



Insurance (prudential standard) determination No. 15 of 2012

Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital

Insurance Act 1973

I, Ian Laughlin, delegate of APRA:

- (a) under subsection 32(4) of the *Insurance Act 1973* (the Act) REVOKE Insurance (prudential standard) determination No. 5 of 2010, including *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital* made under that Determination; and
- (b) under subsection 32(1) of the Act DETERMINE *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital*, in the form set out in the Schedule, which applies to
 - (i) all general insurers and authorised NOHCs; and
 - (ii) a subsidiary of a general insurer or authorised NOHC, where that subsidiary is a parent entity of a Level 2 insurance group.

This instrument takes effect on 1 January 2013.

Dated: 4 December 2012

[Signed]

Ian Laughlin
Member

Interpretation

In this Determination:

APRA means the Australian Prudential Regulation Authority.

authorised NOHC has the meaning given in section 3 of the Act.

general insurer has the meaning given in section 11 of the Act.

Level 2 insurance group has the meaning given in *Prudential Standard GPS 001 Definitions* made by Insurance (prudential standard) determination No. 1 of 2012 or, if that prudential standard is revoked, the meaning given in the replacement prudential standard.

parent entity has the meaning given in *Prudential Standard GPS 001 Definitions* made by Insurance (prudential standard) determination No. 1 of 2012 or, if that prudential standard is revoked, the meaning given in the replacement prudential standard.

replacement prudential standard means any prudential standard made under section 32 of the Act which replaces *Prudential Standard GPS 001 Definitions* made by Insurance (prudential standard) determination No. 1 of 2012.

subsidiary has the meaning given in *Prudential Standard GPS 001 Definitions* made by Insurance (prudential standard) determination No. 1 of 2012 or, if that prudential standard is revoked, the meaning given in the replacement prudential standard.

Schedule

Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital comprises the 48 pages commencing on the following page.



Prudential Standard GPS 112

Capital Adequacy: Measurement of Capital

Objectives and key requirements of this Prudential Standard

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

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

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

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

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Authority

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

Application

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

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

3. **Category C insurers** are not subject to this Prudential Standard. As outlined in *Prudential Standard GPS 110 Capital Adequacy* (GPS 110), a different measure of capital adequacy applies to Category C insurers. This reflects the nature of a Category C insurer's Australian balance sheet, which does not generally include separately identifiable capital instruments.
4. This Prudential Standard applies to insurers and Level 2 insurance groups (**regulated institutions**) from 1 January 2013.

Level 2 insurance groups

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

Interpretation

6. Terms that are defined in GPS 001 appear in bold the first time they are used in this Prudential Standard.
7. For the purposes of this Prudential Standard:
 - (a) a 'component of capital' is any form of capital defined in this Prudential Standard as eligible for inclusion in the capital base; and
 - (b) a 'category of capital' refers to a group of components of capital.

Capital base

8. The capital base of a regulated institution consists of the following categories:
 - (a) Tier 1 Capital, which comprises:
 - (i) Common Equity Tier 1 Capital; and
 - (ii) Additional Tier 1 Capital; and

- (b) Tier 2 Capital.
9. A regulated institution must ensure that at all times:
- (a) the Common Equity Tier 1 Capital for the regulated institution exceeds 60 per cent of the **prescribed capital amount** of the regulated institution;
 - (b) the Tier 1 Capital for the regulated institution exceeds 80 per cent of the prescribed capital amount of the regulated institution; and
 - (c) the capital base for the regulated institution exceeds the **Prudential Capital Requirement** of the regulated institution.
10. APRA may require, by notice in writing, a regulated institution to hold a higher percentage of its prescribed capital amount as Common Equity Tier 1 Capital and/or Tier 1 Capital.
11. A regulated institution must ensure that any component of capital included in its capital base satisfies, in both form and substance, all requirements in this Prudential Standard for the particular category of capital in which it is included.
12. A regulated institution must not include a component of capital in a particular category of 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 capital.
13. A regulated institution must not include a capital instrument in a category of capital based on a future event, such as the future sale or issuance of a higher quality capital instrument, until such time as:
- (a) the future event occurs, and
 - (b) the proceeds have been irrevocably received by the regulated institution.
14. APRA may, in writing, require a regulated institution to:
- (a) exclude from its capital base any component of capital that in APRA's opinion is not a genuine contribution to the financial strength of the regulated institution; or
 - (b) reallocate to a lower category of capital any component of capital that in APRA's opinion does not satisfy the requirements of this Prudential Standard for the category of capital to which it was originally allocated.
15. A regulated institution may not, without obtaining APRA's prior written approval, enter into an arrangement where it may purchase, or provide financial assistance with a dominant purpose of facilitating the purchase by another party of, its own capital instruments. Any such arrangement, if approved by APRA, shall be subject to a limit agreed with APRA.

16. A regulated institution must provide APRA, as soon as practicable, with copies of documentation associated with the issue of Additional Tier 1 Capital and Tier 2 Capital instruments.
17. Where the terms of an instrument depart from established precedent, a regulated institution must consult with APRA on the eligibility of the capital instrument for inclusion in the regulated institution's capital base in advance of the issuance of the capital instrument, and provide APRA with all information it requires to assess the eligibility of the capital instrument.
18. A regulated institution must obtain APRA's written consent before the terms or conditions of an instrument are amended in a way that may affect its eligibility as a component of capital.

Common Equity Tier 1 Capital

19. Common Equity Tier 1 Capital comprises the highest quality components of capital that fully satisfy all of the following characteristics:
 - (a) provide a permanent and unrestricted commitment of funds;
 - (b) are freely available to absorb losses;
 - (c) do not impose any unavoidable servicing charge against earnings; and
 - (d) rank behind the claims of policyholders and other creditors in the event of winding-up of the issuer.
20. Common Equity Tier 1 Capital consists of the sum of:
 - (a) paid-up ordinary shares issued by a regulated institution that meet the criteria in Attachment A;
 - (b) retained earnings;
 - (c) undistributed current year earnings (refer to paragraph 21);
 - (d) accumulated other comprehensive income and other disclosed reserves (refer to paragraphs 23 and 24);
 - (e) technical provisions¹ in surplus or deficit of those required by *Prudential Standard GPS 320 Actuarial and Related Matters* (GPS 320)²; and
 - (f) regulatory adjustments applied in the calculation of Common Equity Tier 1 Capital required under Attachment B.

¹ Technical provisions in this instance refer to both net outstanding claims provisions and net unearned premium calculated under Australian Accounting Standards. Technical provisions in surplus or deficit relating to premiums liabilities also include the deferred reinsurance expense for future business not yet written.

² Technical provisions in surplus or deficit of those required by GPS 320 must be adjusted to take account of tax effects.

