Reserve Bank of New Zealand
Te Pūtea Matua

DRAFT FOR CONSULTATION

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Deposit Takers (Capital) Standard 2027

This standard is issued under section 72 of the Deposit Takers Act 2023 by the Reserve Bank of New Zealand after—

(a) complying with section 75(1) of that Act; and

(b) having regard to the matters set out in section 92(3) of that Act; and

(c) being satisfied of the matters set out in sections 72(1) and 92(4) of that Act; and

(d) the board of the Reserve Bank of New Zealand having regard to the matter set out in section 49(1) of the Reserve Bank of New Zealand Act 2021.

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Standard

1 Title

This is the Deposit Takers (Capital) Standard 2027.

2 Commencement

This standard comes into force on 1 December 2028.

Part 1
Preliminary provisions

3 Application

This standard applies to a deposit taker incorporated in New Zealand.

4 Transitional, savings, and related provisions

The transitional, savings, and related provisions set out in Schedule 1 have effect according to their terms.

5 Interpretation

In this standard, unless the context otherwise requires,—

Act means the Deposit Takers Act 2023

affiliated insurance entity has the meaning set out in clause 300

affiliated insurance group has the meaning set out in clause 300

asset sale with recourse means an arrangement for the sale of a loan or other asset to a third party under which the seller retains an obligation to assume the credit risk on the asset

banking book, in relation to a deposit taker, means the portfolio of banking book instruments of the deposit taker determined under subpart 5 of Part 7

board, in relation to a deposit taker, means the board of directors (or other persons or body exercising powers of management, however described)

capital conservation buffer has the meaning set out in clause 18

capital group has the meaning set out in clause 9

capital requirement, in relation to a deposit taker, means a requirement in subpart 2 of Part 2

clean transfer has the meaning set out in clause 305

close family member, in relation to a person (**A**) means—

(a) A's spouse, civil union partner, or de facto partner; or

(b) a person who is under the age of 20 years and is a child of A or A's spouse, civil union partner, or de facto partner

combined buffer ratio has the meaning set out in clause 17(3)

combined capital ratio has the meaning set out in clause 14(2)

commitment with certain drawdown means an agreement to purchase assets or acquire claims that are certain to be drawn down at a future date, and includes—

(a) a forward asset purchase; or

(b) a partly paid-up share or security; or

(c) a forward deposit

community housing provider—

(a) means a housing provider that has an objective to provide either or both of the following:

  (i) social rental housing:

  (ii) affordable rental housing; but

(b) does not include Kāinga Ora–Homes and Communities, established under section 8 of the Kāinga Ora–Homes and Communities Act 2019

comprehensive methodology, in relation to credit risk mitigation, means the methodology set out in clauses 195 to 202

core market participant means—

(a) the New Zealand Government; or

(b) the Bank; or

(c) a deposit taker

core rate-insensitive asset, **core rate-insensitive liability**, and **core rate-insensitive product** have the meanings set out in clause 234

corresponding deductions approach means the approach to deductions from capital under subpart 3 of Part 3

counter-cyclical buffer has the meaning set out in clause 19

covered bond SPV means a covered bond SPV in relation to a covered bond programme (as those terms are defined in section 403 of the Act)

credit default swap means a credit derivative under which the protection buyer makes a payment to the protection seller in return for compensation in the event of a default (or similar event) by a reference entity

credit derivative means a derivative in respect of which the amount of consideration payable or the value of the derivative is ultimately determined, or derived from, or varies by reference to, the value of 1 or more reference obligations of a reference entity

credit enhancement means a contractual obligation on a party to a funds management or securitisation arrangement, or an arrangement with any member of an affiliated insurance group, under which the party retains or assumes credit risk

credit equivalent amount means an amount calculated in accordance with subpart 6 of Part 5

credit protection provider means, in relation to—

(a) a guarantee, the guarantor:

(b) an indemnity, the indemnifying party:

(c) a credit derivative, the counterparty

credit valuation adjustment capital charge or **CVA** means the capital charge calculated in accordance with subpart 8 of Part 5

Crown has the same meaning as in section 2(1) of the Public Finance Act 1989

currency derivative—

(a) means a derivative in respect of which the amount of consideration payable, or the value of the derivative, is ultimately determined, is derived from, or varies by reference to the amount of an exchange rate; and

(b) includes—

(i) a forward foreign exchange contract; or

(ii) a cross-currency forward rate agreement; or

(iii) a currency option contract; but

(c) does not include—

(i) a contract that has an original maturity that is less than or equal to 14 days; or

(ii) a currency derivative entered into as part of a swap deposit arrangement

debt security has the same meaning as in section 8(1) of the Financial Markets Conduct Act 2013

derivative has the same meaning as in section 8(4) of the Financial Markets Conduct Act 2013

direct credit substitute means an off-balance-sheet exposure with a specified nominal principal amount that has a risk of loss equivalent to a direct claim on the counterparty for that amount

equity means the residual interest in the assets of an entity after deducting all of its liabilities

equity derivative means a derivative in respect of which the amount of the consideration payable or the value of the derivative, is ultimately determined, derived

from, or varies by reference to, the value or amount of an equity instrument or equity index

equity instrument means a contract that give rise to a residual interest in the assets of an entity after deducting all of its liabilities

equity risk means the risk arising from changes in the prices of equity instruments

expressed in NZD, in relation to the value of an instrument denominated in a foreign currency, means the value converted to New Zealand dollars at the mid-point of market bid and offer rates applying at the close of business on the relevant day

financial asset means an asset that meets the requirements for a financial asset under NZ IAS 32

financial instrument means a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity

financial liability means a liability that meets the requirements for a financial liability under NZ IAS 32

forward rate agreement means an agreement between 2 parties to exchange payments at a future date based on interest payments and receipts, on different interest rate bases, on a notional principal amount over a specified period

generally accepted accounting practice has the same meaning as in section 8 of the Financial Reporting Act 2013

group 1 deposit taker means a deposit taker that is identified as a group 1 deposit taker for the purposes of this standard, in a document that—

