:

- (a) the facility represents a recognised capital instrument or is otherwise accepted as standing in place of capital required to be held by the entity; or
- (b) the provider of the facility is subordinated to other creditors, and the facility is not otherwise captured by provisions in APS 112 or APS 113 that consider the level of subordination in determining capital requirements for such facilities.

~~15.16.~~ If a facility covered in paragraphs ~~12-14~~ or ~~13-15~~ of this Attachment ~~represents~~ constitutes a form of capital support, the ADI ~~it~~ must apply the deductions in accordance with the provisions in this Attachment dealing with other capital support~~be considered for the purposes of this Prudential Standard to form part of an ADI's equity holdings. Investments that are not deducted from Common Equity Tier 1 Capital must be risk-weighted at 400 per cent.~~

Holdings of own capital instruments

~~16.17.~~ Unless otherwise indicated, an ADI must deduct from the corresponding category of capital, holdings of its own capital instruments, whether held directly or indirectly³², unless otherwise exempted by APRA or unless eliminated under Australian Accounting Standards from the relevant category of capital. This deduction must include any capital instruments that the ADI (or other members of the Level 2 group) could be contractually obliged to purchase, regardless of whether the holdings are recorded in the banking or trading book. An ADI must also deduct all of the unused portion of any trading limit agreed with APRA.

~~17.18.~~ Unless otherwise indicated, the gross long positions of own capital instruments may be deducted net of short positions in own capital instruments only if the short positions involve no counterparty risk. An ADI must look through holdings of index securities to determine exposures of own ordinary shares to be deducted.³³

~~18.19.~~ For the purposes of this Prudential Standard, an ADI or member of a group headed by an ADI may, as a result of membership of a dealer panel, trading or other activities agreed with APRA, undertake limited purchases of its own

³¹ This does not apply to guarantees provided to non-related Registrable Superannuation Entities (RSEs) or RSE licensees within the meaning of the *Superannuation Industry (Supervision) Act 1993*.

³² Refer to footnote ~~19~~26.

³³ Gross long positions in own ordinary shares resulting from holdings of index securities may be netted against short positions in own ordinary shares resulting from short positions in the same underlying index. In such cases, short positions may involve counterparty risk (which will be subject to the relevant counterparty credit risk charges outlined in APS 112 and APS 113).

Common Equity Tier 1 Capital instruments, Additional Tier 1 Capital instruments and Tier 2 Capital instruments or capital instruments issued by other members of the Level 2 group to which it belongs. Such purchases are subject to a limit as agreed with APRA, and the amount equal to the limit (or alternatively any actual holdings plus unused limit) must be deducted from Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital as appropriate, both at Level 1 and Level 2. This requirement does not apply to holdings of capital instruments by members of a group on behalf of third parties.

Regulatory adjustments to Common Equity Tier 1 Capital

~~19.20.~~ An ADI must make the following ~~regulatory adjustments~~deductions to determine Common Equity Tier 1 Capital at both Level 1 and Level 2.

Asset impairment

~~20.21.~~ An ADI must deduct any identified impairment of an asset where the impairment has not already been taken into account in profit ~~and-or~~ loss.

Cash flow hedge reserve

~~21.22.~~ An ADI must eliminate the amount of the cash flow hedge reserve that relates to the hedging of items that are not recorded at fair value on the balance sheet (including projected cash flows).³⁴

Covered bonds excess assets in cover pools

~~22.23.~~ An ADI must deduct the total value of assets in Australia held in cover pools securing the issue of covered bonds by the ADI that are in excess of eight per cent of the ADI's assets in Australia.

Deferred tax assets and deferred tax liabilities

~~23.24.~~ An ADI must deduct from its Common Equity Tier 1 Capital the net amount of its:

- (a) deferred tax assets; less
- (b) deferred tax liabilities.

An ADI must net these items on a consistent basis for the purposes of this Prudential Standard. In the event that deferred tax liabilities exceed the amount of deferred tax assets, the excess cannot be added to Common Equity Tier 1 Capital (i.e. the net deduction is zero).

~~25.~~ The deferred tax liabilities and deferred tax assets that may be netted must exclude amounts that have been used to adjust:

³⁴ Any gains on hedges are to be deducted and any losses on hedges added back.

(a) Goodwill and intangible assets; and

(b) Defined benefit superannuation assets.

24.26. Netting of deferred tax assets and deferred tax liabilities must only be applied where:

- (a) an ADI or member of a group that the ADI heads 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 ADI or group members to make or receive a single net payment; ~~and~~
- (b) the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same authority on either:
 - (i) the same taxable member of a group; or
 - (ii) different taxable members of a group for which group policies and procedures have been established that provide for the relevant group members to settle current tax assets and liabilities on a net basis, or to realise the assets and liabilities simultaneously, in each future period in which significant amounts of deferred tax assets or liabilities are to be settled or recovered; and
 - (iii) for direct or indirect subsidiaries of the ADI incorporated outside Australia for which:
 - (A) it is claimed current tax assets and liabilities will be settled on a net basis; and
 - (B) netting may have a material impact on any amount of deferred tax assets an ADI may be required to deduct from its capital; ~~;~~
and

the group headed by the ADI ~~must have~~has written opinions from relevant external auditors and legal advisors that the relevant tax authorities allow, or would allow, netting of deferred tax assets and deferred tax liabilities. An ADI must provide relevant written auditor or legal opinions to APRA, if requested.

25.27. An ADI must:

- (a) have procedures in place to monitor changes in relevant laws and taxation practices that may affect the written opinions it is required to obtain covering netting of deferred tax assets and deferred tax liabilities; and
- (b) ensure that the written opinions are updated in the event of changes in laws or taxation practices overseas that could materially impact on overseas taxation authorities continuing to allow netting of deferred tax assets and deferred tax liabilities.

Equity ~~exposures holdings~~ and other capital support provided to commercial (non-financial) entities

~~26.28.~~ Unless otherwise indicated, An an ADI must deduct direct, indirect³⁵ and synthetic equity exposures (as defined in paragraphs 49 to 52 of APS 113)³⁶, guarantees and other ~~forms of~~ capital support (refer to paragraphs 9 to 14 of this Attachment)³⁷ provided to commercial (non-financial) institutions. This includes:

- (a) equity exposures, guarantees and other ~~forms of~~ capital support held in the banking book; and
- (b) underwriting positions in equities held for more than five ~~working business~~ days.

An ADI is not required to deduct:

- (c) equity exposures in the ADI's trading book. Such exposures must be treated in accordance with the provisions in APS 116;
- (d) underwriting positions of equities held for five working days or less. Such exposures must be risk-weighted at 300 per cent if listed and at 400 per cent if unlisted; or
- (e) equity exposures held under a legal agreement on behalf of a third party, even if held in the name of the ADI (or other member of the Level 2 group), where the third party derives exclusively and irrevocably all the gains and losses of such exposures and investments.

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

~~27.29.~~ An ADI must eliminate all unrealised gains and losses that have resulted from changes in the ~~fair~~-value of liabilities (including capital instruments)³⁸ and any associated embedded derivatives, due to changes in the ADI's own creditworthiness. Additional Tier 1 Capital and Tier 2 Capital instruments must continue to be measured for capital adequacy purposes at their contractual values. Additional Tier 1 Capital and Tier 2 Capital instruments can be hedged in accordance with accounting standards.

Goodwill and other intangibles

~~28.30.~~ An ADI must deduct the following, net of any associated deferred tax assets and deferred tax liability liabilities that would be extinguished if the assets

³⁵ Refer to footnote ~~49~~26.

³⁶ This excludes holdings of subordinated debt in commercial (non-financial) institutions, as detailed in ~~Refer to~~ Attachment A to APS 112. All other holdings of capital instruments, including preference shares, even if classified as debt, must be deducted from Common Equity Tier 1 Capital.

³⁷ Refer to footnote ~~27~~36.

³⁸ ~~Additional Tier 1 Capital and Tier 2 Capital instruments must continue to be measured for capital adequacy purposes at their contractual values. Additional Tier 1 Capital and Tier 2 Capital instruments can be hedged in accordance with accounting standards.~~

involved become impaired or derecognised under Australian Accounting Standards:

- (a) goodwill and any other intangible assets³⁹ arising from an acquisition, net of adjustments to profit or loss reflecting any changes arising from ‘impairment’ of goodwill (at Level 1, intangibles also include the intangible components of investments in subsidiaries that could arise in relation to acquisitions); 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, capitalised transaction costs and mortgage servicing rights. These include, but are not limited to:
 - (i) loan/lease origination/broker fees and commissions that are capitalised as an asset which are to be set off against the balance of any corresponding upfront loan/lease origination/broker fees and commissions associated with the lending portfolios that are treated as deferred income and recognised as a liability. The positive balance of the net loan/lease origination/broker fees and commissions must be deducted from Common Equity Tier 1 Capital. A negative balance may be added to Common Equity Tier 1 Capital provided the net deferred income satisfies the criteria in this Prudential Standard. Otherwise, a negative balance must not be added to capital;
 - (ii) costs associated with debt raisings and other similar transaction-related costs that are capitalised as an asset;
 - (iii) costs associated with issuing capital instruments if not already charged to profit and loss;
 - (iv) capitalised information technology software costs;
 - (v) start-up and other establishment costs of a securitisation that are capitalised as an asset, and are to be set-off against the balance of fee income relating to securitisation schemes recognised and deferred as a liability. Any positive net balance must be deducted from Common Equity Tier 1 Capital (refer to Prudential Standard APS 120 Securitisation (APS 120)). Any up-front fee income received in excess of the capitalised securitisation establishment cost may be added to Common Equity Tier 1 Capital provided it meets the criteria in paragraph 22-29 of this Prudential Standard; and
 - (vi) other capitalised expenses including capitalised expenses of a general nature such as strategic business development initiatives. These also include, in addition to the above listed items, other forms of

³⁹ 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.

transaction costs and like costs that are required to be deferred/capitalised and amortised as part of the measurement of assets and liabilities under Australian Accounting Standards.