21. Current year earnings must take into account:
 - (a) negative goodwill;
 - (b) expected tax expenses; and
 - (c) dividends when declared in accordance with Australian Accounting Standards.
22. Declared dividends for the purpose of paragraph 21(c) may be reduced by the expected proceeds, as agreed in writing by APRA, of a Dividend Reinvestment Plan (DRP) to the extent that dividends are used to purchase new ordinary shares issued by the regulated institution. A regulated institution must review every six months the expected subscription for new ordinary shares under its DRP having regard to experience over previous years and reasonable expectations of the level of subscription that might apply in future. If a regulated institution identifies any material change in the expected level of future subscription for new ordinary shares under its DRP, it must notify APRA and obtain APRA's agreement to a new amount by which declared dividends may be reduced for regulatory capital purposes.
23. Accumulated other comprehensive income and other disclosed reserves include, but are not limited to:
 - (a) unrealised gains or losses recognised on the balance sheet;
 - (b) reserves from equity-settled share-based payments (share or share options) granted to employees as part of their remuneration package provided that:
 - (i) the share or share options granted relate only to the ordinary shares of the regulated institution;
 - (ii) the ordinary shares comprise only new ordinary shares to be issued by the regulated institution, or new ordinary shares already issued by the regulated institution for this specific purpose; and
 - (iii) there are no circumstances under which such remuneration can be converted into another form (e.g. cash).

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

 - (c) foreign currency translation reserve;
 - (d) general reserves;
 - (e) cumulative unrealised gains or losses on hedges³ 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

³ This includes cumulative unrealised gains or losses on effective cash flow hedges as defined in Australian Accounting Standards.

offset movements in foreign-currency-denominated items recognised in the foreign currency translation reserve). This includes **fair value** gains or losses on derivatives representing effective economic hedges of assets; and

- (f) any other gains and losses in accumulated other comprehensive income and other disclosed reserves that may be specified by APRA in writing.
24. Revaluation of property holdings where the holdings are not held at fair value on the balance sheet may be included as part of other disclosed reserves only if:
- (a) the property is owned by the regulated institution;
 - (b) the property comprises only land and buildings;
 - (c) the property is readily available to be sold. A property need not be scheduled for sale, nor need a sale be intended. However, such a property must be capable of being readily sold within six months were a decision made to sell the property;
 - (d) the reserves are shown as a component of equity in the audited published financial accounts of the regulated institution;
 - (e) the revaluations are reliable, in accordance with **Australian Accounting Standards**, and subject to audit or review consistent with **Australian Auditing and Assurance Standards**. An investment property must be measured at fair value in accordance with Australian Accounting Standards; and
 - (f) the amount of reserves incorporates the full effect of any fair value gains or losses and any gains or losses on hedges offsetting revaluations of the property.

Additional Tier 1 Capital

25. Additional Tier 1 Capital comprises high quality components of capital that satisfy the following essential characteristics:
- (a) provide a permanent and unrestricted commitment of funds;
 - (b) are freely available to absorb losses;
 - (c) rank behind the claims of policyholders and other more senior creditors in the event of winding up of the issuer; and
 - (d) provide for fully discretionary capital distributions.
26. Additional Tier 1 Capital consists of:
- (a) instruments issued by a regulated institution that are not included in Common Equity Tier 1 Capital and which meet:

- (i) the criteria for inclusion in Additional Tier 1 Capital set out in Attachment C; and
 - (ii) the requirements for loss absorption at the point of non-viability set out in Attachment G; and
- (b) regulatory adjustments applied in the calculation of Additional Tier 1 Capital as required under Attachment B.

Instruments may also be included in Additional Tier 1 Capital in accordance with Attachment H.

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

Tier 2 Capital

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

29. Tier 2 Capital consists of:

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

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

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

30. Additional Tier 1 Capital instruments and Tier 2 Capital instruments may be issued by a regulated institution either in its country of incorporation or through a branch in another country, provided the instrument:
- (a) constitutes an obligation of the regulated institution at all times;
 - (b) is freely available to absorb losses across all of the operations of the regulated institution; and
 - (c) meets all of the requirements of this Prudential Standard for inclusion in Additional Tier 1 or Tier 2 Capital.

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

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

Holding of capital instruments in group members by other group members

32. Direct investments in shares of a regulated institution by an SPV (e.g. a trust) established under a share-based employee remuneration scheme may be included in the regulated institution's Common Equity Tier 1 Capital only if:
- (a) the shares issued to the SPV represent ordinary shares of the regulated institution;
 - (b) the amount included in Common Equity Tier 1 Capital is matched by an equivalent charge to profit and loss of the regulated institution for expensing the issue or funding the acquisition of ordinary shares by the vehicle; and
 - (c) the ordinary shares issued cannot be converted to payment in another form (e.g. cash).
33. If the requirements in paragraph 32 are not satisfied, the relevant capital instruments must be treated as holdings of own capital instruments and deducted from Common Equity Tier 1 Capital in accordance with paragraph 4 of Attachment B.

Adjustments and exclusions

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

Transition

35. On application by a regulated institution, APRA may grant transitional relief from the obligation for the regulated institution to comply with any requirement in this Prudential Standard. Any relief granted by APRA under this paragraph will have effect until no later than 31 December 2014.

Determinations made under previous prudential standards

36. An exercise of APRA's discretion under a previous version of a measurement of capital Prudential Standard does not continue to have effect under this Prudential Standard. For the purposes of this paragraph, 'a previous version of a measurement of capital Prudential Standard' includes:
- (a) *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital* (GPS 112) made on 18 June 2010;

- (b) GPS 112 made on 23 June 2008;
- (c) *Prudential Standard GPS 111 Capital Adequacy: Level 2 Insurance Groups* (GPS 111) made on 23 September 2011; and
- (d) GPS 111 made on 17 December 2008.

Attachment A

Criteria for classification as paid-up ordinary shares

1. To be classified as paid-up ordinary shares in Common Equity Tier 1 Capital, an instrument must satisfy the following criteria:
 - (a) the instrument represents the most subordinated claim in liquidation of the issuer;
 - (b) 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) the principal amount of the instrument is perpetual (i.e. it has no maturity date) and is never repaid outside of liquidation (other than discretionary repurchases subject to APRA approval);
 - (d) the issuer, and any other member of a group to which the issuer belongs, does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled and the statutory or contractual terms of the instrument do not include any feature that might give rise to such an expectation;
 - (e) distributions on the instrument are paid out of distributable items (retained earnings included) of the issuer, and the terms of the instrument do not provide for payment to investors other than in the form of a cash payment. The level of distributions must not be tied or linked to the amount paid up at issuance, or to the credit standing of the issuer, and must not be subject to a contractual cap, except to the extent that restrictions applied to the payment of distributions are in accordance with GPS 110;
 - (f) there are no circumstances under which the distributions are obligatory. Non-payment of a distribution does not trigger any restrictions on the issuer or any other member of the group to which the issuer belongs. Any waived distributions are non-cumulative (i.e. they are not required to be made up by the issuer at a later date). Non-payment of distributions must not be an event of default of the issuer or of any other member of the group to which the issuer belongs;
 - (g) distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. There are no preferential distributions, including in respect of other elements classified as Common Equity Tier 1 Capital;
 - (h) the instruments take the first and proportionately greatest share of any losses as they occur.⁴ Within Common Equity Tier 1 Capital, each

⁴ In cases where capital instruments have a permanent write-off feature, this criterion is still deemed to be met by ordinary shares.

instrument absorbs losses proportionately, and *pari passu*, with all the other instruments included in Common Equity Tier 1 Capital;