(a) sets out the deposit taker's licence conditions; and

(b) is provided by the Bank to the deposit taker

group 2 deposit taker means a deposit taker that is identified as a group 2 deposit taker for the purposes of this standard, in a document that—

(a) sets out the deposit taker's licence conditions; and

(b) is provided by the Bank to the deposit taker

group 3 deposit taker means a deposit taker that is identified as a group 3 deposit taker for the purposes of this standard, in a document that—

(a) sets out the deposit taker's licence conditions; and

(b) is provided by the Bank to the deposit taker

ICAAP or **internal capital adequacy assessment process** has the meaning set out in clause 23

insurance business means the undertaking or assumption of liability as an insurer under a contract of insurance within the meaning of that term in section 7 of the Insurance (Prudential Supervision) Act 2010

insurance entity means an entity whose business predominantly consists of insurance business

insurer has the same meaning as in section 6(1) of the Insurance (Prudential Supervision) Act 2010

interest rate derivative—

(a) means a derivative in respect of which the amount of consideration payable, or the value of the derivative, is ultimately derived from, or varies by reference to the amount of an interest rate; and

(b) includes—

(i) a single-currency forward rate agreement:

(ii) an interest rate swap agreement:

(iii) an interest rate option contract:

(iv) a bond future:

(v) a basis swap agreement

interest rate repricing date, in relation to a financial instrument or part of a financial statement, means the earlier of—

(a) the next interest rate reset date (which is the date on which the rate of interest payable in respect of the financial instrument can or will alter); and

(b) either—

(i) the date on which the principal sum is due and payable; or

(ii) if no principal sum is due and payable, the maturity date of the instrument

internal models approach means the approach to calculating credit risk RWAs set out in the internal models standard

internal models deposit taker means a deposit taker that has the Bank's approval, under clause 23(1) of the internal models standard, to use the internal models approach

internal models standard means the Deposit Takers (Internal Models) Standard 2027

internal risk transfer has the meaning set out in clause 280

issuer has the same meaning as in section 11 of the Financial Markets Conduct Act 2013

joint venture means a joint arrangement under which the parties that have joint control of the arrangement have rights to the net assets of the arrangement

Kāinga Whenua loan product means a loan secured against a residential dwelling situated on Māori land, if Kāinga Ora–Homes and Communities is the provider of lender's mortgage insurance (*see* clause 154(1)(b))

LGD has meaning set out in clause 45 of the internal models standard

loss allowance means an amount that meets the requirements for a loss allowance under NZ IFRS 9

lowest-risk multilateral development bank or supranational has the meaning set out in clause 128

maturity or **maturity date** includes a maturity date or a scheduled redemption date

mitigant, in relation to a deposit taker's credit risk, means a contract or other arrangement that reduces the deposit taker's exposure to the risk

modelled exposure class has the meaning set out in clause 106(2)

multilateral development bank means a supranational institution set up by 2 or more sovereign states, with a remit to reflect the development aid and co-operation policies established by those states

mutual capital instrument means a capital instrument issued by a mutual entity

mutual entity means—

(a) a building society within the meaning of section 2(1) of the Building Societies Act 1965; or

(b) a co-operative company within the meaning of section 2(1) of the Co-operative Companies Act 1996; or

(c) a credit union within the meaning of section 2 of the Friendly Societies and Credit Unions Act 1982; or

new instrument means a new capital instrument referred to in clause 84

new instrument notice means a notice that complies with clause 85

New Zealand Superannuation Fund means the fund established under section 37 of the New Zealand Superannuation and Retirement Income Act 2001

non-modelled exposure class has the meaning set out in clause 106(3)

non-property investment RML has the meaning set out in clause 149(1)

note issuance facility—

(a) means an arrangement under which—

(i) a borrower may draw down funds up to a prescribed limit over a pre-defined period by making repeated note issues to the market; and

(ii) if the issue is not fully taken up by the market, the unplaced amount is to be taken up, or funds made available, by the facility provider; and

(b) includes a revolving underwriting facility

notional underlying instrument, in relation to a derivative, means a notional financial instrument that would, if it were the underlying instrument for the derivative, result in the same payments as the derivative

NZ IAS 12 means the New Zealand Equivalent to International Accounting Standard 12 (Income Taxes)

NZ IAS 32 means the New Zealand Equivalent to International Accounting Standard 32 (Financial Instruments: Presentation)

NZ IFRS 9 means the New Zealand Equivalent to International Financial Reporting Standard 9 (Financial Instruments)

original maturity, in relation to a financial instrument is—

(a) the period between the issue date and the maturity date of the instrument; or

(b) if the instrument has no specified maturity date, the period between the issue date and the earliest date on which the deposit taker can cancel the facility or withdraw its funds

other development bank has the meaning set out in clause 128(3)

overseas bank means a bank or other entity that is licensed, registered, or otherwise authorised to accept deposits under the law of an overseas jurisdiction

owner-occupied residential property has the meaning set out in clause 149(1)

past due must be determined in accordance with NZ IFRS 9, and an asset that is a specified number of days past due includes an asset for which, under the contracted terms, conditions, or limits that applied to the asset immediately before non-performance commenced,—