~~29.31.~~ 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 ~~up-front~~ fee income received over deferred costs may be included in Common Equity Tier 1 Capital provided the ~~up-front~~ fee income received satisfies the criteria in paragraph ~~23-29~~ of this Prudential Standard. Otherwise, up-front fee income received must not be added to capital.

Guarantees

~~30.32.~~ An ADI must deduct any guarantee, or credit derivative covering a credit exposure of the ADI, that provides for a materiality threshold below which no payment will be made in the event of a loss (refer to APS 112 and APS 113 for limits on the amounts an ADI is required to deduct).

Industry support schemes

~~31.33.~~ An ADI must deduct any non-repayable loans advanced by another ADI under APRA-certified industry support arrangements.

Securitisation

~~32.34.~~ An ADI must deduct:

- (a) the value of securitisation exposures subject to capital deduction under APS 120;
- (b) any increase in Common Equity Tier 1 Capital arising from any gain on sale (refer to APS 120);
- (c) any capitalised expected future income relating to securitisation activities prior to it being irrevocably received; and
- (d) the difference between the book value and the value realised for transfers of exposures to an SPV where the realised value is less than the book value, unless the difference has been written off to the ADI's profit and loss (refer to APS 120).

Shortfall in provisions for credit losses

~~33.35.~~ An ADI must deduct the shortfall in the stock of eligible provisions under the IRB approach to credit risk (refer to APS 113).

Specific provisions

~~34.36.~~ An ADI must deduct specific provisions (refer to APS 220), including that portion of collective provisions deemed to be a specific provision for regulatory purposes, and any prescribed provisions that have not already resulted in a charge to profit and loss by way of establishment of a provision in audited published financial accounts.

Superannuation funds

~~35.37.~~ An ADI must deduct any surplus in a defined benefit fund, of which the ADI is an employer-sponsor, unless otherwise approved 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. An ADI may apply to APRA to include a surplus as an asset for capital adequacy purposes where the ADI (or member of the ADI's group) employer-sponsor is able to demonstrate unrestricted and unfettered access to a fund surplus in a timely manner. Subject to APRA approval, an ADI may include the surplus in its risk-weighted assets at a 100 per cent risk weight rather than deducting the surplus.

~~36.38.~~ An ADI must deduct any deficit in a defined benefit superannuation fund of which an ADI (or at Level 2 any member of the Level 2 group) is an employer-sponsor and that is not already reflected in Common Equity Tier 1 Capital.

Other adjustments

~~37.39.~~ An ADI must deduct any other deductions required under any other ADI Prudential Standard.

~~38.40.~~ APRA may require an ADI to deduct from Common Equity Tier 1 Capital at Level 1 and Level 2 an amount to cover undercapitalisation of a ~~non-consolidated~~ subsidiary (or subsidiaries). An ADI may be required to provide to APRA details of, amongst other things:

- (a) the size and scale of the operations of the non-consolidated subsidiary;
- (b) the materiality of the subsidiary's operations to group income and strategic outlook;
- (c) the level of net tangible assets of the subsidiary;
- (d) the risk profile of the subsidiary;
- (e) the level of exposure of the ADI on a Level 1 basis and of the Level 2 group to the subsidiary; and
- (f) the size of any identified capital shortfall and the likelihood of such a shortfall being remedied within a reasonable period of time.

Attachment E - Criteria for inclusion in Additional Tier 1 Capital

1. To qualify as Additional Tier 1 Capital, an instrument must satisfy the following minimum criteria:
 - (a) the instrument must be paid-up and the amount must be irrevocably received by the issuer;
 - (b) the instrument represents, prior to any conversion to Common Equity Tier 1 Capital (refer to Attachment F, ~~Attachment J~~ and Attachment ~~K-H~~ of to this Prudential Standard), the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 Capital instruments. Where an issuer is a holding company, the subordination applicable must apply to all general creditors of the holding company⁴⁰;
 - (c) 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 entity⁴¹, or other arrangement that legally or economically enhances the seniority of the holder's claim.⁴² The instrument may not be secured or otherwise subject to netting or offset claims on behalf of the holder or issuer of the instrument;
 - (d) the principal amount of the instrument is perpetual (i.e. it has no maturity date)⁴³;
 - (e) the instrument contains no step-ups or other incentives to redeem. The issuer and any other member of a group to which the issuer belongs must not create an expectation at issuance that the instrument will be bought back, redeemed or cancelled. The contractual terms of the instrument must not provide any feature that might give rise to such an expectation⁴⁴;
 - (f) 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:

⁴⁰ ~~Where an issuer is a holding company, the subordination applicable must apply to all general creditors of the holding company.~~

⁴¹ Refer to footnote 4218.

⁴² ~~This would preclude any provision of support (including contribution of reserves) to any SPV used to issue capital instruments that form part of an ADI or Level 2 group's issue of Additional Tier 1 and Tier 2 Capital instruments.~~

⁴³ An instrument may be treated as perpetual if it will mandatorily convert to ordinary shares at a pre-defined date after 5 years from issue. Instruments with maturity dates and automatic roll-over features do not qualify as perpetual instruments.

⁴⁴ 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 ADI must not otherwise do anything to create an expectation that the call will be exercised.

- (i) must receive prior approval from APRA to exercise a call option. ~~For instruments issued by subsidiaries not regulated by APRA included in a Level 2 group, prior approval must be obtained from APRA;~~
- (ii) must not do anything that creates an expectation that a call will be exercised; and
- (iii) must not exercise a call unless:
 - (A) 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
 - (B) the ADI meets the requirements relating to reductions in capital in APS 110.
- (g) ~~An~~ the instrument may provide for multiple call dates after five years. However, the specification of multiple call dates must not act to create an expectation that the instrument will be redeemed upon any call date;
- (h) issuers must not assume, or create market expectations, that supervisory approval will be forthcoming for the issuer to redeem, call or purchase an instrument;
- (i) an issuer must:
 - (i) have full discretion at all times to cancel distributions/payments on the instrument.⁴⁵ 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;
 - (ii) 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;
 - (iii) have full access to cancelled distributions/payments to meet obligations as they fall due; and

⁴⁵ 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.

- (iv) 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;
- (j) distributions on the instrument are paid out of distributable items⁴⁶ 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. All distributions are subject to the restrictions applied under APS 110;
- (k) 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). ~~However, a~~An instrument may utilise a broad index as a reference rate for distribution or payments calculation purposes. Where an issuer is a reference entity in the determination of the reference rate, the reference rate must not exhibit any significant correlation with the issuer's credit standing. APRA ~~will~~may require an ADI to exclude~~not allow inclusion of~~ an instrument ~~from as part of~~ Additional Tier 1 Capital where ~~APRA~~[#] considers that the reference rate is sensitive to the credit standing of the issuer;
- (l) the instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of any national insolvency law applying in the jurisdiction of issue. ~~In such cases, t~~The issue documentation must specify that the insolvency law that applies is the law of the place of incorporation of the issuer⁴⁷;
- (m) an instrument that is classified as a liability under Australian Accounting Standards must comply with the loss absorption requirements in Attachment F of this Prudential Standard;
- (n) 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 entity⁴⁸, cannot have purchased or directly or indirectly⁴⁹ funded the purchase of the instrument or be funding the purchase of the instrument;
- (o) the instrument has no features that hinder recapitalisation of the issuer, or any other members of the group to which the issuer belongs. This includes

⁴⁶ Refer to footnote 16.

⁴⁷ If an overseas branch of an ADI issues in a foreign jurisdiction where insolvency law is different from the jurisdiction where the parent ADI is based, issue documentation must specify that the insolvency law in the parent's jurisdiction will apply.

⁴⁸ Refer to footnote ~~42~~18.

⁴⁹ Refer to footnote ~~43~~26.

features that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified timeframe;

- (p) where the terms of the instrument provide the ability (even in contingent circumstances) to substitute the issuer of the Additional Tier 1 Capital instruments, or the issuer of ordinary shares into which they may convert (i.e. to replace the ADI with another party), the relevant documentation must set out the mechanism to ensure that there will be a simultaneous capital injection into the ADI to replace the transferred capital instrument. ~~Any replacement~~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;
- (q) the instrument does not contain any terms, covenants or restrictions that could inhibit the issuer's ability to be managed in a sound and prudent manner, particularly in times of financial difficulty, or restrict APRA's ability to resolve any problems encountered by the issuer;
- (r) 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;
- ~~(s) where an issue of an instrument involves the use of an SPV, the issue of the instrument is subject to Attachment I of this Prudential Standard;~~
- ~~(t)~~(s) the instrument includes provisions addressing which comply with the loss absorption requirements at the point of non-viability as required by Attachment ~~J-H~~ of to this Prudential Standard;
- (t) the instrument is clearly and separately disclosed in the issuer's financial statements and, at Level 2, in any consolidated financial statements; ~~and~~
- (u) the instrument must not include the following clauses:
 - (i) 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
 - (ii) an event of default clause specifying an event relating to any debt instrument or other capital instrument of the issuer, that brings the issuer into default under the instrument itself.