- (i) only the paid-up amount of the instrument, irrevocably received by the issuer, is recognised as equity capital (i.e. it is not recognised as a liability) for determining balance sheet insolvency;
 - (j) the paid-up amount of the instrument is classified as equity under relevant accounting standards⁵;
 - (k) the instrument is directly issued by the issuer, and, except where otherwise permitted in this Prudential Standard, the issuer, any other member of a group to which the issuer belongs, or any 'related entity'⁶, cannot have purchased or directly or indirectly funded the purchase of the instrument;
 - (l) the paid-up amount of the instrument, or any future payments related to the instrument, is neither secured nor covered by a guarantee of the issuer or a related entity or subject to any other arrangement that legally or economically enhances the seniority of the claim. The instrument may not be subject to netting or offset claims on behalf of the holder or the issuer of the instrument;
 - (m) the instrument is only issued with the approval of the owners of the issuer, either given directly by the owners or, if permitted by applicable law, given by the **Board** or by other persons duly authorised by the owners; and
 - (n) the instrument is clearly and separately disclosed on the issuer's financial statements and in any consolidated financial statements. Disclosure must be in line with the frequency with which a regulated institution, or group of which it is a member, publishes its financial results.
2. Where an instrument is subject to the laws of a jurisdiction other than Australia or its territories, the regulated institution must also ensure that the instrument satisfies all relevant qualifying criteria for Common Equity Tier 1 Capital under the laws of that jurisdiction. APRA may require the regulated institution to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the expense of the regulated institution, confirming that the instrument meets all or any of the criteria applied to Common Equity Tier 1 Capital instruments in this Prudential Standard.

⁵ For Level 2 insurance groups, these must be Australian Accounting Standards.

⁶ A reference to 'related entity', which is a subset of a related party, in this Prudential Standard is one over which the regulated institution or its parent exercises control or significant influence and includes a parent company, a sister company, a subsidiary or any other affiliate. A holding company is a related entity irrespective of whether it forms part of a Level 2 insurance group or wider **corporate group**. This does not preclude the parent entity of the Level 2 insurance group from holding the instrument where the instrument is directly issued by an entity within the group to the parent entity.

Attachment B

Regulatory adjustments

General rules for regulatory adjustments

1. In determining the size of deductions from a regulated institution's capital base, items must be valued on the same basis as a regulated institution's accounts prepared in accordance with the *Financial Sector (Collection of Data) Act 2001*.
2. For the purposes of regulatory adjustments to Additional Tier 1 Capital and Tier 2 Capital:
 - (a) where the amount of Additional Tier 1 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Common Equity Tier 1 Capital; and
 - (b) where the amount of Tier 2 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Additional Tier 1 Capital and, if Additional Tier 1 Capital is insufficient to cover the amount of the deductions required, the remaining amount must be deducted from Common Equity Tier 1 Capital.
3. Where a capital instrument is required to be deducted and it is not possible to determine whether it should be deducted from Common Equity Tier 1 Capital, Additional Tier 1 Capital or Tier 2 Capital, the regulatory adjustment must be made from Common Equity Tier 1 Capital. A regulated institution must consult APRA if there is uncertainty about the category of capital against which a deduction must be made.

Holdings of own capital instruments

4. Unless otherwise indicated, a regulated institution must deduct from the corresponding category of capital holdings of the regulated institution's own capital instruments, whether held directly or indirectly, unless otherwise exempted in writing by APRA or unless eliminated under Australian Accounting Standards from the relevant category of capital. This deduction must include any capital instruments that the regulated institution could be contractually obliged to purchase and also all of the unused portion of any limit agreed with APRA under paragraph 15 of this Prudential Standard.
5. For the purposes of deducting holdings of Additional Tier 1 Capital and Tier 2 Capital instruments, a regulated institution may net any specific provisions raised against the relevant exposures or holdings before making the necessary deductions from the relevant categories of capital.

Regulatory adjustments to Common Equity Tier 1 Capital

6. A regulated institution must make the following regulatory adjustments to determine Common Equity Tier 1 Capital.

Cash flow hedge reserve

7. A regulated institution must eliminate the amount of the cash flow hedge reserve that relates to the hedging of items that are not recorded at fair value on the balance sheet (including projected cash flows).⁷

Deferred tax

8. Subject to paragraphs 9 and 10 of this Attachment, a regulated institution must deduct deferred tax assets net of deferred tax liabilities.⁸ The netting of these items must be on a consistent basis. Where deferred tax liabilities exceed deferred tax assets, the excess of deferred tax liabilities must not be added to Common Equity Tier 1 Capital (i.e. the net deduction is zero).
9. The netting of deferred tax assets and deferred tax liabilities must only be applied where the regulated institution has a legally enforceable right to set-off current tax assets against current tax liabilities where they relate to income taxes levied by the same taxation authority and the taxation authority permits the regulated institution to make or receive a single net payment.
10. In order to apply the treatment in paragraph 8 of this Attachment, a regulated institution must:
 - (a) have procedures in place to monitor changes in relevant laws and taxation practices that may affect the written opinions it is required to obtain covering netting of deferred tax assets and deferred tax liabilities; and
 - (b) ensure that the written opinions are updated in the event of changes in laws or taxation practices overseas that could materially impact on overseas taxation authorities continuing to allow netting of deferred tax assets and deferred tax liabilities.

Fair value gains and losses arising from changes in own creditworthiness

11. A regulated institution must eliminate all unrealised gains and losses that have resulted from changes in the fair value of liabilities (including capital instruments)⁹ due to changes in the regulated institution's own creditworthiness.

Goodwill and other intangibles

12. Subject to paragraph 13 of this Attachment, a regulated institution must deduct the following items¹⁰ net of any associated deferred tax liability that would be

⁷ Any gains on hedges are to be deducted and any losses on hedges added back to Common Equity Tier 1 Capital.

⁸ Excluding any deferred tax liabilities which have already been netted off elsewhere in accordance with this Prudential Standard.

⁹ Additional Tier 1 Capital and Tier 2 Capital instruments must continue to be measured for capital adequacy purposes at their contractual values. Additional Tier 1 Capital and Tier 2 Capital instruments may be hedged in accordance with accounting standards.

¹⁰ For the avoidance of doubt, this deduction, subject to paragraph 13 of this Attachment, must include goodwill and intangibles attributable to investments in subsidiaries, joint ventures and associates.

extinguished if the assets involved become impaired or derecognised under Australian Accounting Standards:

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

13. An investment in a subsidiary, joint venture¹¹ or **associate** that:

- (a) is operationally independent;
- (b) represents a genuine arm’s-length investment;
- (c) is not subject to prudential capital requirements; and
- (d) does not undertake **insurance business** or business related to insurance business¹²

does not have its intangible assets (including the intangible component that could arise after or outside of acquisition) deducted under paragraph 12 of this Attachment.

Superannuation funds

14. A regulated institution must deduct any surplus in a defined benefit superannuation fund, of which the regulated institution is an employer-sponsor, unless otherwise approved in writing by APRA. The surplus must be net of any associated deferred tax liability that would be extinguished if the assets involved

¹¹ 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.

¹² Entities that undertake business related to insurance business include entities that provide a financing role to insurance business, insurance intermediaries and service companies.

become impaired or derecognised under Australian Accounting Standards. A regulated institution may apply to APRA to include a surplus as an asset for capital adequacy purposes where the regulated institution is able to demonstrate unrestricted and unfettered access to a fund surplus in a timely manner. Subject to APRA approval, the regulated institution may include the surplus in its capital base. This surplus will no longer be required to be deducted from Common Equity Tier 1 Capital.

