Prudential Standard APS 160

Capital Adequacy: Basel III Transitional Arrangements

Objectives and key requirements of this Prudential Standard

This Prudential Standard sets out transitional arrangements for implementing certain elements of the Basel III capital adequacy framework.

The key requirements of this Prudential Standard are that:

- formerly eligible regulatory capital instruments that do not comply with Basel III requirements for Additional Tier 1 or Tier 2 Capital may be phased out beginning 1 January 2013;
- non-complying minority interest and other capital issued by consolidated subsidiaries and held by third parties may also receive a transitional treatment; and
- ADIs must notify APRA and receive approval to apply transitional provisions.

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Authority

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

Interpretation

2. Unless otherwise defined in this Prudential Standard, expressions in bold are defined in ADI *Prudential Standard APS 001 Definitions* (**APS 001**).

Application

3. This Prudential Standard applies to all authorised deposit-taking institutions (**ADIs)** under the Banking Act to which *Prudential Standard APS 110 Capital Adequacy* (**APS 110**) applies. In addition, it applies to a **Level 2** group of which an ADI is a member.

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.

Instruments eligible for transition

6. Non-common equity Tier 1 and Tier 2 Capital instruments that do not fully meet the criteria in Attachments D and G, respectively, of *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* (**APS 111**) may be eligible for transition in accordance with this Prudential Standard.

7. Capital instruments issued before 17 December 2009 that complied with APRA's prudential capital requirements in force at the time of issue may be eligible for the transitional arrangements provided in this Prudential Standard. However, if the instrument has a call and a step-up (or another incentive to be redeemed) after 12 September 2010 and before 1 January 2013, it will be fully derecognised in the relevant category of regulatory capital from 1 January 2013.

8. Instruments issued after 17 December 2009 and before 1 January 2013 that do not include a step-up or other incentive to redeem, but otherwise complied with

APRA's prudential capital requirements in force at the time of issue, may be eligible for the transitional arrangements provided in this Prudential Standard.

9. APRA may, however, determine in writing whether an instrument is eligible for the transitional arrangements provided in this Prudential Standard.

Transitional arrangements (other than for capital issued by consolidated subsidiaries and held by third parties)

10. Capital instruments (other than capital issued by consolidated subsidiaries and held by third parties) that meet the requirements in paragraphs 7 and 8, together with instruments in relation to which APRA has made a determination under paragraph 9 (non-complying instruments), will be 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 in writing by APRA.

11. The amount of non-complying instruments that may be included in regulatory capital is determined by reference to the 'base amount' of Additional Tier 1 or Tier 2 capital (refer to Attachment A). The proportion of the base amount that may be included in regulatory 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 non-complying instruments eligible for transition.

Table 1: Transitional arrangements for capital instruments (other than those issued by consolidated subsidiaries)

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

Transitional arrangements for capital issued by consolidated subsidiaries

12. Non-complying capital issued by subsidiaries and held by third parties (e.g. minority interests) will also be phased out. Where such capital does not meet the criteria for inclusion in regulatory capital under APS 111 but met APRA's requirements at the date of issue, the amount that may be included in regulatory capital will be subject to the amortisation schedule set out in Table 2.

Table 2: Transitional arrangements for capital instruments issued by consolidated subsidiaries and held by third parties

Year commencing	Percentage of instruments that may be included in regulatory capital.
1 January 2014	80
1 January 2015	60
1 January 2016	40
1 January 2017	20
1 January 2018	0

Notification and approval requirement

13. An ADI must, prior to 1 January 2013, obtain APRA's written approval for:

    (a) the capital instruments to be included in the phase-out arrangements;

    (b) the nominal amount of capital instruments to be included in the phase-out arrangements; and

    (c) the base amounts of Additional Tier 1 and Tier 2 Capital, respectively (where relevant),

    in order for the transitional arrangements to apply to the capital instruments.

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

Adjustments and exclusions

14. APRA may, by notice in writing, adjust or exclude a specific prudential requirement in this Prudential Standard in relation to one or more specific ADIs or authorised NOHCs.[1]

[1] Refer to subsection 11AF(2) of the Act

Attachment A

Base amount

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

2. The base amount must not include:

   (a) capital instruments ineligible for transition under this Prudential Standard;

   (b) existing Tier 1 and Tier 2 Capital instruments ineligible for recognition under the January 2008 version of APS 111 because of the limits for recognition or the amortisation requirements of that Prudential Standard; or

   (c) capital instruments that are otherwise not permitted to be included under this Prudential Standard.

3. Where a Tier 2 Capital instrument has started to amortise prior to 1 January 2013 in accordance with the January 2008 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.

4. In calculating the base amount, an ADI must use the AUD value of foreign currency denominated Additional Tier 1 Capital instruments and Tier 2 Capital instruments, respectively, 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.

5. 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 APS 111.

   An ADI may replace such an instrument with the amounts of other transitional instruments not already included in regulatory capital, up to the capped amount applying to the year in which the instrument is redeemed or derecognised.