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

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

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

(C) any consequence arising from, or any action taken or intended to prevent⁵⁰, the above events or a default by the issuer under the debt instrument or other capital instrument,

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

~~(u)~~(v) the issue documentation must clearly and prominently indicate state:

(i) the instrument is perpetual;

(ii) the instrument is unsecured;

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

(iv) the instrument is not subject to netting;

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

~~(ii)~~(vi) if relevant, the application of requirements for loss absorption required under Attachment F ~~to~~ this Prudential Standard;

(vii) the application of requirements for loss absorption at the point of non-viability under Attachment ~~J-H~~ ~~of~~ ~~to~~ this Prudential Standard; ~~and~~

(viii) the instrument does not represent a deposit liability of an issuing ADI;

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

~~(iv)~~(x) where the issuer has full discretion over the timing and amount of any distributions paid on the instrument, including not paying a distribution is classified for accounting purposes as a liability, it does not represent a deposit liability of an issuing ADI.

2. For the purposes of ~~In accordance with~~ paragraph 1 ~~(hi)~~ of this Attachment, failure to make a distribution or payment must not trigger any restrictions⁵¹ on the issuer

⁵⁰ For example, by way of a scheme of arrangement.

⁵¹ 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 issuer of the instrument. This includes situations where a future holding company

other than its ability to pay a distribution on Common Equity Tier 1 Capital instruments⁵² 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;~~or~~

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

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

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

3. An instrument must not include any provision that permits an additional optional distribution or payment to be made. Any structuring of a distribution or payment as a bonus payment, or any arrangement to make up/compensate for unpaid distributions or payments is also prohibited. An instrument cannot provide for investors to convert an instrument into ordinary shares or mutual equity interests upon a non-payment of a distribution.
4. For the purposes of paragraph 1(e) 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 shares⁵³ if the call is not exercised;~~or~~
 - (b) a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate less the swap rate (i.e. the fixed rate paid to the call date to receive the second reference rate);
 - (c) a call option combined with an increase in redemption amount in the future;

may be substituted as the issuer of ordinary shares on conversion, but not substituted as the issuer of the instrument.

⁵² Any reference to Common Equity Tier 1 Capital instruments in this paragraph includes a reference to mutual equity interests issued in accordance with Attachment ~~K~~L.

⁵³ ~~For the avoidance of doubt, reference to ‘ordinary shares’ in this paragraph, and in paragraphs 5 and 8 of this Attachment, does not refer to mutual equity interests issued in accordance with Attachment K.~~

- (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 8 of this Attachment); and
- ~~(b)~~(g) application of maximum and minimum rates on distributions.-
5. 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 ADI may have an option to call the instrument to the nearest subsequent date upon which that conversion option may be exercised.
6. Calling an instrument and replacing it with an instrument with a higher credit spread or that is otherwise more expensive ~~may~~ is deemed to create the expectation that the issuer will exercise a call option on other outstanding Additional Tier 1 Capital instruments or Tier 2 Capital instruments with call options, unless the issuer can satisfy APRA as to the economic and prudential rationale and that such an action will not create an expectation that other instruments will be called in similar circumstances.
- ~~6.7.~~ An instrument must provide for the immediate, automatic and permanent revocation of a call notice upon a loss absorption event (refer to Attachment F to this Prudential Standard) and upon a non-viability event (refer to Attachment H to this Prudential Standard). A call option cannot be exercised in anticipation of a loss absorption event or a non-viability event.
8. 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.
- ~~7.9.~~ APRA may require an ADI not to exercise a call where it relates to a tax or regulatory event if will not approve such a call under paragraph 1(f)(i) of this Attachment if it APRA forms the view that the ADI 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 1(f)(i) to 1(f)(iii) of this Attachment.

8.10. Where an Additional Tier 1 Capital instrument provides for conversion into ordinary shares⁵⁴, 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 fixed. The conversion number must be capable of being ascertained immediately and objectively; and
- (c) set the maximum⁵⁵ 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 ADI's⁵⁶ ordinary share price⁵⁷ at the same time. In calculating the ordinary share price at time of issue, adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations. In calculating the ordinary share price at 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.⁵⁸ 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, objectively and without further steps; 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 (i.e. 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

⁵⁴ Conversion must be into the ordinary shares of the ADI or its parent entity, which must be listed at the time of issue. For an unlisted ADI 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 ADI. Where an unlisted ADI issues the instrument to its listed parent entity, conversion may be into the unlisted ordinary shares of the ADI.

⁵⁵ There is no cap on the maximum number of ordinary shares which may be issued on conversion where the only holder of the converting capital instrument is a listed parent entity which wholly-owns the issuer of the capital instruments.

⁵⁶ Reference to ADI captures any entity whose ordinary shares are issued as a result of conversion provisions.

⁵⁷ For an unlisted ADI 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.

⁵⁸ This may include subsequent ordinary share splits, bonus issues and share consolidations.

exchange rates would be determined, if at a time of conversion, foreign exchange markets were to be closed at the intended time of conversion.

11. For mutually owned ADIs, where an Additional Tier 1 Capital instrument provides for conversion into mutual equity interests, the issue documentation must:

- (a) specify the number of mutual equity interests to be received upon conversion, or specify the conversion formula for determining the number of mutual equity interests received;
- (b) provide for the number of mutual equity interests to be received under the formula specified in (a) of this paragraph to be fixed. The conversion number must be capable of being ascertained immediately and objectively; 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 Additional Tier 1 Capital instrument converted.

9.12. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the ADI under Australian Accounting Standards.

13. 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 written-off amount of the instrument;
- (c) there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the ADI; 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).

10.14. 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.

~~14.15.~~ 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.

~~16.~~ ~~There must be no cross-default clauses in the~~ documentation of any debt or other capital instrument of the issuer of an Additional Tier 1 Capital instrument linking the issuer's obligations under the instrument to default by the issuer under any of its other obligations, or default by another party, related or otherwise. 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;⁵⁹ 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.

~~17.~~ For the purposes of paragraph 16(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 or intended to prevent,⁶⁰ the above events or a default by the issuer under the Additional Tier 1 Capital instrument.

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

~~18.~~ ~~The An~~ instrument ~~must be marketed in accordance with its prudential treatment and~~ must not include any 'repackaging' arrangements that have the effect of compromising the quality of the capital raised.

~~12.19.~~ ~~Where issue~~ ~~if a prospectus or other offer~~ documentation, or marketing of the instrument ~~could be reasonably held to suggest to investors that~~ the instrument is not consistent with the eligibility requirements in this Attachment for Additional Tier 1 Capital instruments ~~has attributes of a lower level of capital than claimed~~

⁵⁹ These provisions on cross-default clauses are in addition to the general prohibition on cross-default clauses involving related entities set out in *Prudential Standard APS 222 Associations with Related Entities* (APS 222).

⁶⁰ For example, by way of a scheme of arrangement.

~~by the issuer (or Level 2 group) for prudential purposes~~, the instrument will be ineligible to be included in the ADI's Additional Tier 1 Capital.

~~13.20.~~ The instrument, ~~whether issued by the ADI or another member of the Level 2 group to which the ADI belongs (including overseas subsidiaries)~~ may be subject to the laws of a ~~foreign country jurisdiction other than Australia or its territories~~, except that the terms and conditions of the instrument that relate to:

- (a) loss absorption conversion or write-off (where relevant); and
- (b) non-viability conversion or write-off

must be subject to the laws of ~~an Australian jurisdiction or its territories~~.

~~14.21.~~ Where the instrument, ~~whether issued by the ADI or another member of the Level 2 group to which the ADI belongs (including an overseas subsidiary)~~, is subject to the laws of a ~~foreign country jurisdiction other than Australia or its territories~~, the ADI ~~issuer~~ must also ensure that ~~the instrument satisfies~~ all relevant qualifying criteria ~~applicable to the instrument under this Attachment are enforceable for Additional Tier 1 Capital~~ under the laws of that jurisdiction.

~~15.22.~~ APRA may require an ADI to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice at the ADI's expense, confirming that the instrument ~~meets~~ ~~satisfies all applicable criteria for an Additional Tier 1 Capital instrument under the requirements in paragraphs 14 and 15 of this Attachment~~ Prudential Standard.

Attachment F - Loss absorption requirements: Additional Tier 1 Capital

1. An Additional Tier 1 Capital instrument classified as ‘liabilities’ under Australian Accounting Standards must include a provision whereby upon the occurrence of a loss absorption event (refer to paragraph 2 of this Attachment) it will be immediately and irrevocably:

(a) converted into the ordinary shares of the ADI or its parent entity, which must be **listed** at the time the instrument is issued⁶¹;

(b) converted into mutual equity interests; or

(c) written off.