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

Reinsurance assets

16. A regulated institution must deduct all reinsurance assets¹³ reported in relation to each reinsurance arrangement that does not meet the reinsurance documentation test in *Prudential Standard GPS 230 Reinsurance Management* (GPS 230).
17. A regulated institution must deduct all reinsurance assets reported in relation to each reinsurance contract entered into by the regulated institution incepting on or after 31 December 2008 that does not meet the governing law requirements in GPS 230.

Investments in subsidiaries, joint ventures and associates

18. A regulated institution must make a deduction for investments in subsidiaries, joint ventures and associates that are subject to regulatory capital requirements. The amount of the deduction is the lesser of the regulated institution's share of the regulatory capital requirements¹⁴ and the value of the investment that is recorded on the regulated institution's balance sheet after adjustment for any intangible component in accordance with paragraphs 12 and 13 of this Attachment. This deduction must be applied after any deduction for intangibles in the investment in accordance with paragraphs 12 and 13 of this Attachment.
19. For the purposes of the deduction in paragraph 18 of this Attachment, the regulatory capital requirement of the investment is:
 - (a) the prescribed capital amount if the investment is in an insurer as defined under the Act; or
 - (b) the equivalent amount to the prescribed capital amount if the investment is an entity carrying on insurance business in a foreign jurisdiction; or

¹³ For the purposes of this Prudential Standard, 'reinsurance assets' refers to reinsurance assets as defined in GPS 001, net of doubtful debts.

¹⁴ The regulated institution's share of the regulatory capital requirements is determined by applying the ownership percentage of the subsidiary, joint venture or associate (as relevant) to the total regulatory capital requirement of the investment.

- (c) a comparable regulatory capital requirement as agreed with APRA.¹⁵

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

20. If the investment subject to the deduction in paragraph 18 of this Attachment is a **non-operating holding company** (NOHC), the regulated institution must 'look-through' the investment to the value and regulatory capital requirements of the entity/entities owned by the NOHC.

Assets under a fixed or floating charge

21. Subject to paragraph 22 of this Attachment, a regulated institution must deduct all assets of the regulated institution that are under a fixed or floating charge¹⁶, mortgage or other security to the extent of the indebtedness secured on those assets. This deduction may be reduced by the amount of any liability for the charge that is recognised on the regulated institution's balance sheet.
22. Where the security referred to in paragraph 21 of this Attachment exclusively supports a regulated institution's insurance liabilities, the deduction only applies to the amount by which the fair value of the charged assets exceeds the regulated institution's supported insurance liabilities. These insurance liabilities are to be valued in accordance with GPS 320.

Fair value adjustments

23. A regulated institution must deduct any amount required by APRA in writing where APRA considers that fair values on the balance sheet are not prudent or reliable.

Other adjustments

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

¹⁵ Examples of the entities that are subject to a comparable regulatory capital requirement are authorised deposit-taking institutions, life companies and health insurers.

¹⁶ Charge as defined in the Act.

Attachment C

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 G), the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 Capital instruments¹⁷;
 - (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 entity or other arrangement that legally or economically enhances the seniority of the holder's claim.¹⁸ The instrument may not be secured or otherwise subject to netting or offset claims on behalf of the holder or the issuer of the instrument;
 - (d) the principal amount of the instrument is perpetual (i.e. it has no maturity date);
 - (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 expectation¹⁹;
 - (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 written approval from APRA to exercise a call option. For instruments issued by subsidiaries not regulated by APRA included in a Level 2 insurance group, prior written approval from APRA must also be obtained;
 - (ii) must not do anything that creates an expectation that a call will be exercised; and

¹⁷ Where an issuer is a holding company, the subordination applicable must apply to all general creditors of the holding company.

¹⁸ This would preclude any provision of support (including contribution of reserves) to any SPV used to issue capital instruments that form part of a regulated institution's issue of Additional Tier 1 and Tier 2 Capital instruments.

¹⁹ Conversion from a fixed rate to a floating rate (or vice versa) in combination with a call option without any increase in the credit spread is not considered an incentive to redeem. However, the regulated institution must not otherwise do anything to create an expectation that the call will be exercised.

- (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 regulated institution meets the requirements relating to reductions in capital in GPS 110.

An 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;

- (g) issuers must not assume, or create market expectations, that supervisory approval will be forthcoming for the issuer to redeem, call or purchase an instrument;
- (h) an issuer must:
 - (i) have full discretion at all times to cancel distributions/payments on the instrument. Any waived distributions are non-cumulative (i.e. are not required to be made up by the issuer at a later date). The instrument must not provide for payment of a higher dividend or interest rate if dividend or interest payments are not made on time, or a reduced dividend or interest rate if such payments are made on time;
 - (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
 - (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;
- (i) distributions on the instrument are paid out of distributable items of the issuer, and the instrument must not provide for payments to investors other than in the form of a cash payment. The level of distributions must not be tied or linked to the credit standing of the issuer;
- (j) the instrument cannot have a credit sensitive distribution/payment feature (i.e. a distribution/payment that is 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 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 not allow inclusion of an instrument as part of Additional Tier 1 Capital where it considers that the reference rate is sensitive to the credit standing of the issuer;

- (k) the instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of any national insolvency law applying in the jurisdiction of issue. In such cases, the issue documentation must specify that the insolvency law that applies is the place of incorporation of the issuer²⁰;
- (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 entity cannot have purchased or directly or indirectly funded 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 the terms of the instrument provide the ability (even in contingent circumstances) to substitute the issuer (i.e. to replace the regulated institution with another party), the relevant documentation must set out the mechanism to ensure that there will be a simultaneous capital injection into the regulated institution to replace the transferred capital instrument. Any replacement capital injection must occur at least simultaneously with the substitution and must be unconditional. The capital injection must be of equal or better quality capital and at least the same amount as the original issue, unless otherwise approved by APRA in writing;
- (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 an issue of an instrument involves the use of an SPV, the issue of the instrument is subject to Attachment F;

²⁰

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

- (r) the instrument includes provisions addressing loss absorption at the point of non-viability as required by Attachment G;
 - (s) the instrument is clearly and separately disclosed in the issuer's financial statements and, for a Level 2 insurance group, in any consolidated financial statements; and
 - (t) issue documentation clearly indicates:
 - (i) the subordinated nature of the instrument and that neither the issuer nor the holder of the instrument is allowed to exercise any contractual rights of set-off; and
 - (ii) the application of requirements for loss absorption at the point of non-viability under Attachment G .
2. In accordance with paragraph 1(h) of this Attachment, failure to make a distribution or payment must not trigger any restrictions on the issuer other than its ability to pay a distribution on Common Equity Tier 1 Capital instruments 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).
- A 'stopper' provision may, however, act to prohibit actions that are equivalent to payment of dividend or interest, such as a regulated institution undertaking discretionary buybacks of ordinary shares.
3. An instrument must not include any provision that permits an optional distribution or payment to be made. Any structuring of a distribution or payment as a bonus payment to make up for unpaid distributions or payments is also prohibited.
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 shares if the call is not exercised; or

- (b) a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate less the swap rate (i.e. the fixed rate paid to the call date to receive the second reference rate).
- 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 regulated institution 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 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.
- 7. An instrument may only provide for a call within the first five years of issuance as a result of a tax or regulatory event. APRA will not permit such a call if it forms the view that the regulated institution was in a position to anticipate the tax or regulatory event when the instrument was issued. In order for a call to be exercised the issuer must comply with the provisions in paragraph 1(f)(i) to (iii) of this Attachment.
- 8. Where an Additional Tier 1 Capital instrument provides for conversion into ordinary shares²¹, 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) 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 its issue divided by 20 per cent of the regulated institution's²² ordinary share price²³ 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.