(a) any payment of principal, interest, or other forms of monies owing is overdue, or has not been paid in accordance with the asset's terms and conditions, for at least the specified number of days; or

(b) amounts owing under the revolving facilities have been continuously outside of limits for at least the specified number of days

PD has meaning set out in clause 43 of the internal models standard

performance-related contingent item—

(a) means an exposure involving an irrevocable obligation to pay a third party if a counterparty fails to fulfil or perform a contractual non-monetary obligation, such as delivery of goods by a specified date; and

(b) includes the following:

(i) a performance bond:

(ii) a bid bond:

(iii) a warranty or indemnity:

(iv) a performance-related standby letter of credit:

perpetual preference share has the meaning set out in clause 36

placement of forward deposit means an agreement to place a deposit with another party at an agreed rate of interest on a predetermined future date

precious metal means gold, silver, platinum, or palladium

precious metal derivative means a commodity derivative in respect of which the relevant commodity is a precious metal

property investment RML has the meaning set out in clause 149(1)

public sector entity means,—

(a) in the case of a New Zealand entity,—

(i) a local authority; or

(ii) the New Zealand Local Government Funding Agency Limited; or

(b) in any other case, a non-national level government (such as a state, provincial, or regional government) that has powers to raise revenue and borrow money

qualifying central counterparty or **QCCP** has the meaning set out in clause 180

rate-insensitive asset, rate-insensitive liability, and **rate-insensitive product** have the meanings set out in clause 234

recognise, in relation to a credit risk mitigation of a credit exposure under Part 6, means to treat the amount of the exposure as reduced by the amount of the credit risk mitigation when calculating credit risk RWAs

related entity has the meaning set out in clause 6

repay includes repay by way of a call, acquisition, or redemption

residential mortgage loan or **RML** has the meaning set out in clause 148

reverse residential mortgage loan or **reverse RML** has the meaning given to reverse RML in clause 149(1)

RWA means risk-weighted assets

RWA equivalents has the meaning set out in clause 8

seasonal rate-insensitive asset has the meaning set out in clause 234

seasonal rate-insensitive liability has the meaning set out in clause 234

securities financing transaction or **SFT** means a transaction in which a person agrees to do 1 or more of the following:

(a) sell a security to a counterparty and repurchase the security from the counterparty, at an agreed price, on an agreed future date:

(b) buy a security from a counterparty and resell the security to the counterparty, at an agreed price, on an agreed future date:

(c) lend a security to a counterparty and receive money or other securities from the counterparty as collateral:

(d) borrow a security from a counterparty and provide money or other securities to the counterparty as collateral

significant influence has the meaning set out in clause 7

simple methodology, in relation to credit risk mitigation, means the methodology set out in clauses 203 and 204

solo basis has the meaning set out in clause 11

sovereign,—

(a) in the case of New Zealand, means the Crown; and

(b) in the case of any other country,—

(i) means the Government of that country; but

(ii) does not include the Government of a province, State, territory, or other political subdivision of the country

SPV means special purpose vehicle

standardised approach means the calculation of a deposit taker's credit risk RWAs in accordance with Part 5

structural position in relation to a deposit taker's banking book, means any financial instrument that has a fixed term and is long-term

swap deposit arrangement means an arrangement under which—

(a) a party sells foreign currency at the spot rate against another currency to a counterparty; and

(b) at the same time, that counterparty deposits the foreign currency with the seller and enters into a currency derivative with the seller to sell the foreign currency back to the seller against another currency, at a specified exchange rate, on a future date

tier 1 capital has the meaning set out in clause 38

tier 1 capital ratio has the meaning set out in clause 13(2)

tier 2 capital has the meaning set out in clause 50

total capital has the meaning set out in clause 37

total credit risk RWA has the meaning set out in—

(a) clause 104 for an internal models deposit taker:

(b) clause 100 for any other deposit taker

trade-related contingent item—

(a) means a contingent liability arising from trade-related obligations that are secured against an underlying shipment of goods; and

(b) includes documentary letters of credit issued, acceptances on trade bills, shipping guarantees issued, and other trade-related contingencies

trading book, in relation to a deposit taker, means the portfolio of trading book instruments of the deposit taker determined under subpart 6 of Part 7

underlying instrument, in relation to a derivative, means a financial instrument by reference to which payments on the derivative are determined

ultimate holding entity means an ultimate holding company within the meaning of that term in section 2(1) of the Companies Act 1993.

6 Meaning of related entity

(1) In this standard, an entity (**A**) is **related** to a deposit taker if—

(a) A has significant influence over a member of the deposit taker's licensed deposit taker group; or

(b) A is an entity over which a member of the deposit taker's licensed deposit taker group has significant influence; or

(c) a person has significant influence over both A and a member of the deposit taker's licensed deposit taker group.

(2) **Related entity** has a corresponding meaning.

7 Meaning of significant influence

(1) In this standard, a person (**A**) has **significant influence** over an entity if—

(a) A has the power, directly or indirectly, to—

(i) exercise, or control the exercise of, 20% or more of the voting rights in the entity; or

(ii) appoint 20% or more of the directors of the entity; or

(b) A has, together with 1 or more connected persons, the power, directly or indirectly, to—

(i) exercise, or control the exercise of, 20% or more of the voting rights in the entity; or

(ii) appoint 20% or more of the directors of the entity.

(2) For the purposes of subclause (1)(b), a **connected person**, in relation to A, means—

(a) a person who is acting or will act jointly or in concert with A in exercising, or controlling the exercise of, a power referred to in subclause (1)(b)(i) or (ii); or

(b) a person who acts, or is accustomed to acting, in accordance with the wishes of A.