~~when the issuing ADI’s Level 1 or Level 2 Common Equity Tier 1 Capital ratio falls to, or below 5.125 per cent of total risk-weighted assets (the loss absorption trigger point).~~

2. A loss absorption event occurs when the issuing ADI’s Level 1 or Level 2 Common Equity Tier 1 Capital ratio under APS 110 falls to, or below 5.125 per cent of total risk-weighted assets (the loss absorption trigger point).

3. Conversion or write-off must generate an unequivocal addition to Common Equity Tier 1 Capital of the ADI under Australian Accounting Standards.

4. For the purposes of conversion or write-off of an Additional Tier 1 Capital instrument, the amount to be converted or written off must be the face value of the instrument. 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 of 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.

~~2.6.~~ To qualify as eligible Additional Tier 1 Capital at Level 2, an instrument issued by an ADI or a fully consolidated subsidiary of a Level 2 group must provide for conversion or write-off of the instrument upon the Level 2 group reaching the loss absorption trigger point. An instrument may also provide for conversion or

⁶¹ For an unlisted ADI 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 ADI. Where an unlisted ADI issues the instrument to its listed parent entity, conversion may be into the unlisted ordinary shares of the ADI.

write-off should a host regulatory authority of an issuing subsidiary determine a loss absorption event in respect of the subsidiary.

~~3.7.~~ The amount of an Additional Tier 1 Capital instrument that may be recognised in the ADI's Tier 1 Capital and Total Capital is the minimum level of Common Equity Tier 1 Capital that would be generated by full conversion or write-off of the instrument on the occurrence of a loss absorption event. In determining, at any point in time, the amount of Common Equity Tier 1 Capital that would be generated by conversion or write-off, the ADI must take into account any tax or other potential offsets which might impact the minimum level of Common Equity Tier 1 Capital that would be generated if conversion or write-off were to take place. Adjustments to the value of Additional Tier 1 Capital instruments included in Tier 1 Capital or Total Capital must be updated over time to reflect any changes in the best estimates of the offset value. Where an instrument's primary loss absorption mechanism is conversion into ordinary shares, an ADI is not required to take into account any taxation effect resulting from write-off of the instrument in the event conversion was not achievable as required. Where an instrument provides for write-off as the primary loss absorption mechanism, the amount recognised must account for potential taxation liabilities or other potential offsets at the time of issuance. Adjustments must be updated over time to reflect the best estimates of the offset value.

~~8.~~ The aggregate amount of full or partial⁶² conversion or write-off of Additional Tier 1 Capital instruments must, as a minimum, be no less than the lower of the following :

~~(a) the amount required to ensure the loss absorption event no longer applies (i.e. the amount required to restore fully the Common Equity Tier 1 Capital ratio under APS 110 of the ADI and Level 2 group to 5.125 per cent); or~~

~~(b) the principal amount of all the instruments.~~

~~9.~~ If a loss absorption event ceases to apply, unless otherwise required by APRA, no further conversion or write-off of Additional Tier 1 Capital instruments need be undertaken.

~~4.~~ Where an ADI's Level 1 or Level 2 Common Equity Tier 1 Capital reaches the loss absorption trigger point, the aggregate amount of Additional Tier 1 Capital outstanding to be converted or written off must be sufficient to return the Common Equity Tier 1 Capital ratio of the ADI and Level 2 group to above 5.125 per cent of total risk-weighted assets, if possible.

~~5.1.~~ Conversion or write-off must generate an unequivocal addition to Common Equity Tier 1 Capital of the ADI under Australian Accounting Standards.

~~6.10.~~ Where an Additional Tier 1 Capital instrument provides for conversion into ordinary shares (or mutual equity interests), the ADI must ensure that, at the time

⁶² Where a partial conversion or write-off of an Additional Tier 1 Capital instrument occurs, the amount of the instrument which remains unconverted or not written off may retain its original seniority subject to any future application of the requirements in this Attachment.

of issue and on a continuing basis, there are no legal or other impediments to issuing the relevant number of shares (or mutual equity interests) and all necessary authorisations have been obtained to effect conversion.

~~7.11. An Additional Tier 1 Capital instrument must unequivocally provide for the amount of the instrument to be immediately and irrevocably written off (including termination of the right to receive ordinary shares, mutual equity interests, principal, dividends or interest) effective from the occurrence of the loss absorption event and result in an unequivocal addition to Common Equity Tier 1 Capital. Where, if, following a trigger loss absorption event, conversion of an Additional Tier 1 Capital instrument:~~

~~(a) is not capable of being undertaken;~~

~~(a)(b) has not been fully effected for any reason within 5 business days;~~

~~(b)(c) is not irrevocable; and/or~~

~~(e)(d) will not result in an immediate and unequivocal increase in Common Equity Tier 1 Capital of the ADI at Level 1 or Level 2, as applicable.;~~

~~the amount of the instrument must immediately and irrevocably be written off in the accounts and result in an unequivocal addition to Common Equity Tier 1 Capital.~~

~~12. Where issue documentation may provides for a ranking under which instruments may be hierarchy of converted or written-off upon a loss absorption event. The terms attached to such a hierarchy must not impede the ability of the capital instrument to be immediately converted or written off.~~

~~8.13. Where an Additional Tier 1 Capital instrument provides for conversion into ordinary shares (or mutual equity interests) when the a loss absorption trigger point is breached event occurs, the conversion provisions in the issue documentation must satisfy the requirements in paragraphs 10 and 11 to Attachment E of this Prudential Standard.;~~

~~(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 formula specified in (a) of this paragraph to be fixed; and~~

~~(c) set the maximum number of ordinary shares received so as not to exceed the price of the Additional Tier 1 Capital instrument at the time of issue divided by 20 per cent of the ADI's⁶³ ordinary share price⁶⁴ at that same~~

⁶³ Reference to ADI captures any entity whose ordinary shares are issued as a result of conversion provisions.

⁶⁴ For an unlisted ADI 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.

~~time. In calculating the ordinary share price at time of issue, adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations.~~

- ~~9. For mutually owned ADIs, where an Additional Tier 1 Capital instrument provides for conversion into mutual equity interests when the loss absorption trigger point is breached, 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 fixed; 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 Additional Tier 1 Capital instrument converted.~~
- ~~10. In issuing Additional Tier 1 Capital instruments an ADI may, within each category of capital:~~
- ~~(a) differentiate between instruments as to whether an instrument is required to convert or be written off in the first instance;~~
 - ~~(b) provide for a ranking under which Additional Tier 1 Capital instruments will be converted or written off; and~~
 - ~~(c) where conversion or write off of capital instruments is required at Level 2, the Level 2 group may provide for a ranking under which Additional Tier 1 Capital instruments issued by individual members of the group may need to be converted or written off. This would be subject to any requirements for conversion or write off of Additional Tier 1 Capital instruments required to be undertaken on a Level 1 basis.~~
- ~~11.1. Where issue documentation provides for a hierarchy of conversion or write off, the terms attached to such a hierarchy must not impede the ability of the capital instrument to be immediately converted or written off.~~
- ~~12. For the purposes of conversion or write off of an Additional Tier 1 Capital instrument, the amount to be converted or written off will be the face value of the instrument recorded in the books of the ADI or subsidiary, where relevant.~~
- ~~13.14. Where an Additional Tier 1 Capital instrument provides for a write-off upon a loss absorption event mechanism, the write-off provisions in the issue documentation must satisfy the requirements in paragraph 13 of Attachment E to this Prudential Standard. ~~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 written-off amount of the instrument;~~
- ~~(c) there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the ADI; 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).~~

~~14.15.~~ The contractual terms and conditions of an Additional Tier 1 Capital instrument must ~~not~~ provide that, on conversion of the instrument upon a loss absorption event, for any residual claims on-against the issuer in relation to the converted portion of the instrument that are not senior to the ordinary shares of the ADI (or mutual equity interests), and not senior to ordinary shares or the of any parent entity of the ADI, in the event that a trigger point is reached and conversion or write-off is undertaken.