²¹ Conversion must be into the ordinary shares of the insurer or its parent entity, which must be listed at the time of issue. For an unlisted insurer with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into the unlisted ordinary shares of the insurer. Where an unlisted insurer issues the instrument to its listed parent entity, conversion may be into unlisted ordinary shares of the insurer.

²² Reference to regulated institution captures any entity whose ordinary shares are issued as a result of conversion provisions.

²³ For an unlisted regulated institution that has no listed parent entity at the time of issue, the ordinary share price is based on the book value per share at the time of issue.

9. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the regulated institution under Australian Accounting Standards.
10. 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.
11. 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.
12. There must be no cross-default clauses in the documentation of any debt or other capital instrument of the issuer 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.
13. The instrument must be marketed in accordance with its prudential treatment and must not include any 'repackaging' arrangements that have the effect of compromising the quality of the capital raised. If a prospectus or other offer documentation, or marketing of the instrument could be reasonably held to suggest to investors that the instrument has attributes of a lower level of capital than claimed by the issuer (or its corporate group) for prudential purposes, the instrument will be ineligible to be included in the regulated institution's Additional Tier 1 Capital.
14. The instrument 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 must be subject to the laws of Australia.
15. Where the instrument is subject to the laws of a jurisdiction other than Australia or its territories, the regulated institution must also ensure that the instrument satisfies all relevant qualifying criteria for Additional Tier 1 Capital under the laws of that jurisdiction.
16. APRA may require the regulated institution to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the regulated institution's expense, confirming that the instrument meets the requirements in paragraphs 14 and 15 of this Attachment.

Attachment D

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, subject to satisfying the following additional minimum criteria:
 - (a) the preference share is issued directly by a regulated institution and is 'stapled' to securities issued directly by an overseas branch of the regulated institution. The stapled structure must not involve use of SPVs and must be simple and transparent;
 - (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:
 - (ii) a non-viability trigger event occurs in accordance with Attachment G;
 - (iii) proceedings for the liquidation of the regulated institution have commenced;
 - (iv) APRA issues a recapitalisation direction to the regulated institution in accordance with sub-section 103B(1) of the Act; or
 - (v) a judicial manager is appointed to the regulated institution pursuant to sub-section 62L of the 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 regulated institution or another entity has become, or is likely to become, insolvent, including where it is in administration, receivership, winding up or where a judicial manager has been appointed under the Act.

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

- (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 E

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 G), the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 Capital instruments and Additional Tier 1 Capital instruments²⁴;
 - (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 entity or other arrangement that legally or economically enhances the seniority of the claim.²⁵ The instrument may not be secured or otherwise subject to netting or offset of claims on behalf of the holder or the issuer of the instrument;
 - (d) the principal amount of the instrument:
 - (i) has a minimum maturity of at least five years; and
 - (ii) is only recognised in Tier 2 Capital (and so in the capital base) in the five years prior to maturity on a straight-line amortised basis (refer to paragraph 2 of 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 expectation²⁶;
 - (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:

²⁴ Where an issuer is a holding company the subordination applicable must apply to all general creditors of the holding company.

²⁵ This would preclude any provision of support (including contribution of reserves) to any SPV used to issue capital instruments that form part of the regulated institution's issue of Additional Tier 1 and Tier 2 Capital instruments.

²⁶ Conversion from a fixed rate to a floating rate (or vice versa) in combination with a call option without any increase in the credit spread is not considered an incentive to redeem. However, the regulated institution must not otherwise do anything to create an expectation that the call will be exercised.

- (i) must receive prior written approval from APRA to exercise a call option. For instruments issued by subsidiaries not regulated by APRA included in a Level 2 insurance group, prior written approval from APRA must also be obtained;
- (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 at conditions that are sustainable for the income capacity of the issuer; or
 - (B) the regulated institution meets the requirements relating to reductions in capital in GPS 110.

An 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;

- (g) issuers must not assume, or create market expectations, that supervisory approval will be forthcoming for the issuer to redeem, call or purchase an instrument;
- (h) the instrument must confer no rights on holders to accelerate the repayment of future scheduled payments (coupon or principal) except in bankruptcy (including wind-up) and liquidation. Wind-up of the regulated institution must be irrevocable (that is, either by way of a court order or an effective resolution by shareholders or members). The making of an application to wind-up or the appointment of a receiver, administrator, or official with similar powers, including the exercise of APRA's powers under Part V of the Act, must not be sufficient to accelerate repayment of the instrument;
- (i) the instrument must not provide for payment to investors other than in the form of a cash payment;
- (j) the instrument cannot have a credit sensitive distribution/payment feature (i.e. a distribution/payment that is 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 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 not allow inclusion of an instrument as part of Tier 2 Capital where it considers that the reference rate is sensitive to the credit standing of the issuer;

- (k) the instrument is directly issued by the issuer, and, except where otherwise permitted in this Prudential Standard, the issuer, any other member of a group to which the issuer belongs, or any related entity cannot have purchased or directly or indirectly funded the purchase of the instrument;
- (l) 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;
- (m) where the terms of the instrument provide the ability (even in contingent circumstances) to substitute the issuer (i.e. to replace the regulated institution with another party), the relevant documentation must set out the mechanism to ensure that there will be a simultaneous capital injection into the regulated institution to replace the transferred capital instrument. Any replacement capital injection must occur at least simultaneously with the substitution and must be unconditional. The capital injection must be of equal or better quality capital and at least the same amount as the original issue, unless otherwise approved by APRA in writing;
- (n) 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;
- (o) 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;
- (p) where an issuer defaults under the terms of the instrument, remedies available to the holders must be limited to actions for specific performance, recovery of amounts currently outstanding or the winding-up of the issuer. The amounts that may be claimed in the event that the issuer defaults may include any accrued unpaid dividends and interest, including payment of market interest on these unpaid amounts. All such unpaid dividends and interest must be subordinated to the claims of policyholders and other creditors of the issuer;
- (q) 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;
- (r) where an issue of an instrument involves the use of an SPV, the issue of the instrument is subject to Attachment F;
- (s) the instrument includes provisions addressing loss absorption at the point of non-viability in accordance with Attachment G ;
- (t) the instrument is clearly and separately disclosed in the issuer's financial statements and, for a Level 2 insurance group, in any consolidated financial statements; and

- (u) issue documentation clearly indicates:
- (i) the subordinated nature of the instrument, and that neither the issuer nor the holder of the instrument is allowed to exercise any contractual rights of set-off; and
 - (ii) the application of requirements relating to loss absorption at the point of non-viability under Attachment G .
2. The amount of the 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. 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 shares if the call is not exercised; or
 - (b) a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate less the swap rate (i.e. the fixed rate paid to the call date to receive the second reference rate).
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 regulated institution 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 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.