Part 2
Capital requirements

Subpart 1—General provisions

8 Meaning of RWA equivalents

In this standard, **RWA equivalents**, in relation to a deposit taker, means the sum of—

(a) its total credit risk RWAs; and

(b) its capital requirement for market risk multiplied by 12.5; and

(c) its capital requirement for operational risk multiplied by 12.5.

Compare: BPR100 B2.5

9 Deposit taker must comply with capital requirements in respect of capital group

(1) A deposit taker must comply with the requirements in this Part in respect of the group (the **capital group**) comprising—

(a) the deposit taker and its subsidiaries; and

(b) any SPV included under clause 297 or 299(3)(c); and

(c) a particular entity or class of entities that a licence condition specifies must be included in the deposit taker's capital group.

(2) A deposit taker that has an applicable overseas subsidiary must also comply with capital requirements in respect of the capital group, excluding the overseas subsidiary.

(3) The Bank, when deciding whether to impose a licence condition under subclause (1)(c), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

(4) In this clause, **applicable overseas subsidiary** means a subsidiary of the deposit taker that—

(a) is an overseas company; and

(b) is licensed or registered in an overseas jurisdiction to carry on banking business in that jurisdiction.

10 Deposit taker may be required to comply with capital requirements on solo basis

(1) A deposit taker must comply, on a solo basis, with any requirement in this Part that is specified in the deposit taker's licence conditions to apply on that basis.

(2) The Bank, when deciding whether to specify a condition under subclause (1), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

(3) Any obligation imposed on a deposit taker under this clause is in addition to the obligations set out in clause 9.

Compare: BPR100 B2.3

11 Meaning of solo basis

(1) In this standard, a deposit taker that is required to comply with a requirement on a **solo basis** must comply with the requirement in respect of the group comprising—

(a) the deposit taker; and

(b) any subsidiary that is not a funds management or securitisation SPV if—

(i) it is funded exclusively, and wholly owned, by the deposit taker; or

(ii) there is a full, unconditional, and irrevocable cross-guarantee between the subsidiary and the deposit taker, and the deposit taker chooses to include the subsidiary; and

(c) any funds management or securitisation SPV included under clause 297 or 299(3)(c) and that is—

(i) a covered bond SPV; or

(ii) an internal RMBS SPV.

(2) In this clause,—

a subsidiary is **funded exclusively** by a deposit taker if the subsidiary has no liabilities (including off-balance-sheet obligations) other than to—

(a) the deposit taker; or

(b) Inland Revenue; or

(c) trade creditors, but only if the aggregate exposure of the subsidiary to trade creditors does not exceed the greater of—

(i) 5% of the subsidiary's shareholders' funds; and

(ii) 1% of the subsidiary's total assets

internal RMBS SPV, in relation to a deposit taker, means an SPV that is set up to securitise residential mortgage loans originated by the deposit taker and that is funded exclusively by the deposit taker

a subsidiary is **wholly owned** by a deposit taker if the subsidiary is 100% owned by—

(a) the deposit taker; or

(b) another subsidiary that is ultimately owned by the deposit taker through a chain of ownership in which each entity is 100% owned by its immediate parent.

Compare: BPR100 B2.4

Subpart 2—Capital requirements

Minimum capital requirements

12 Capital base

(1) A deposit taker must—

(a) have tier 1 capital of at least $5 million; or

(b) refrain from making distributions in respect of tier 1 securities.

(2) However, a deposit taker may not rely on subclause (1)(b) at the time that it commences business under the Act.

13 Tier 1 capital ratio

(1) A deposit taker must have a tier 1 capital ratio that meets or exceeds the total of—

(a) 6%; and

(b) any capital overlay imposed under clause 15.

(2) In this clause, **tier 1 capital ratio** means tier 1 capital divided by RWA equivalents, expressed as a percentage.

14 Combined capital ratio

(1) A deposit taker must have a combined capital ratio that meets or exceeds the total of—

(a) 9%; and

(b) any capital overlay imposed under clause 15; and

(c) any loss-absorbing capacity that applies to the deposit taker under clause 16.

(2) In this clause, **combined capital ratio** means tier 1 and tier 2 capital divided by RWA equivalents, expressed as a percentage.

15 Capital overlay

(1) A condition of a deposit taker's licence may, for the purposes of clauses 13(1)(b) and 14(1)(b), specify a percentage as a **capital overlay.**

(2) The Bank, when deciding whether to specify a condition under subclause (1), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

16 Loss-absorbing capacity

For the purposes of clause 14(1)(c), a group 1 deposit taker's **loss-absorbing capacity** is—

(a) 6%; or

(b) if a lower percentage is specified in the deposit taker's licence conditions, that percentage.

Buffer requirements

17 Combined buffer ratio

(1) This clause applies to a deposit taker that has 1 or more of the following buffer requirements:

(a) a capital conservation buffer imposed under clause 18:

(b) a counter-cyclical buffer imposed under clause 19:

(c) a buffer overlay imposed under clause 20.

(2) The deposit taker must—

(a) have—

(i) a combined buffer ratio that meets or exceeds the combined buffer; and

(ii) if a counter-cyclical buffer for a deposit taker is set below 1% having previously been set at 1%, a combined buffer ratio that exceeds the combined buffer as if the counter-cyclical buffer were 1%; or

(b) restrict distributions to holders of tier 1 securities in accordance with clause 21.