16. An ADI must notify APRA immediately, ~~if in writing, when~~

- ~~(a) the ADI anticipates its Level 1 or Level 2 Common Equity Tier 1 Capital ratio may falls to or below 5.125 per cent of total risk weighted assets; or~~
- ~~(a)(b) the ADI's Level 1 or Level 2 Common Equity Tier 1 Capital ratio falls to or below 5.125 per cent.~~

Attachment G - Additional Tier 1 Capital: Stapled security structure

1. — A stapled security structure consisting of the issue of a preference share and a stapled instrument of another form may be included in Additional Tier 1 Capital for both Level 1 and Level 2, subject to satisfying the following additional minimum criteria:
 - (a) — the preference share is issued directly by an ADI and is ‘stapled’ to securities issued directly by an overseas branch of the ADI. The stapled structure must not involve use of SPVs and must be simple and transparent;
 - (b) — at least one of the preference share and the security to which it is stapled must be fully paid-up. Any partly paid preference share or stapled security is eligible only to the extent that it has been paid-up;
 - (c) — the preference share and the instrument to which it is stapled must each individually satisfy the criteria in this Prudential Standard for an Additional Tier 1 Capital instrument;
 - (d) — the terms and conditions of the stapled security must substantially mirror those of the preference share such that the stapled security operates effectively as if it was a preference share;
 - (e) — the preference share and the instrument to which it is stapled must not be traded separately and are to remain stapled together until an ‘unstapling event’ occurs;
 - (f) — ‘unstapling’ at the option of the issuer is permitted. The instrument documentation must clearly stipulate the events that will cause the preference share to be ‘unstapled’ resulting in the stapled security being extinguished, leaving the holder of the stapled security holding the preference share instead. Unstapling must take place if:
 - (i) — a loss absorption trigger point is reached in accordance with Attachment F of this Prudential Standard;
 - (ii) — a non-viability trigger event occurs in accordance with Attachment J of this Prudential Standard;
 - (iii) — proceedings for the liquidation of the ADI have commenced;
 - (iv) — APRA issues a recapitalisation direction to the ADI in accordance with subsection 13E(1) of the Banking Act; or
 - (v) — APRA appoints a statutory manager to the ADI pursuant to subsection 13A(1) of the Banking Act;
 - (g) — to reduce the inherent legal risk associated with unstapling of the structure, the issue documentation must ensure the clarity, consistency and certainty

~~with which the contractual terms and conditions are specified, and specifically that:~~

- ~~(i) all entities involved in the stapled structure have the capacity and power to issue the instruments and perform obligations under them;~~
- ~~(ii) the rights and obligations created by the preference share and the stapled security are legally valid, binding and enforceable on all parties in all jurisdictions where they are issued;~~
- ~~(iii) the stapled security will be extinguished and holders of the stapled security will hold the underlying preference share upon the occurrence of an unstapling event; and~~
- ~~(iv) the 'unstapling' mechanism will take effect as contemplated in the issue documentation even if the ADI or another entity has become, or is likely to become, insolvent, including where it is in administration, receivership, winding up or where a statutory manager has been appointed under the Banking Act.~~

~~Where necessary, APRA may require an ADI to obtain independent legal opinion confirming the above; and~~

- ~~(h) adequate internal policies and controls must be in place such that the unstapling procedures are correctly followed.~~

~~2. A preference share and instrument to which it is stapled must be issued by the same issuer but they need not be issued in the same jurisdiction.~~

Attachment H - Attachment G - Criteria for inclusion in Tier 2 Capital

1. To qualify as Tier 2 Capital, an instrument must satisfy the following minimum criteria:
 - (a) the instrument must be paid-up and the amount must be irrevocably received by the issuer;
 - (b) the instrument represents, prior to any conversion to Common Equity Tier 1 Capital (refer to Attachment ~~J-H~~ and ~~Attachment K~~ of ~~to~~ this Prudential Standard), the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 Capital instruments and Additional Tier 1 Capital instruments. Where an issuer is a holding company, any claim in relation to the instrument must be subordinate to the claims of general creditors of the holding company⁶⁵;
 - (c) 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 entity⁶⁶, or other arrangement that legally or economically enhances the seniority of the claim.⁶⁷ The instrument may not be secured or otherwise subject to netting or offset of claims on behalf of the holder or issuer of the instrument;
 - (d) the principal amount of the instrument:
 - (i) has a minimum maturity of at least five years⁶⁸; and
 - (ii) is only recognised in Tier 2 Capital (and therefore in Total Capital) in the five years prior to maturity on a straight-line amortised basis (refer to paragraph 2 ~~of~~ to this Attachment);
 - (e) the instrument contains no step-ups or other incentives to redeem. The issuer and any other member of a group to which the issuer belongs must not create an expectation at issuance that the instrument will be bought back, redeemed or cancelled before its contractual maturity. The contractual terms of the instrument must not provide any feature that might give rise to such an expectation⁶⁹;

⁶⁵ ~~Where an issuer is a holding company the subordination applicable must apply to all general creditors of the holding company.~~

⁶⁶ Refer to footnote ~~12~~18.

⁶⁷ ~~Refer to footnote 33.~~

⁶⁸ 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.

⁶⁹ 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 ADI must not otherwise do anything to create an expectation that the call will be exercised.

- (f) 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:
- (i) must receive prior approval from APRA to exercise a call option. ~~For instruments issued by subsidiaries not regulated by APRA included in a Level 2 group, prior approval must be obtained from APRA;~~
 - (ii) must not do anything that creates an expectation that a call will be exercised; and
 - (iii) must not exercise a call unless:
 - (A) 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
 - (B) the ADI meets the requirements relating to reductions in capital in APS 110;
- (g) ~~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;
- (h) issuers must not assume, or create market expectations, that supervisory approval will be forthcoming for the issuer to redeem, call or purchase an instrument;
- (i) the instrument must confer no rights on holders to accelerate the repayment of future scheduled payments (coupon or principal) except in bankruptcy (including wind~~ing~~-up) and liquidation. Wind~~ing~~-up of the ADI must be irrevocable (that is, either by way of ~~a court order or~~ an effective resolution by shareholders or members for a wind-up, or a court order has been made, and the time for appeal of the decision has passed). The making of an application ~~to~~ for wind~~ing~~-up or the appointment of a receiver, administrator, or official with similar powers, including the exercise of APRA's powers under section 13A(1) of the Banking Act, must not be sufficient to accelerate repayment of the instrument;
- (j) the instrument must not provide for payment to investors other than in the form of a cash payment;
- (k) 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). ~~However, an~~ 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 an ADI to exclude~~ ~~will not allow inclusion of~~ an instrument ~~from treatment as part of~~ Tier 2 Capital where ~~it~~ APRA considers that the reference rate is sensitive to the credit standing of the issuer;

- (l) 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 entity⁷⁰, cannot have purchased or directly or indirectly⁷¹ funded the purchase of the instrument ~~or be funding the purchase of the instrument~~;
- (m) the instrument has no features that hinder recapitalisation of the issuer, or any other members of the group to which the issuer belongs. This includes features that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified timeframe;
- (n) ~~where if~~ the terms of the instrument provide the ability (even in contingent circumstances) to substitute the issuer ~~of the Tier 2 Capital instruments or the issuer of the ordinary shares into which they may convert~~ (i.e. to replace the ADI with another party), the relevant documentation must set out the mechanism to ensure that there will be a ~~simultaneous~~ capital injection into the ADI to replace the transferred capital instrument. ~~Any~~ ~~The~~ replacement capital injection must occur at least simultaneously with the substitution and must be unconditional. The capital injection must be of equal or better quality capital and at least the same amount as the original issue, unless otherwise approved by APRA;
- (o) the instrument does not contain any terms, covenants or restrictions that could inhibit the issuer's ability to be managed in a sound and prudent manner, particularly in times of financial difficulty, or restrict APRA's ability to resolve any problems encountered by the issuer;
- (p) 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;
- (q) ~~where if~~ an issuer defaults under the terms of the instrument, ~~the~~ remedies available to the holders must be limited to actions for specific performance, recovery of amounts currently outstanding or the winding-up of the issuer. The amounts that may be claimed in the event that the issuer defaults may include any accrued unpaid dividends and interest, including payment of market interest on these unpaid amounts. ~~Any claim against the issuer~~ ~~All such for~~ unpaid dividends and interest must be ~~treated as~~ subordinated ~~claims on the issuer in an equivalent manner to subordination of to the claims on the principal value of the instrument as provided for in paragraph 1 (b) of this Attachment of depositors and other creditors of the issuer~~;

⁷⁰ Refer to footnote ~~42~~18.

⁷¹ Refer to footnote ~~49~~26.

- (r) 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;
- ~~(s) where an issue of an instrument involves the use of an SPV, the issue of the instrument is subject to Attachment I of this Prudential Standard;~~
- ~~(s)~~ the instrument includes provisions which comply with the addressing loss absorption requirements at the point of non-viability ~~in accordance with~~under Attachment ~~J-H of to~~ this Prudential Standard;
- ~~(t)~~ the instrument is clearly and separately disclosed in the issuer's financial statements and, at Level 2, in any consolidated financial statements; ~~and~~
- (u) the instrument must not include the following clauses:
- (i) 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
- (ii) 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 purposes of paragraph (u)(ii), an event of default clause includes a clause specifying the following events:

- (A) the exercise or non-exercise of discretions within the debt instrument or other capital instrument;
- (B) an adverse event or change, however so described or determined, occurring in respect of the debt instrument or other capital instrument; and
- (C) any consequence arising from, or any action taken or intended to prevent⁷², the above events or a default by the issuer under the debt instrument or other capital instrument,

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

- (v) issue documentation must clearly and prominently state~~indicates~~:

⁷² For example, by way of a scheme of arrangement.