7. An instrument may only provide for a call within the first five years of issuance as a result of a tax or regulatory event. APRA will not permit such a call if it forms the view that the regulated institution was in a position to anticipate the tax or regulatory event when the instrument was issued. In order for a call to be exercised the issuer must comply with the provisions in paragraph 1(f)(i) to (iii) of this Attachment.
8. Where a Tier 2 Capital instrument provides for conversion into ordinary shares²⁷, the issue document must:
 - (a) specify the number of ordinary shares to be received upon conversion or specify the conversion formulae for determining the number of ordinary shares received
 - (b) provide for the number of ordinary shares to be received under the formula specified in (a) to be fixed; and
 - (c) set the maximum number of ordinary shares received so as not to exceed the price of the Tier 2 Capital instrument at the time of its issue divided by 20 per cent of the regulated institution's²⁸ ordinary share price²⁹ 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.
9. Conversion must generate an unequivocal addition to Common Equity Tier 1 Capital of the regulated institution under Australian Accounting Standards.
10. 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.
11. There must be no cross-default clauses in the documentation of any debt or other capital instrument of the issuer linking the issuer's obligations under the

²⁷ Conversion must be into the ordinary shares of the insurer or its parent entity, which must be listed at the time of issue. For an unlisted insurer with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into the unlisted ordinary shares of the insurer. Where an unlisted insurer issues the instrument to its listed parent entity, conversion may be into unlisted ordinary shares of the insurer.

²⁸ Reference to regulated institution in this context captures any entity whose ordinary shares are issued as a result of conversion provisions.

²⁹ For an unlisted regulated institution that has no listed parent entity at the time of issue, the ordinary share price is based on the book value per share at the time of issue.

instrument to default by the issuer under any of its other obligations, or default by another party, related or otherwise.

12. The instrument must be marketed in accordance with its prudential treatment and must not include any 'repackaging' arrangements that have the effect of compromising the quality of the capital raised. If a prospectus or other offer documentation or marketing of the instrument could be reasonably held to suggest to investors that the instrument has attributes other than those claimed by the issuer (or its corporate group) for prudential purposes, the instrument is ineligible to be included in the regulated institution's Tier 2 Capital.
13. The instrument 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 must be subject to the laws of Australia.
14. Where the instrument is subject to the laws of a jurisdiction other than Australia or its territories, the regulated institution must also ensure that the instrument satisfies all relevant qualifying criteria for Tier 2 Capital under the laws of that jurisdiction.
15. APRA may require the regulated institution to provide an independent expert opinion, addressed to APRA by a firm or practitioner of APRA's choice and at the regulated institution's expense, confirming that the instrument meets the requirements in paragraphs 13 and 14 of this Attachment.

Attachment F

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 capital:
 - (a) the SPV issuing the instrument is a single purpose non-operating entity established for the sole purpose of raising capital for the 'relevant institution'³⁰;
 - (b) capital instruments issued by the relevant institution to the SPV, and capital instruments issued by the SPV to investors, must meet the requirements of this Prudential Standard for Additional Tier 1 and Tier 2 Capital set out in Attachment C and Attachment E, as appropriate;
 - (c) capital instruments issued by the SPV must not be funded, directly or indirectly, by the relevant institution or any other member of a corporate group to which the relevant institution belongs. Similarly, the regulated institution or other member of a corporate group to which it belongs may not provide any funding to the SPV itself, other than to cover its administrative operating expenses;
 - (d) the only asset³¹ of the SPV is its investment in capital instruments issued by the relevant institution for which it raises capital. The SPV must have no material liabilities other than its issued capital instruments;
 - (e) instruments issued by the relevant institution to the SPV, and by the SPV to 'third party'³² investors, must:
 - (i) be of the same category of 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 relevant institution;
 - (g) where a non-viability trigger event occurs (Attachment G), the instruments issued to the SPV, and by the SPV to investors, must be subject to conversion or write-off into ordinary shares in accordance with the requirements in Attachment G. In such circumstances, investors in

³⁰ In this Attachment, reference to 'relevant institution' includes an insurer, an ultimate holding company or an operating subsidiary included in the Level 2 insurance group.

³¹ Assets that relate to the operation of the SPV may be excluded from this assessment if they are *de minimis*.

³² For the purposes of this Prudential Standard, a 'third party' is defined as an entity that is not the regulated institution or a **related body corporate** of the regulated institution.

instruments issued by the SPV irrevocably cease to have any claims on the SPV or the relevant institution;

- (h) where capital instruments issued by an SPV are converted into ordinary shares of the relevant institution, such conversions are subject to the requirements (including limits) covering conversion set out in Attachments C, E and G; and
 - (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 a regulated institution's Additional Tier 1 Capital or Tier 2 Capital where the complexity of its structure raises doubt over the legal and regulatory risk associated with it.
2. An SPV may be established to issue tranches of one instrument where the only change in the terms and conditions of the tranches is a variation in distribution or payments to be made on the instrument. An SPV may not issue different forms of an instrument even if they belong to the same category of capital instruments.

Attachment G

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, on the occurrence of a non-viability trigger event (as defined in paragraphs 3 and 4 of this Attachment), it will be immediately and irrevocably:
 - (a) be converted into the ordinary shares of the regulated institution or its parent entity, which must be listed³³ at the time the instrument is issued³⁴; or
 - (b) written off.
2. The amount of an instrument that may be recognised in the regulated institution's Tier 1 Capital and capital base on the occurrence of a non-viability trigger event is the minimum level of Common Equity Tier 1 Capital that would be generated by a full conversion or write-off of the instrument. Where an instrument provides for write-off as the primary loss absorption mechanism, the amount recognised must account for potential taxation liabilities or other potential offsets at the time of issuance. Adjustments must be updated over time to reflect the best estimates of the offset value.
3. A non-viability trigger event in relation to a regulated institution (including **Category B insurers**) is the earlier of:
 - (a) the issuance of a notice in writing by APRA to the regulated institution that conversion or write-off of capital instruments is necessary because, without it, APRA considers that the regulated institution would become non-viable; or
 - (b) a determination by APRA, notified to the regulated institution in writing, that without a public sector injection of capital, or equivalent support, the regulated institution would become non-viable.
4. In addition to paragraph 3 of this Attachment, a non-viability trigger event in relation to a Category B insurer is the earlier of:
 - (a) the issuance of a notice by the home regulator of the Category B insurer's parent to the Category B insurer's parent that conversion or write-off of capital instruments issued by a Category B insurer is necessary because, without it, the Category B insurer's parent or the Category B insurer itself would become non-viable; or

³³ For the purposes of this paragraph, 'listed' refers to an institution admitted to, and not removed from, a stock exchange.

³⁴ For an unlisted regulated institution with no listed upstream entity at the time the instrument is issued, the instrument is to be converted into unlisted ordinary shares of the regulated institution. Where an unlisted regulated institution issues the instrument to its listed parent entity, conversion may be into unlisted ordinary shares of the regulated institution.