(3) In this clause,—

applicable tier 1 capital means—

(a) tier 1 capital; but

(b) does not include capital that the deposit taker is required to hold to meet capital requirements in clauses 13 or 14

combined buffer means the total percentage of the deposit taker's buffer requirements referred to in subclause (1)

combined buffer ratio means applicable tier 1 capital divided by RWA equivalents, expressed as a percentage.

18 Capital conservation buffer

A condition of a deposit taker's licence may, for the purposes of clause 17(1)(a), specify, as a **capital conservation buffer**, a percentage of at least 4% but no more than 5%.

Compare: BPR100 B1.3

19 Counter-cyclical buffer

A condition of a deposit taker's licence may, for the purposes of clause 17(1)(b), specify, as a **counter-cyclical buffer**, a percentage that is not more than 1%.

20 Buffer overlay

(1) A condition of a deposit taker's licence may, for the purposes of clause 17(1)(c), specify a percentage as a **buffer overlay**.

(2) The Bank, when deciding whether to specify a condition under subclause (1), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

Distribution restrictions relating to combined buffer ratio

21 Distribution restrictions relating to combined buffer ratio

(1) This clause applies to a deposit taker that is required under clause 17(2)(b) to restrict distributions.

(2) The deposit taker must not make, or have a subsidiary that makes, a distribution in respect of tier 1 securities unless the requirements in subclause (3) are met.

(3) The distributions by the deposit taker or its subsidiary in respect of tier 1 securities in any period must not exceed—

(a) 0% of net profit if the deposit taker's combined buffer ratio is less than or equal to 1%:

(b) 30% of net profit if the deposit taker's combined buffer ratio is less than or equal to half of its capital conservation buffer:

(c) 60% of net profit if the deposit taker's combined buffer ratio is less than or equal to the percentage that is 0.5% less than its capital conservation buffer:

(d) 100% of net profit in any other case.

(4) In this clause,—

applicable tier 1 capital means—

(a) tier 1 capital; but

(b) does not include capital that the deposit taker uses to meet capital requirements in any of clauses 13 to 15

combined buffer ratio has the meaning set out in clause 17(3)

net profit means the net profit after tax of the deposit taker as at the deposit taker's most recent balance date.

Compare: BPR100 B1.3

22 Distribution restrictions imposed by licence condition

(1) A condition of a deposit taker's licence may specify that the deposit taker is restricted from making any distributions in respect of tier 1 securities.

(2) The Bank, when deciding whether to specify a condition under subclause (1), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

Subpart 3—Internal capital adequacy assessment process

General requirements

23 Board must ensure overall capital adequacy

A deposit taker's board must ensure that the deposit taker and its capital group have adequate capital in relation to all the risks in their businesses.

Compare: BPR100 D1.3.2, D2.1.3

24 Deposit taker must have internal capital adequacy assessment process (ICAAP)

(1) A deposit taker must, in accordance with this subpart,—

(a) have a process to ensure that it has adequate overall capital in relation to its risk profile (an **internal capital adequacy assessment process** or **ICAAP**); and

(b) take all practicable steps to comply with the process.

(2) The ICAAP must—

(a) identify and measure material risks of the capital group that are not taken into account in the capital requirements in clauses 13 and 14; and

(b) determine an internal capital allocation for each risk identified and measured under paragraph (a).

Compare: BPR100 D1.1, D1.4

25 Board must approve ICAAP

A deposit taker's board, or a committee of the board, must approve the deposit taker's ICAAP and any amendments to it.

Compare: BPR100 D2.2

26 ICAAP must be appropriate to operations of deposit taker

A deposit taker's ICAAP must be appropriate to the operations of the deposit taker, having regard to factors relevant to its risk profile (for example, the size of the deposit taker, its funding structure, the market sector in which it operates, and its relationship with its capital group).

Compare: BPR100 D3.1; 2013 No 104 s 27(2)(e)

27 ICAAP must take future events into account

A deposit taker's ICAAP must take future events into account (for example, a proposed change to the deposit taker's strategic plan).

Compare: BPR100 D3.5.1

28 Deposit taker must document ICAAP

A deposit taker must ensure that its ICAAP, including its methodologies, assumptions, and procedures, is appropriately documented.

Compare: BPR100 D3.2.1

29 ICAAP must be reviewed

(1) An ICAAP must be reviewed to assist the board to meet its obligations under clause 23.

(2) A review must be carried out,—

(a) for a group 1 or group 2 deposit taker, at least every year:

(b) for a group 3 deposit taker, at least every 2 years:

(3) A review must occur earlier than required under subclause (1) if there is a change in respect of the deposit taker that materially affects assumptions or methodology under the ICAAP (for example, a change to the strategic focus of the deposit taker or the establishment of new operating lines).

(4) Each review must be carried out by a person with operational independence from the deposit taker's capital function.

(5) A review must include the following matters:

(a) whether the ICAAP is appropriate for the size and nature of the deposit taker's business:

(b) whether the data inputs for the capital assessment are accurate and complete:

(c) whether the severe loss scenarios used in the ICAAP are reasonable and valid:

(d) stress-testing and analysis of assumptions and inputs.

(6) The outcome of each review must be reported to the board.

Compare: BPR100 D3.8

Group 1 or group 2 deposit taker

30 ICAAP must have comprehensive coverage

A group 1 or group 2 deposit taker must ensure that its ICAAP takes into account all material risks that the deposit taker faces, including the following:

(a) risks not covered or adequately covered by requirements in this standard or the internal models standard; and

(b) risk factors external to the deposit taker.

Compare: BPR100 D3.3

31 Relationship between capital and risk

A group 1 or group 2 deposit taker's ICAAP must—

(a) use an approach to deriving capital allocations from measured risk that is consistent with the deposit taker's established level of risk tolerance; and

(b) use—

(i) quantitative assessment; and

(ii) qualitative assessment or management judgment.