- (i) the maturity date of the instrument at which time the issuer is required to redeem the instrument;
 - (ii) 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 right of set-off;
 - (iii) the instrument is not subject to netting;
 - (i)(iv) that the issuer cannot buy back, repurchase or redeem the instrument other than in terms permitted under this Prudential Standard;
 - (ii)(v) the application of requirements relating to loss absorption at the point of non-viability under Attachment JH to this Prudential Standard; and
 - (vi) that the instrument does not represent a deposit liability of an issuing ADI; and
 - (iii)(vii) that the instrument is neither covered by the Financial Claims Scheme nor guaranteed by the Australian Government.
2. The amount of ~~the an~~ instrument eligible for inclusion in Tier 2 Capital is to be amortised on a straight-line basis at a rate of 20 per cent per annum over the last four years to maturity as follows:

Years to Maturity	Amount Eligible for Inclusion in Tier 2 Capital
More than 4	100 per cent
Less than and including 4 but more than 3	80 per cent
Less than and including 3 but more than 2	60 per cent
Less than and including 2 but more than 1	40 per cent
Less than and including 1	20 per cent

- ~~3. 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.~~
- 4.3. For the purposes of paragraph 1(e) of this Attachment, an incentive or expectation to call or otherwise redeem a Tier 2 Capital instrument includes, but is not limited to:

- (a) a call option combined with a requirement, or an investor option, to convert the instrument into ordinary shares⁷³ if the call is not exercised; ~~or~~
- (b) a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate less the swap rate (i.e. the fixed rate paid to the call date to receive the second reference rate);
- (c) a call option combined with an increase in redemption amount in the future;
- (d) automatic redemption or an option to redeem following a change of control event;
- (e) mandatory conversion within the first five years of issue, except conversions arising from change of control, regulatory or tax events;
- (f) any arrangement whereby an investor will become subject to: (i) known tax or charges; or to (ii) known higher tax or charges than they would have had to pay before, following a call date and the issuer is required to compensate an investor for any payment of the additional tax or charges (refer to paragraph 7 of this Attachment); and
- ~~(b)~~(g) application of maximum and minimum rates on distributions.

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

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

6. 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 H to this Prudential Standard). A call option cannot be exercised in anticipation of a non-viability event.

7. An A Tier 2 Capital instrument may only provide for a call within the first five years of issuance as a result of a tax or regulatory event. A tax or regulatory event is confined to:

⁷³ ~~For the avoidance of doubt, reference to 'ordinary shares' in this paragraph and paragraphs 5 and 8 of this Attachment does not refer to mutual equity interests issued in accordance with Attachment K.~~

- (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.

7.8. APRA may require an ADI not to exercise a call where it relates to a tax or regulatory event if APRA will not permit such a call if it forms the view that the ADI was in a position to anticipate the taxation 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 1(f)(i) to (iii) of this Attachment.

8.9. Where a Tier 2 Capital instrument provides for conversion into ordinary shares⁷⁴, 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 fixed. The conversion number must be capable of being ascertained immediately and objectively; and
- (c) set the maximum number⁷⁵ 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 ADI's⁷⁶ ordinary share price⁷⁷ at the same time. In calculating the ordinary share price at time of issue, adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations. In calculating the ordinary share price at 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.⁷⁸ Adjustments must exclude transactions involving cash

⁷⁴ Conversion must be into the ordinary shares of the ADI or its parent entity, which must be listed at the time of issue. For an unlisted ADI 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 ADI. Where an unlisted ADI issues the instrument to its listed parent entity, conversion may be into the unlisted ordinary shares of the ADI.

⁷⁵ Refer to footnote 55.

⁷⁶ Reference to ADI captures any entity whose ordinary shares are issued as a result of conversion provisions.

⁷⁷ For an unlisted ADI 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.

⁷⁸ This may include subsequent ordinary share splits, bonus issues and share consolidations.

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, objectively and without further steps; and

(e)(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 (i.e. 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.

10. For mutually owned ADIs, where an 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 fixed. The conversion number must 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.

11. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the ADI under Australian Accounting Standards.

12. In issuing Tier 2 Capital instruments an ADI may, within each category of capital:

(a) differentiate between instruments as to whether an instrument is required to convert or be written-off in the first instance;

(b) provide for a ranking under which Tier 2 Capital instruments will be converted or written off; and

(c) where conversion or write-off of capital instruments is required at Level 2, the Level 2 group may provide for a ranking under which Tier 2 Capital instruments issued by individual members of the group may need to be converted or written off. This would be subject to any requirements for conversion or write-off of Tier 2 Capital instruments required to be undertaken on a Level 1 basis.

13. 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 written-off amount of the instrument;
- (c) there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the ADI; 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).

9.14. 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.

15. 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.

~~10.16.~~ ~~There must be no cross-default clauses in the~~ The documentation of any debt or other capital instrument of the issuer of a Tier 2 Capital instrument must not include the following clauses: –linking the issuer’s obligations under the instrument to default by the issuer under any of its other obligations, or default by another party, related or otherwise.

- (a) a cross-default clause linking the issuer’s obligations under the Tier 2 Capital instrument to default by the issuer under any of its other obligations, or default by another party (related or otherwise) under the debt instrument or other capital instrument⁷⁹; 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.

17. For the purposes of paragraph 16(b), an event of default clause includes a clause specifying the following events:

⁷⁹ These provisions on cross-default clauses are in addition to the general prohibition on cross-default clauses involving related entities set out in *Prudential Standard APS 222 Associations with Related Entities* (APS 222).

- (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 prevent⁸⁰, the above events or a default by the issuer under the Tier 2 Capital instrument,

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

18. AnThe instrument must ~~be marketed in accordance with its prudential treatment and must~~ not include any ‘repackaging’ arrangements that have the effect of compromising the quality of the capital raised.

11.19. Where issue ~~If a prospectus or other offer~~ documentation, ~~or~~ marketing of ~~the~~ an instrument, ~~or any ongoing dealings with investors~~ ~~could be reasonably held to suggest to investors~~ that the instrument has attributes not consistent with the eligibility requirements in this Attachment for Tier 2 Capital instruments~~other than those claimed by the issuer (or Level 2 group) for prudential purposes~~, the instrument is ineligible to be included in ~~the ADI's~~ Tier 2 Capital.

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

13.21. Where the instrument whether issued by the ADI or another member of a Level 2 group to which the ADI belongs (including an overseas subsidiary), is subject to the laws of a foreign country~~jurisdiction other than Australia or its territories~~, the ~~issuer~~AD~~I~~ must also ensure all relevant criteria applicable to the instrument under this Attachment is enforceable~~that the instrument satisfies all relevant qualifying criteria for Tier 2 Capital~~ under the laws of that jurisdiction.

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

⁸⁰ For example, by way of a scheme of arrangement.

~~Attachment I - Criteria for capital issues involving special purpose vehicles~~

- ~~1. The following requirements must be met for capital instruments issued through an SPV to qualify as Regulatory Capital:
 - ~~(a) the SPV issuing the instrument is a single purpose non-operating entity established for the sole purpose of raising capital for the ADI⁸¹ and the SPV would, in accordance with Australian Accounting Standards, be fully consolidated in the Level 2 group;~~
 - ~~(b) capital instruments issued by the ADI to the SPV, and capital instruments issued by the SPV to investors, must meet the requirements of this Prudential Standard for Additional Tier 1 and Tier 2 Capital set out in Attachment E and Attachment H of this Prudential Standard, as appropriate;~~
 - ~~(c) capital instruments issued by the SPV must not be funded, directly or indirectly, by the ADI or any other member of a group to which the ADI belongs. Similarly, the ADI or other member of a group to which it belongs may not provide any funding to the SPV itself, other than to cover its administrative operating expenses;~~
 - ~~(d) the only asset⁸² of the SPV is its investment in capital instruments issued by the ADI for which it raises capital. The SPV must have no material liabilities other than its issued capital instruments;~~
 - ~~(e) instruments issued by the ADI to the SPV, and by the SPV to third party investors, must:
 - ~~(i) be of the same category of Regulatory Capital (e.g. both Additional Tier 1 Capital instruments, or both Tier 2 Capital instruments);~~
 - ~~(ii) if Tier 2 Capital instruments, have the same maturity; and~~
 - ~~(iii) have terms and conditions that mirror each other;~~~~
 - ~~(f) the proceeds from the issue of a capital instrument by the SPV must be immediately and directly invested in, and available without limitation to, the ADI.~~
 - ~~(g) where a loss absorption trigger point is reached (Attachment F of this Prudential Standard) or a non-viability trigger event occurs (Attachment J of this Prudential Standard), the instruments issued to the SPV, and by the SPV to investors, must be subject to conversion or write-off into ordinary shares (or mutual equity interests) in accordance with the requirements~~~~

⁸¹ In this Attachment reference to an ADI includes a standalone ADI, an ultimate holding company or an operating subsidiary included in the Level 2 group.

⁸² Assets that relate to the operation of the SPV may be excluded from this assessment if they are *de minimis*.