- (b) a determination by the home regulator of the Category B insurer's parent, that without a public sector injection of capital, or equivalent support, the Category B insurer's parent or the Category B insurer itself would become non-viable.
- 5. Conversion or write-off need only occur to the extent necessary to enable APRA to conclude that the regulated institution is viable without further conversion or write-off. In such circumstances, conversion or write-off would need to fully exhaust Additional Tier 1 Capital instruments before involving Tier 2 Capital instruments. APRA will not approve partial conversion or partial write-off in those exceptional circumstances where a public sector injection of funds is deemed necessary.
- 6. 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.
- 7. A regulated institution may provide for Additional Tier 1 Capital instruments to be converted or written off prior to any conversion or write-off of Tier 2 Capital instruments. In these circumstances, conversion or write-off of Tier 2 Capital instruments will only be necessary to the extent that conversion of Additional Tier 1 Capital instruments has not resulted in APRA withdrawing the notice issued to the regulated institution under paragraph 3 or paragraph 4 of this Attachment, as appropriate.
- 8. Conversion or write-off must generate an unequivocal addition to Common Equity Tier 1 Capital of the regulated institution under Australian Accounting Standards.
- 9. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares, the regulated institution must ensure that, at the time of issue and on a continuing basis, there are no legal or other impediments to issuing the relevant number of shares and all necessary authorisations have been obtained to effect conversion.
- 10. Where, following a trigger event, conversion of a capital instrument:
 - (a) is not capable of being undertaken;
 - (b) is not irrevocable; or
 - (c) will not result in an immediate and unequivocal increase in Common Equity Tier 1 Capital of the regulated institution,the amount of the instrument must immediately and irrevocably be written-off in the accounts of the regulated institution and result in an unequivocal addition to Common Equity Tier 1 Capital.
- 11. Where an Additional Tier 1 or Tier 2 Capital instrument provides for conversion into ordinary shares when a non-viability trigger event occurs, the issue documentation must:

- (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) 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 regulated institution's³⁵ ordinary share price³⁶ 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.
12. 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.
13. 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 insurance group may provide for a ranking under which Additional Tier 1 and Tier 2 Capital instruments issued by individual members of the group may need to be converted or written off. This would be subject to any requirements for conversion or write-off of capital instruments required to be undertaken on a Level 1 basis.
14. For the purposes of conversion or write-off of an Additional Tier 1 or Tier 2 Capital instrument, the amount to be converted or written off will be the face value of the instrument recorded in the books of the regulated institution, where relevant.
15. 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;

³⁵ Reference to regulated institution captures any entity whose ordinary shares are issued as a result of conversion provisions.

³⁶ For an unlisted regulated institution that has no listed parent entity at the time of issue, the ordinary share price is based on the book value per share at the time of issue.

- (c) there is an immediate and unequivocal addition to the Common Equity Tier 1 Capital of the regulated institution; and
 - (d) the distribution/payments payable on the instrument must be permanently reduced (i.e. distributions/payments must be calculated at no more than the rate set for the written off value of the instrument).
16. The contractual terms and conditions of the issue of an instrument must not provide for any residual claims on the issuer that are senior to ordinary shares of the regulated institution, or the parent entity, in the event that a conversion or write-off is undertaken.

Attachment H

Transitional arrangements for capital instruments

Instruments eligible for transition

1. Non-common equity Tier 1 and Tier 2 Capital instruments, including instruments issued by fully consolidated subsidiaries that are held by third parties, that do not fully meet the criteria in Attachments C and E, respectively, may be eligible for transition in accordance with this Attachment.
2. Capital instruments issued before 9 April 2010 that complied with APRA's prudential capital requirements in force at the time of issue may be eligible for the transitional arrangements provided in this Attachment. However, if the instrument had a call and a step-up (or other incentive to be redeemed) after 22 September 2010 and before 1 January 2013, it must be fully derecognised in the relevant category of capital.
3. Instruments issued after 9 April 2010 and before 1 January 2013 that do not include a step-up or other incentive to redeem, but otherwise complied with APRA's prudential capital requirements in force at the time of issue, may be eligible for the transitional arrangements outlined in this Attachment.
4. APRA may, however, determine in writing whether an instrument is eligible for the transitional arrangements provided in this Attachment.

Transitional arrangements

5. Capital instruments approved by APRA for transitional arrangements under paragraph 12 of this Attachment (transitional instruments) will be phased out from inclusion in the capital base from 1 January 2013. Such instruments may be included in the relevant category of capital until their first available call date (if any), or as determined in writing by APRA.
6. The amount of transitional instruments that may be included in the capital base is determined by reference to the 'base amount' of Additional Tier 1 or Tier 2 Capital (refer to paragraphs 7 to 11 of this Attachment). The proportion of the base amount that may be included in the capital base is amortised over nine years, commencing at 90 per cent of the base amount on 1 January 2013, with the cap reducing by 10 percentage points on 1 January of each of the following years. Table 1 sets out the amortisation schedule for the phase-out of transitional instruments.

Table 1: Transitional arrangements for capital instruments

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

Base amount

7. 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.
8. The base amount must not include existing Tier 1 and Tier 2 Capital instruments ineligible for recognition under the June 2010 version of GPS 112 because of the limits for recognition or the amortisation requirements of that Prudential Standard.
9. Where a Tier 2 Capital instrument has started to amortise prior to 1 January 2013 in accordance with the June 2010 version of GPS 112:
 - (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.

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

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

Notification and approval requirement

12. A regulated institution must, prior to 1 January 2013, obtain APRA's written approval for:
 - (a) any transitional instruments; and
 - (b) the total base amounts of Additional Tier 1 and Tier 2 Capital

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

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

Attachment I

Level 2 insurance groups

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

Capital base

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

Capital issued by fully consolidated subsidiaries and held by third parties

Common Equity Tier 1 Capital

3. In addition to paragraph 20 of this Prudential Standard, Common Equity Tier 1 Capital of a Level 2 insurance group may include a portion of the minority interest (calculated in accordance with paragraphs 4 through to 8 of this Attachment) arising from the issue of ordinary shares to third parties by a fully consolidated subsidiary included in the Level 2 insurance group where:
 - (a) the shares giving rise to the minority interest would, if issued by the parent entity of the Level 2 insurance group, meet the criteria in Attachment A; and
 - (b) the subsidiary issuing the shares is itself an insurer or an entity undertaking **insurance business** in a foreign jurisdiction³⁷ and is subject to equivalent minimum prudential requirements and level of supervision as an insurer.
4. Where a fully-consolidated subsidiary of a Level 2 insurance group has its own subsidiaries, all calculations must be undertaken in respect of that subsidiary and its subsidiaries as a consolidated group.
5. The minority interest in Common Equity Tier 1 Capital³⁸ of a fully consolidated subsidiary that is eligible to be included in the Level 2 insurance group's Common Equity Tier 1 Capital in accordance with paragraph 3 of this Attachment is calculated as:

³⁷ Subject to prior consultation with APRA, the subsidiary may also be a non-operating holding company and qualify for the treatment under this paragraph.

³⁸ This includes third parties interest in ordinary shares issued by a subsidiary, current year and retained earnings and distributable reserves of a subsidiary.