Compare: BPR100 D3.4

32 ICAAP requirements for strategic and contingency plans

(1) A group 1 or group 2 deposit taker's ICAAP must ensure that the deposit taker's strategic planning—

(a) specifies near- and longer-term capital needs, capital expenditures required for the foreseeable future, target capital levels, and external capital sources; and

(b) includes capital planning and budgeting.

(2) When undertaking contingency planning for the purposes of the ICAAP, a deposit taker must—

(a) ensure that the capital plan would provide adequate capital under the strategic plan, under a range of business conditions and at different points of the business cycle; and

(b) perform rigorous and forward-looking stress tests that identify plausible severe loss events or adverse changes in market conditions and assess their impact on the deposit taker's capital adequacy.

Compare: BPR100 D3.5.2–4

33 Risk monitoring and reporting

(1) A group 1 or group 2 deposit taker's ICAAP must include a system for monitoring and reporting risk exposures to help the deposit taker adequately assess how changes in its risk profile affect its capital needs.

(2) The board and senior managers must receive regular reports on the matters in subclause (1) to enable senior management to—

(a) evaluate the level and trend of material risks and their effect on capital requirements; and

(b) evaluate the sensitivity and reasonableness of central assumptions used in the deposit taker's capital measurements; and

(c) determine that the deposit taker holds sufficient capital against risks; and

(d) determine that the deposit taker meets its internal capital adequacy goals; and

(e) assess its future capital requirements based on the deposit taker's risk profile and make necessary adjustments to the deposit taker's strategic plan.

Compare: BPR100 D3.6

34 Updating ICAAP

(1) A group 1 or group 2 deposit taker must update its ICAAP with appropriate frequency to ensure that—

(a) the ICAAP continues to cover the deposit taker's risks; and

(b) the risks are covered by capital consistent with its risk profile.

(2) The deposit taker must also update its ICAAP in response to any changes in the deposit taker's strategic focus, business plan, operating environment, or other factors that materially affect assumptions or methodology.

Compare: BPR100 D3.7

Group 3 deposit taker

35 ICAAP for group 3 deposit taker must meet requirements

A ICAAP for a group 3 deposit taker must—

(a) set out procedures that the deposit taker will use for effectively identifying and managing the following risks:

(i) credit risk:

(ii) liquidity risk:

(iii) market risk:

(iv) operational risk; and

(b) describe the steps that the deposit taker will take to ensure that the ICAAP remains current, which must include procedures for regular review of the ICAAP to identify deficiencies in its effectiveness.

Compare: 2013 No 104 s 27

Part 3
Components of capital

Subpart 1—Definition

36 Meaning of perpetual preference share

(1) In this standard, **perpetual preference share** means a fully paid-up non-cumulative preference share that meets the following requirements:

(a) the payment of dividends on the share is able to be withheld if the financial condition of the deposit taker or capital group would not support payment of those dividends:

(b) dividends that are withheld in accordance with paragraph (a) are not cumulative:

(c) the dividend rate for the share is set—

(i) as a fixed percentage rate; or

(ii) as a fixed margin above a benchmark floating rate (for example, a bank bill rate):

(d) the share is not—

(i) subject to any arrangement for resetting the dividend rate; or

(ii) redeemable within the meaning of section 68 of the Companies Act 1993; or

(iii) repayable or redeemable at the option of the holder.

Compare: SR 2010/167 r 10

Subpart 2—Categories of capital

Total capital

37 Meaning of total capital

In this standard, **total capital** means a deposit taker's—

(a) tier 1 capital; and

(b) tier 2 capital.

Compare: BPR110 A2.2

Tier 1 capital

38 Meaning of tier 1 capital

(1) In this standard, **tier 1 capital**, in relation to a deposit taker, means the total of the components in subclause (2), less—

(a) adjustments required by clauses 39 to 0; and

(b) deductions required under the corresponding deductions approach set out in subpart 3.

(2) The components of tier 1 capital are—

(a) any paid-up ordinary share, issued by the deposit taker, that meets the requirements in subpart 4; and

(b) any share premium from a share included in tier 1 capital under paragraph (a); and

(c) retained earnings net of any appropriations (for example, tax payable, dividends to be paid, and transfers to other reserves); and

(d) accumulated other comprehensive income and other disclosed reserves—

(i) including—

(A) foreign currency translation reserves; and

(B) reserves that are created or increased by appropriations of retained earnings and unrealised gains and losses on measuring assets at fair value through other comprehensive income in accordance with NZ IFRS 9; but

(ii) excluding—

(A) reserves that are earmarked for particular assets or particular categories of deposit taking activities; and

(B) reserves held on account of any assessed likelihood of loss; and

(C) revaluation reserves that may be included in tier 2 capital under clause 50(2)(d); and

(e) any interest, arising from the issue of ordinary shares to a third party by a subsidiary of the deposit taker that is a member of the capital group, that meets the requirements in clause 77; and

(f) any paid-up mutual capital instrument issued by the deposit taker that meet the requirements in subpart 5.

(3) In this clause, a **disclosed reserve** means a reserve disclosed in the deposit taker's financial statements.

Compare: BPR110 B1.2

Adjustments to tier 1 capital

39 Deduction of goodwill and other intangible assets

(1) Goodwill and other intangible assets must be deducted from tier 1 capital.

(2) A deduction under subclause (1) must include any goodwill included in the valuation of—

(a) a significant investment in the capital of another deposit taker or an insurance entity (or overseas equivalent); and

(b) a significant investment in the equity of an entity, other than a deposit taker or insurance entity, that is a financial service provider and is outside the capital group.