~~respectively in Attachment F and Attachment J of this Prudential Standard. In such circumstances, investors in instruments issued by the SPV irrevocably cease to have any claims on the SPV or the ADI;~~

- ~~(h) where capital instruments issued by an SPV are converted into ordinary shares of the ADI (or mutual equity interests) or parent entity, such conversions are subject to the requirements (including limits) covering conversion set out in Attachment E, Attachment F, Attachment H and Attachment J of this Prudential Standard; and~~
 - ~~(i) the main features of the instrument issued by the SPV and the structure of the issue are transparent and capable of being understood by investors. An issue is not eligible for inclusion in an ADI's Additional Tier 1 Capital or Tier 2 Capital, at Level 1 or Level 2, where the complexity of its structure raises doubt over the legal and regulatory risk associated with it.~~
- ~~1. An SPV may be established to issue tranches of one instrument where the only change in the terms and conditions of the tranches is a variation in distribution or payments to be made on the instrument. An SPV may not issue different forms of an instrument even if they belong to the same category of capital instruments.~~
 - ~~2. The amount of capital issued by consolidated subsidiaries to third parties through an SPV, that may be included in Tier 1 Capital or Total Capital, is to be determined in accordance with Attachment C of this Prudential Standard.~~

Attachment J - Attachment H - 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 ~~under which, whereby upon~~ on the occurrence of a non-viability ~~trigger~~ event (as defined in paragraphs ~~3, 4 and 5~~ 2 of this Attachment), it will be immediately and irrevocably:
 - (a) converted into the ordinary shares of the ADI or its parent entity, which must be listed at the time the instrument is issued⁸³;
 - (b) converted into mutual equity interests; or
 - (c) written off.
- ~~2. The amount of an instrument that may be recognised in the ADI's Tier 1 and Total Capital, on the occurrence of a non-viability trigger event, is the minimum level of Common Equity Tier 1 Capital that would be generated by full conversion or write off of the instrument. Where an instrument provides for write off as the primary loss absorption mechanism, the amount recognised must account for potential taxation liabilities or other potential offsets at the time of issuance. Adjustments must be updated over time to reflect the best estimates of the offset value.~~
- ~~3.2.~~ A non-viability ~~trigger~~ event in relation to an ADI is the earlier of:
 - (a) the issuance of a notice by APRA to the ADI that conversion or write-off of capital instruments is necessary because, without it, APRA considers that the ADI would become non-viable; ~~or~~
 - (b) a determination by APRA, notified to the ADI that without a public sector injection of capital, or equivalent support, the ADI would become non-viable; or
 - (b)(c) for a fully-consolidated subsidiary in the Level 2 group, or a foreign bank owned locally-incorporated ADI subsidiary, the application of a non-viability event imposed upon the subsidiary by a host or home regulator or by statute.
- ~~4. A non-viability trigger event in relation to instruments issued by a fully consolidated subsidiary of an ADI is the earlier of:~~
 - ~~(a) a non-viability trigger event in relation to a parent ADI set out in paragraph 3 of this Attachment;~~
 - ~~(b) the issuance of a notice by an host regulator of an overseas subsidiary that conversion or write-off of capital instruments issued by a fully consolidated~~

⁸³ Refer to footnote ~~43~~ 61.

~~subsidiary of an ADI is necessary because, without it, the host regulator considers that the subsidiary would become non-viable; or~~

- ~~(c) a determination by the host regulator, that without a public sector injection of capital, or equivalent support, the overseas subsidiary would become non-viable.~~
- ~~5. A non-viability trigger event in relation to instruments issued by a locally incorporated subsidiary ADI of a foreign bank is the earlier of:~~
- ~~(a) a non-viability trigger event in relation to the subsidiary ADI set out in paragraph 3 of this Attachment;~~
- ~~(b) the issuance of a notice by the home regulator of the foreign bank to the foreign bank that conversion or write-off of capital instruments is necessary because, without it, the foreign bank or its subsidiary ADI would become non-viable; or~~
- ~~(c) a determination by the home regulator of the foreign bank, that without a public sector injection of capital, or equivalent support, the foreign bank or its subsidiary ADI would become non-viable.~~
- ~~6. Conversion or write-off need only occur to the extent necessary to enable APRA to conclude that the ADI is viable without further conversion or write-off. In such circumstances, conversion or write-off would need to fully exhaust Additional Tier 1 Capital instruments before involving Tier 2 Capital instruments. APRA will not approve partial conversion or partial write-off in those exceptional circumstances where a public sector injection of funds is deemed necessary.~~
- ~~7. The amount of conversion or write-off of capital instruments undertaken in accordance with this Attachment will be subject to the requirements applied by the relevant regulator.~~
- ~~8. An ADI may provide for Additional Tier 1 Capital instruments to be converted or written-off prior to any conversion or write-off of Tier 2 Capital instruments. In these circumstances, conversion or write-off of Tier 2 Capital instruments will only be necessary to the extent that conversion of Additional Tier 1 Capital instruments has not resulted in APRA withdrawing the notice issued to the ADI under paragraph 3 of this Attachment.~~
3. Conversion or write-off of an Additional Tier 1 or Tier 2 Capital instrument must generate an unequivocal addition to the ADI's Level 1 and Level 2 Common Equity Tier 1 Capital of the ADI under Australian Accounting Standards.
4. For the purposes of conversion or write-off 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. 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 Capital or Tier 2 Capital, an instrument issued by a fully consolidated subsidiary included in the Level 2 group must satisfy the requirements in this Attachment. As a result, a non-viability event applicable to a parent ADI must function as a non-viability event for the subsidiary itself for the instrument. A fully consolidated subsidiary incorporated overseas may, however, also be subject to non-viability requirements imposed by a host regulator or under statute provided that the requirements are disclosed by the regulator, and issue documentation for instrument discloses that the instrument is subject to potential loss as a result of the requirements. The implementation of such non-viability requirements upon the overseas incorporated subsidiary must not serve as a loss absorption event for a parent ADI under paragraph 1 of this Attachment.
7. To qualify as eligible Additional Tier 1 Capital or Tier 2 Capital, an instrument issued by a foreign bank owned locally-incorporated ADI subsidiary must satisfy the requirements in this Attachment. A non-viability event in terms of paragraphs 2(a) and 2(b) to this Attachment, however, need not trigger any loss absorption requirement upon the foreign bank parent.
8. For purposes of paragraph 2(c) to this Attachment, a foreign bank owned locally-incorporated ADI subsidiary 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 bank parent, provided that the requirements are disclosed by the regulator, and issue documentation for the instrument discloses that the instrument is subject to potential loss as a result of the requirements. A foreign bank owned locally-incorporated ADI subsidiary is permitted to, but not required to, provide for the application of a non-viability event based on non-viability requirements⁸⁴ applied to a foreign bank parent or group to which the subsidiary belongs. As a result, a non-viability requirement applicable to a parent foreign bank, or to the group to which the foreign bank owned locally-incorporated ADI subsidiary belongs, may function as a non-viability event for the subsidiary itself in relation to Additional Tier 1 Capital or Tier 2 Capital instruments issued by the ADI.
9. Where a non-viability event occurs in accordance with paragraphs 2(a) or 2(b) to this Attachment, the amount of conversion or write off of Additional Tier 1 or Tier 2 Capital instruments is to be determined in accordance with paragraphs 11 and 12 to this Attachment. If a non-viability event occurs as a result of only host or home regulator or statutory non-viability requirements (refer to paragraph 2(c) to this Attachment), then the amount of conversion or write-off of Additional Tier

⁸⁴ Requirements may be applied by home regulator or under statute.

1 or Tier 2 Capital instruments issued by a fully consolidated subsidiary of an ADI, or by a foreign bank owned locally-incorporated ADI subsidiary will be determined by the relevant host or home regulator or statutory requirements.

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

11. The aggregate amount of full or partial conversion or write-off of Additional Tier 1 Capital or Tier 2 Capital instruments must, at a minimum, be no less than the lower of: the amount required to provide, if possible, for a declaration that a non-viability event ceases to apply⁸⁵; or the principal amounts of all instruments. An ADI must carry out full conversion or write off if its Additional Tier 1 capital and Tier 2 Capital instruments unless APRA is satisfied that the aggregate amount of a partial conversion or partial conversion or write off is sufficient to meet the requirements of this paragraph and a public sector injection of funds into the ADI would not be necessary.

9.12. If a non-viability event ceases to apply, unless otherwise required by APRA, further conversion or write-off of Additional Tier 1 Capital or Tier 2 Capital instruments need not be undertaken.

10.13. Where an Additional Tier 1 Capital instrument or Tier 2 Capital instrument provides for conversion into ordinary shares (or mutual equity interests), the ADI 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 interests) and all necessary authorisations have been obtained to effect conversion.

11.14. An Additional Tier 1 Capital or Tier 2 Capital instrument must unequivocally provide for the amount of the instrument to be immediately and irrevocably written-off (including termination of the right to receive ordinary shares, mutual equity interests, principal, dividends or interest) in the accounts of the ADI and result in an unequivocal addition to Common Equity Tier 1 Capital if ~~where~~, following a ~~trigger non-viability~~ event, conversion of an ~~capital~~ instrument:

(a) is not capable of being undertaken;

~~(a)~~(b) has not been fully effected for any reason within 5 business days;

~~(b)~~(c) is not irrevocable; or

⁸⁵ Such a declaration would typically be provided, as appropriate, by APRA or another regulator, or by way of statutory provisions.

~~(e)(d)~~ will not result in an immediate and unequivocal increase in Common Equity Tier 1 Capital of the ADI, at Level 1 and Level 2, as applicable.⁷

~~the amount of the instrument must immediately and irrevocably be written off in the accounts of the ADI and result in an unequivocal addition to Common Equity Tier 1 Capital.~~

~~12. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares when the non-viability trigger point is reached, 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 formula specified in (a) of this paragraph to be fixed; and~~

~~(c) set the maximum number of ordinary shares received so as not to exceed the price of the Additional Tier 1 or Tier 2 Capital instrument at the time of its issue divided by 20 per cent of the ADI's⁸⁶ ordinary share price⁸⁷ at the same time. In calculating the ordinary share price at time of issue, adjustments may be made for subsequent ordinary share splits, bonus issues and share consolidations.~~

~~13. For mutually owned ADIs, where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into mutual equity interests when the non-viability trigger point is reached, 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 fixed; and~~

~~(c) set the maximum number of mutual equity interests received such that the aggregate nominal value of the instruments received cannot exceed, at the date of conversion, the nominal value of the Additional Tier 1 or Tier 2 Capital instrument converted.~~

~~14.15. Where 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 attached to such a hierarchy must not impede the ability of the capital instrument to be immediately converted or written off. Any ranking must provide for all Additional Tier 1 Capital instruments to be fully converted or written-off before any Tier 2 Capital instruments are required to be converted or written-off.~~

⁸⁶ ~~Refer to footnote 44.~~

⁸⁷ ~~Refer to footnote 45.~~

Any conversion or write-off of Tier 2 Capital instruments will only be necessary to the extent that conversion or write-off of Additional Tier 1 Capital instruments is insufficient to permit a declaration that a non-viability event ceases to apply.

16. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares or mutual equity interests when a non-viability event occurs the conversion provisions in issue documentation must satisfy in the case of Additional Tier 1 Capital instruments the requirements of paragraphs 10 and 11 of Attachment E to this Prudential Standard, and, in the case of a Tier 2 Capital instruments, the requirements in paragraphs 9 and 10 of Attachment G to this Prudential Standard.
17. Where an Additional Tier 1 Capital and Tier 2 Capital instruments 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 13 of Attachment E to this Prudential Standard for an Additional Tier 1 Capital instrument, and the write-off provisions must satisfy paragraph 13 of Attachment G to this Prudential Standard for a Tier 2 Capital instrument.
- ~~15. Issuing Additional Tier 1 or Tier 2 Capital instruments may, within each category of capital:
 - (a) differentiate between instruments as to whether an instrument is required to convert or be written off in the first instance;
 - (b) provide for a ranking under which Additional Tier 1 and Tier 2 Capital instruments will be converted or written off; and
 - (c) where conversion or write-off of capital instruments is required at Level 2, the Level 2 group may provide for a ranking under which Additional Tier 1 and Tier 2 Capital instruments issued by individual members of the group may need to be converted or written off. This would be subject to any requirements for conversion or write-off of capital instruments required to be undertaken on a Level 1 basis.~~
- ~~16. For the purposes of conversion or write-off of an Additional Tier 1 or Tier 2 Capital instrument, the amount to be converted or written off will be the face value of the instrument recorded in the books of the ADI or subsidiary, where relevant.~~
- ~~17. Where an Additional Tier 1 or 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 written-off amount of the instrument;
 - (c) there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the ADI; 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).~~

18. The contractual terms and conditions of an Additional Tier 1 Capital or Tier 2 Capital instrument must of the issue of an instrument must not provide that on conversion or write-off of the instrument upon a non-viability event, for any residual claims associated with the portion of the instrument converted or written off, are not on the issuer that are senior to ordinary shares of the ADI (or mutual equity interests) of the ADI, and not senior to claims to ordinary shares of the parent entity, in the event that a trigger point is reached and a conversion or write-off is undertaken.

19. An ADI must notify APRA, if the ADI anticipates:

- (a) the ADI may be exposed to the occurrence of a non-viability event;
- (b) a fully consolidated subsidiary in the Level 2 group may be exposed to the occurrence of a non-viability event contained in non-viability requirements imposed on it by a host regulator or by statute; or
- (c) a foreign bank owned locally-incorporated ADI subsidiary may be subject to a non-viability event contained in non-viability requirements imposed by a home regulator or statute upon its foreign bank parent or group; and
- (d) a non-viability event may occur in relation to a fully consolidated subsidiary in the Level 2 group or in relation to a foreign bank parent of a foreign bank owned locally-incorporated ADI subsidiary.

Attachment K – Attachment I - 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 B, except that paragraphs 1(ab), 1(bc), 1(fe) and 1(hi) of Attachment B to this Prudential Standard are to be read as follows:
 - (a) 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;
 - (b) 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 any 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 F and Attachment ~~J-H~~ 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;
 - (c) distributions on the mutual equity interest are paid out of distributable items⁸⁸ (including retained earnings) of the issuer, and the terms of the mutual equity interest do not provide for payment to investors other than in the form of a cash payment. The level of distributions must not be tied or linked to the 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.⁸⁹ All distributions on mutual equity interests must be treated as dividends for

⁸⁸ Refer to footnote 16.

⁸⁹ '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 payment of distributions. For example, where an ADI makes available half-yearly operating results, a financial year will refer to the preceding two publicly available half-yearly operating results for the ADI.

the purposes of APS 110 and the issuer is subject to the restrictions applied to the payment of distributions in accordance with APS 110;

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

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

2. Issue documentation and marketing material for mutual equity interests must clearly and prominently state that:
 - (a) the mutual equity interest is not a deposit liability of the ADI;
 - (b) the mutual equity interest is ~~not~~neither covered by the Financial Claims Scheme ~~and is not~~nor guaranteed by the Australian Government;
 - (c) the principal amount of the mutual equity interest is perpetual and never repaid outside liquidation (other than discretionary ADI cannot buy back, repurchases subject to or redeem the mutual equity interest other than in exceptional circumstances and with APRA's approval);
 - (d) the holder of a mutual equity interest may only be entitled to a claim on the issuing ADI's residual assets after other more senior claims (including Additional Tier 1 Capital and Tier 2 Capital instruments) have been paid;
 - (e) 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
 - (f) the ADI has full discretion over the timing and amount of any distributions paid on the mutual equity interest, including not paying a distribution.
3. An ADI 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 F and Attachment ~~J-H~~of to this Prudential Standard.
4. The principal amounts of all mutual equity interests on issue (determined in accordance with paragraph 1(b)(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 ADI's total Common Equity Tier 1 Capital before applying regulatory adjustments under paragraph 20(g) of this Prudential Standard.
5. The principal amounts of all mutual equity interests on issue (determined in accordance with paragraph 1(b)(ii) of this Attachment) are eligible for inclusion in Tier 1 Capital and Total Capital.

Attachment L – Attachment J - Transitional arrangements for capital instruments

Instruments to which the transitional arrangements apply

- ~~1. The transitional arrangements in this Attachment apply to non Common Equity Tier 1 and Tier 2 Capital instruments (including instruments issued by fully consolidated subsidiaries that are held by third parties) that do not fully meet the criteria in Attachment E and Attachment H if the ADI had obtained APRA’s approval prior to 1 January 2013 under a previous version of this Prudential Standard for those arrangements to apply.~~

Transitional arrangements

- Capital instruments approved by APRA for transitional arrangements (transitional instruments) are being phased out from inclusion in Regulatory Capital from 1 January 2013. Such instruments may be included in the relevant category of Regulatory Capital until their first available call date (if any), or as determined by APRA.
- The amount of transitional instruments that may be included in Regulatory Capital is determined by reference to the ‘base amount’ of Additional Tier 1 [Capital](#) or Tier 2 Capital (refer to paragraphs [4-3](#) to [8-7](#) of this Attachment). The proportion of the base amount that may be included in [Regulatory Additional Tier 1 Capital and Tier 2 Capital](#) is amortised over nine years, commencing at 90 per cent of the base amount on 1 January 2013, with the cap reducing by 10 percentage points on 1 January of each of the following years.

Table 1 sets out the amortisation schedule for the phase-out of transitional instruments.

Table 1: Transitional arrangements for capital instruments

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

Year commencing	Percentage of base amount of transitional instruments that may be included in Additional Tier 1 <u>Capital</u> and Tier 2 Capital under the phase-out arrangements.
1 January 2019	30
1 January 2020	20
1 January 2021	10
1 January 2022	0

Base amount

3. The base amount is calculated for each category of capital and is the sum of the nominal amounts of transitional instruments within that class that are outstanding on 31 December 2012.
4. The base amount must not include: existing Tier 1 Capital and Tier 2 Capital instruments ineligible for recognition under the January 2012 version of APS 111 because of the limits for recognition or the amortisation requirements of that Prudential Standard.
5. Where a Tier 2 Capital instrument has started to amortise prior to 1 January 2013 in accordance with the January 2012 version of APS 111:
 - (a) only the amortised amount of that capital instrument as at 1 January 2013 may be included in the base amount; and
 - (b) the amount of the instrument eligible to be included in Tier 2 Capital will continue to be amortised at 20 per cent per annum.
6. In calculating the base amount, an ADI must use the value of Additional Tier 1 Capital instruments and Tier 2 Capital instruments in the ADI's balance sheet as at 1 January 2013. In calculating the amount of foreign currency denominated Additional Tier 1 Capital and Tier 2 Capital instruments eligible to be included under the relevant cap, the amount of the capital instruments reported would be the amount of such instruments that would be reported by the ADI as outstanding in its financial statements (adjusted for any amortisation arrangement applicable to Tier 2 Capital instruments) as at 31 December 2012.
7. The base amount remains unchanged even where an instrument:
 - (a) is redeemed;
 - (b) meets its first call date; or
 - (c) is included in Tier 2 Capital and its recognition in capital is amortised in accordance with this Prudential Standard.

An ADI may replace such an instrument with the amounts of other transitional instruments not already included in [Additional Tier 1 Regulatory Capital](#) and [Tier 2 Capital](#), up to the capped amount applying to the year in which the instrument is redeemed or derecognised.

Notification requirement

8. The ADI must notify APRA of the first available call date for each instrument included in the base amount.