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

Additional Tier 1 Capital

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

Tier 2 Capital

- 10. In addition to paragraph 29 of this Prudential Standard, Tier 2 Capital of a Level 2 insurance group includes instruments issued by a fully consolidated subsidiary of the parent entity of the Level 2 insurance group and held by third parties where:

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

Regulatory adjustments to Common Equity Tier 1 Capital

11. In addition to the regulatory adjustments to Common Equity Tier 1 Capital in Attachment B, a Level 2 insurance group must deduct from Common Equity Tier 1 Capital:
 - (a) any surplus, net of deferred tax liabilities, in any defined benefit superannuation fund of which an insurer or other group entity is an employer-sponsor unless otherwise approved by APRA. Any excluded surplus must reverse any associated deferred tax liability from Common Equity Tier 1 Capital;
 - (b) equity exposures and other capital investments³⁹ in non-consolidated subsidiaries or controlled entities, whether regulated or unregulated, subject to the materiality of the controlled entity (to be determined in consultation with APRA).⁴⁰ This deduction does not apply to a controlled entity, where it acts as a holding company for pass-through of equity exposures and other capital investments in Level 1 insurers or equivalent overseas entities carrying on insurance business. In the event that a controlled entity holds equity exposures and other capital investments in controlled entities not eligible for consolidation, the Level 2 insurance group must deduct its equity exposures and other capital investments in the holding company net of the value of the holding company's investment in any Level 1 insurer or equivalent overseas entities carrying on insurance business; and
 - (c) goodwill and any other intangible component of the investments in non-consolidated subsidiaries (to the extent these have not been deducted under sub-paragraph (b)).
12. The deductions relating to investments in subsidiaries, joint ventures and associates (refer to Attachment B) do not apply to investments in subsidiaries of Level 2 insurance groups. Investments in subsidiaries are treated as either consolidated subsidiaries and as a result treated as part of the Level 2 insurance group or as non-consolidated subsidiaries.
13. The deductions relating to reinsurance assets, as set out in paragraphs 16 and 17 of Attachment B, do not apply to the **international business** of a Level 2 insurance group, unless the deduction is required in the relevant jurisdiction.

³⁹ As defined in paragraphs 26 and 27 of this Attachment.

⁴⁰ Paragraph (b) requires the goodwill component of these investments to be deducted from Common Equity Tier 1 Capital. This deduction is to be performed prior to deducting the (remaining) value of the investment from Common Equity Tier 1.

14. The deduction relating to assets under a fixed or floating charge, as set out in paragraphs 21 and 22 of Attachment B, do not apply to the international business of a Level 2 insurance group.
15. APRA may require a Level 2 insurance group to deduct from Common Equity Tier 1 Capital an amount to cover undercapitalisation of a non-consolidated subsidiary (or subsidiaries). A Level 2 insurance group may be required to provide to APRA details of, amongst other things, the:
 - (a) size and scale of the operations of the non-consolidated subsidiary;
 - (b) materiality of the subsidiary's operations to group income and strategic outlook;
 - (c) level of net tangible assets of the subsidiary;
 - (d) risk profile of the subsidiary;
 - (e) level of exposure of the Level 2 insurance group to the subsidiary; and
 - (f) size of any identified capital shortfall and the likelihood of such a shortfall being remedied within a reasonable period of time.

Additional Tier 1 or Tier 2 Capital issued overseas by parent entities or subsidiaries

16. In addition to paragraph 30 of this Prudential Standard, Additional Tier 1 Capital instruments and Tier 2 Capital instruments may be issued by the parent entity of the Level 2 insurance group, or a fully consolidated subsidiary of the group, either in its country of incorporation or through a branch in another country, provided the instrument:
 - (a) represents an obligation of the parent entity or the consolidated subsidiary itself at all times;
 - (b) is freely available to absorb losses across all of the operations of the parent entity or the consolidated subsidiary that issued the instrument; and
 - (c) meets all of the requirements of this Prudential Standard for inclusion in Additional Tier 1 or Tier 2 Capital.

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

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

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

18. In addition to the non-viability trigger event defined in Attachment G, for a Level 2 insurance group, a non-viability trigger event in relation to instruments issued by a fully consolidated subsidiary of a Level 2 insurance group is the earlier of:
- (a) the issuance of a notice by an host regulator of an overseas subsidiary that conversion or write-off of capital instruments issued by a fully consolidated subsidiary of a regulated institution is necessary because, without it, the host regulator considers that the subsidiary would become non-viable;
 - (b) a determination by the host regulator, that without a public sector injection of capital, or equivalent support, the overseas subsidiary would become non-viable; or
 - (c) a non-viability trigger event occurs in relation to a parent entity of the Level 2 insurance group in accordance with paragraph 3 of Attachment G.

Intra-group capital transactions

19. The matters APRA may consider in assessing whether a component of capital resulting from intra-group transactions does not represent a genuine contribution to financial strength include, but are not limited to, whether a component of capital:
- (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 Level 2 insurance group; or
 - (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 Level 2 insurance group failing to meet any servicing obligations.
20. In assessing the overall strength of a Level 2 insurance group, APRA will have regard to the ability of the Level 2 insurance group to readily extract capital from members of the group should the need arise to recapitalise the parent entity or other members of the group. APRA may require a Level 2 insurance group to adjust its Prudential Capital Requirement to reflect any inability to readily extract capital and any limitations on the amount of capital that may be extracted.
21. In measuring the capital base of a Level 2 insurance group, a Level 2 insurance group must exclude any instrument issued by a member of the group where the obligations under that instrument are guaranteed by another group member.

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

Holdings of capital instruments in group members by other group members

23. Capital instruments⁴¹ of a parent entity of a Level 2 insurance group or of a controlled entity within the group that are held as direct investments by a vehicle⁴² subject to consolidation within the Level 2 insurance group's financial statements in accordance with Australian Accounting Standards, may be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital only if:
 - (a) the parent entity (or relevant vehicle) did not fund the acquisition of the capital instruments (i.e. acquisition of capital instruments is funded by third parties such as life insurance policyholders or other third-party investors);
 - (b) the risk and rewards associated with the investments are borne primarily by third parties; and
 - (c) the parent entity can demonstrate to APRA, if required, that decisions to acquire or sell such capital instruments are made independently of the issuer of the capital instruments and in the interests of the third parties who primarily bear the risks and rewards of the investments in the instruments.
24. Where the requirements in paragraph 23 of this Attachment are not satisfied, the relevant capital instruments must be treated as holdings of own capital instruments and deducted from Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital, as appropriate in accordance with paragraph 5 of Attachment B.
25. For the purposes of measuring a Level 2 insurance group's capital base, the SPV holding the shares referred to in paragraph 31 of this Prudential Standard must be excluded from the Level 2 insurance group. As a consequence, any associated change in the fair value of the shares held by an SPV must be excluded from the capital base.

⁴¹ Capital instruments include all capital instruments eligible to be included in Common Equity Tier 1 Capital, Additional Tier 1 Capital and Tier 2 Capital.

⁴² These vehicles exclude any SPV, such as a trust, involved with employee share-based remuneration schemes.

Capital support

26. For the purposes of determining whether a capital instrument constitutes capital support, including a guarantee provided to a related entity, APRA will have regard to, amongst other things, whether:
- (a) the facility represents a recognised capital instrument or is otherwise accepted as standing in place of capital required to be held by a related entity; or
 - (b) the provider of the facility, in terms of either repayment or maturity, ranks below other senior unsecured or unsubordinated creditors, or
 - (c) the facility is provided by an insurer or other group entity and the funding provided flows through one group entity (including any SPV) to another group entity and the funding received by the second entity meets either (a) or (b).
27. If a facility covered in paragraph 26 of this Attachment represents a form of capital support, it must be considered for the purposes of this Prudential Standard to form part of the Level 2 insurance group's 'other capital investments'. Investments are not deducted from Common Equity Tier 1 Capital, must be subject to the **Asset Risk Charge** under *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge*.