(3) The amount of goodwill to be deducted may be reduced by the value of any associated deferred tax liability that would be extinguished if the assets involved became impaired or derecognised under generally accepted accounting practice.

(4) In subclause (2), **significant investment** means an investment in the ordinary shares or mutual capital instruments of another entity that exceeds 10% of the issued ordinary shares or mutual capital instruments, as the case may be, of that entity.

Compare: BPR110 B1.3

40 Deduction of deferred tax assets

(1) Deferred tax assets must be deducted from tier 1 capital.

(2) The deduction under subclause (1) may be reduced by deferred tax liabilities if the deferred tax assets and liabilities—

(a) arise from deductible temporary differences determined in accordance with NZ IAS 12; and

(b) do not arise from the carry-forward of unused tax losses or tax credits; and

(c) relate to taxes levied by Inland Revenue; and

(d) may be offset under NZ IAS 12.

Compare: BPR110 B1.4

41 Deductions for funds management, securitisation, and insurance business

Amounts must be deducted from tier 1 capital as follows:

(a) any deduction required under clause 299(3)(a) (a credit enhancement provided to any associated funds management or securitisation SPV); and

(b) any deduction required under clause 301(2)(a) (a credit enhancement provided to any member of an affiliated insurance group); and

(c) any deduction required under clause 302(2) (funding provided to an affiliated insurance group); and

(d) any deduction required under clause 304 (aggregate funding provided to all affiliated insurance groups and associated funds management and securitisation SPVs).

Compare: BPR110 B1.5

42 Deduction of capital lending to related party

(1) Any lending of a capital nature to a related party must be deducted from tier 1 capital.

(2) Lending to a related party must be treated as being of a capital nature if it is—

(a) described as a capital or subordinated debt instrument in the related party's financial statements; or

(b) counted as capital under the capital adequacy requirements imposed by a prudential supervisor.

(3) In this clause, **related party** has the same meaning as in clause 4 of the Deposit Takers (Related Party Exposures) Standard 2027

Compare: BPR110 B1.6

43 Exclusion of fair value gains and losses

(1) Amounts must be excluded from the calculation of tier 1 capital as follows:

(a) any unrealised gain or loss that has resulted from a change in the fair value of liabilities due to a change in the creditworthiness of—

(i) a member of the capital group, for the purpose of the group capital ratio calculation; or

(ii) an entity within the scope of the solo capital ratio calculation, for the purpose of that calculation; and

(b) any fair value gain or loss relating to a financial instrument for which a fair value cannot reliably be calculated.

(2) Despite subclause (1)(b), a fair value loss arising from credit impairment on a loan, and recognised in retained earnings, must not be added back to tier 1 capital.

Compare: BPR110 B1.7

44 Deduction of cash flow hedge reserve

The reserves included in capital must be adjusted to remove 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).

Compare: BPR110 B1.8

45 Deduction of superannuation fund assets

(1) Any asset on the balance sheet arising from a defined benefit superannuation fund must be deducted from tier 1 capital.

(2) The amount to be deducted is the value of the asset net of any associated deferred tax liability that would be extinguished if the asset were to become impaired or derecognised under generally accepted accounting practice.

(3) Any liability on the balance sheet arising from a defined benefit superannuation fund must be fully recognised when calculating tier 1 capital.

Compare: BPR110 B1.9

46 Deduction for holdings of own shares or mutual capital instruments

(1) This clause applies to a holding of a deposit taker's own ordinary shares or mutual capital that has not been deducted from tier 1 capital in accordance with generally accepted accounting practice.

(2) The value of the holding must be deducted from tier 1 capital if—

(a) the deposit taker owns the ordinary shares or mutual capital instruments (as the case may be), whether directly or indirectly, regardless of whether they are held for trading or investment purposes; or

(b) terms of a contract provide that the deposit taker or a member of the capital group is or may be required to purchase the ordinary shares or mutual capital instruments (as the case may be).

Compare: BPR110 B1.10

47 Deduction for unrealised loss on securities

(1) An unrealised revaluation loss on a holding of securities must be deducted from tier 1 capital if—

(a) the book value of the securities exceeds their market value; and

(b) the resulting unrealised loss has not been recognised in the deposit taker's financial statements.

(2) The amount to be deducted is the full value of the difference between the book value and the market value.

Compare: BPR110 B1.11

48 Deduction for under-collateralised reverse mortgages

(1) A portion of the loan value of a reverse residential mortgage loan must be deducted from tier 1 capital if the loan value on the balance sheet exceeds the value of the security for the loan.

(2) The required deduction is the amount by which the loan value exceeds the value of the security.

Compare: BPR110 B1.12

49 Deduction of expected losses by deposit taker using internal models approach

A deposit taker that uses the internal models approach must deduct from tier 1 capital the amounts required by clause 122(1) and (2) of the internal models standard.

Compare: BPR110 B1.13

Tier 2 capital

50 Meaning of tier 2 capital

(1) In this standard, **tier 2 capital**, in relation to a deposit taker, means the total of the components in subclause (2) and (3), less any deductions required under the corresponding deductions approach set out in subpart 3.

