



14 January 2010

To All Locally Incorporated General Insurers

NON-INNOVATIVE TIER 1 CAPITAL INSTRUMENTS

APRA is seeking to clarify the intent of paragraphs 5(c)(ii)-(iii) of *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital* (GPS 112) Attachment A, relating to the conversion requirements of Non-innovative Tier 1 capital instruments issued by General Insurers (GIs) either at Level 1 or Level 2. Non-innovative Tier 1 capital instruments may contain adjustment clauses that impact the number of ordinary shares received, as well as the cap on the maximum number of shares that can be received, upon the conversion of preference shares. The following guidance aims to ensure that these adjustment clauses satisfy the requirements and intent of paragraphs 5(c)(ii)-(iii) of GPS 112 Attachment A.

A comparable letter has been sent to all locally-incorporated authorised deposit-taking institutions.

GPS 112 Attachment A paragraph 5(c)(ii) - Conversion Formula

Instruments may contain clauses which include adjustments to the conversion formula in the event of a capital reconstruction i.e. where the ordinary shares are reconstructed, consolidated, divided or reclassified. GIs are reminded that the conversion formula is required to be fixed at the time of issuance of the instrument. Therefore, the calculation for any adjustments to the conversion formula must also be fixed in the issue documentation.

GPS 112 Attachment A paragraph 5(c)(iii) - Maximum Conversion Number

Some issuers have interpreted the phrase 'similar transactions' in GPS 112 Attachment A paragraph 5(c)(iii) to include corporate initiatives such as rights issues, off market buy-backs, return of capital and payments of special dividends. GIs are advised that the paragraph aims to limit dilution of ordinary shares upon the conversion of preference shares. Adjustments are permitted for subsequent ordinary share splits and bonus issues as these events result in notional changes which do not impact a GI's capital base and do not involve cash consideration on the part of the GI or its investors.

APRA's intention is that similar transactions should be limited to those where no payment is exchanged for the new shares issued. Where payment is received, particularly where it bears relationship with the current market prices such as with a rights issue, it is not appropriate to consider the issue of new shares to be a 'similar transaction'. The dilution and other risks from ordinary capital initiatives carried out by a GI are expected to be borne by the instrument holders. GIs should consider 'similar transactions' in the same vein as ordinary share splits and bonus issues. Rights issues, off market buy-backs, return of capital and payments of special dividends are not 'similar transactions' for the purposes of this paragraph.

Eligibility of Existing Non-innovative Tier 1 Capital Instruments

APRA will not require GIs to change the terms of any issued capital instruments that have been previously confirmed as being eligible for inclusion in a GI's regulatory capital base. However, going forward, the requirements of GPS 112 Attachment A paragraph 5(c)(ii)-(iii) will be applied more strictly. As such, any Non-innovative Tier 1 capital instruments received by APRA after the date of this letter which contain clauses that do not satisfy the aforementioned paragraphs will not be considered eligible for inclusion in a GI's capital base.

If you have any question regarding these matters, please contact your APRA Responsible Supervisor.

Yours sincerely



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