(2) The components of tier 2 capital are—

(a) any instrument issued by the deposit taker, or an SPV of the deposit taker, that—

(i) is not included in tier 1 capital; and

(ii) meets the requirements in subpart 6, subject to subpart 7 in the case of a group 1 deposit taker; and

(iii) if issued by an SPV, meets the requirements in subpart 8; and

(b) any instrument that—

(i) is issued by a subsidiary of the deposit taker that is a member of the capital group; and

(ii) is held by a third party; and

(iii) meets the eligibility criteria in clause 79; and

(iv) is a portion recognised under clause 80; and

(c) any share premium from an instrument included in tier 2 capital under paragraph (a) or (b); and

(d) any revaluation reserve, comprising—

(i) reserves arising from a revaluation of tangible fixed assets (including owner-occupied property) and cumulative fair value gains on investment property, which have been subject to audit or review by the deposit taker's auditor; and

(ii) reserves arising from a revaluation of security holdings, with the value to be included in tier 2 capital being—

(A) the full value of any such reserves that have been incorporated into the accounts; and

(B) 45% of the value of any such reserves that have not been incorporated into the accounts.

(3) A deposit taker that uses the internal models approach may include in tier 2 capital the amount specified in clause 122(3) to (5) of the internal models standard.

(4) For the purposes of subclause (2)(d), cumulative losses below depreciated cost value on any individual property must not be netted against revaluation gains on other property.

Compare: BPR110 B3.2

51 Valuation of tier 2 instrument issued in foreign currency

A tier 2 instrument issued in a foreign currency must be valued at the spot exchange rate.

Subpart 3—Deductions from total capital for capital ratio calculations

Corresponding deductions approach

52 Relationship with subpart 2

If a deduction has been made from tier 1 capital under any of clauses 39 to 0, no deduction is required under this subpart in respect of the same instrument.

Compare: BPR110 C1.1

53 Corresponding deductions approach

(1) This clause sets out how a deposit taker must, in respect of an instrument held by a member of the capital group, make a corresponding deduction under this subpart (in this standard, the **corresponding deductions approach**).

(2) A deduction must be made from the category of capital for the instrument to which the deduction relates would qualify under subpart 2 if it were issued by a member of the capital group.

(3) If the amount of the deduction exceeds the total value of the category of capital from which it is to be deducted, the amount of the excess must be deducted from a higher quality category of capital.

(4) If the instrument of the entity in which the investment is made does not meet the requirements for tier 1 or tier 2 capital, the capital must be treated as ordinary shares for the purposes of making the deduction.

Compare: BPR110 C1.2

54 Reciprocal cross-holdings

A reciprocal cross-holding in the capital of a deposit taker or insurance entity (or overseas equivalent), or in the equity of another entity that is a financial service provider, must be deducted from capital using the corresponding deductions approach.

Compare: BPR110 C1.3

55 Total applicable investments exceeding 10% of tier 1 capital

(1) This clause applies to a deposit taker if its total applicable investments exceed 10% of the capital group's tier 1 capital.

(2) An amount must be deducted from tier 1 capital using the corresponding deductions approach.

(3) The deduction required is the amount by which the total applicable investments exceed 10% of the tier 1 capital, multiplied by the ratio between—

(a) the value of applicable investments that are in tier 1 capital; and

(b) the total value of applicable investments.

(4) In this clause, **applicable investments** means investments—

(a) in respect of which the capital group does not own more than 10% of the ordinary shares, or the mutual capital instruments, of the entity in which the investment is held; and

(b) that meet the requirements in clause 57.

Compare: BPR110 C1.4

56 Individual investments exceeding 10% and investments in related entities

(1) The amount of applicable investments must be deducted from the relevant category of capital using the corresponding deductions approach.

(2) In this clause, **applicable investments** means investments—

(a) in respect of which—

(i) the capital group owns more than 10% of the ordinary shares, or the mutual capital instruments, of the entity in which the investment is held; or

(ii) the entity is a related entity of any member of the capital group (or the deposit taker, for solo capital); and

(b) that meet the requirements in clause 57.

Compare: BPR110 C1.5

57 General requirements for deductions relating to investments

For the purposes of clauses 55(4)(b) and 56(2)(b), an investment—

(a) must be a holding of an instrument of an entity that is outside the capital group; and

(b) may be held directly, indirectly, or through an index; and

(c) must not arise from an underwriting position that is held for 5 days or less; and

(d) must be in—

(i) an instrument that can be used to meet capital requirements of a deposit taker or insurance entity (or overseas equivalent); or

(ii) the equity of another entity that is a financial service provider.

Compare: BPR110 C1.6

58 Investments in unconsolidated subsidiaries

The corresponding deductions approach must be applied to any investment that has not been deducted from capital under—

(a) a group capital ratio calculation, if the investment is in the ordinary share capital of a subsidiary of the deposit taker and the subsidiary has not been included in the scope of the calculation; or

(b) a solo capital ratio calculation, if the investment is in the ordinary share capital of a subsidiary of the deposit taker and the subsidiary has not been included in the scope of that calculation under clause 11.

Compare: BPR110 C1.7

Subpart 4—Requirements for ordinary shares to be tier 1 capital

59 General requirements for ordinary share to be tier 1 capital

The general requirements for an ordinary share to be tier 1 capital are that—

(a) the share must be classified as equity under generally accepted accounting practice; and

(b) only the paid-up amount of the share, irrevocably received by the deposit taker, may be included as tier 1 capital; and

(c) the share must be of a type that, after retained earnings and other reserves, takes the first and proportionately greatest share of any losses as they occur, and absorbs losses on a going-concern basis proportionately and pari passu with each other share of the same type; and

(d) the holder of the share must have full voting rights arising from the ownership of the share; and

(e) the share must represent the most subordinated claim in any liquidation of the deposit taker; and

(f) the holder of the share must be entitled to a claim on the residual assets of the deposit taker that is proportional to its share of issued capital, after all senior claims have been repaid in a liquidation; and

(g) the principal amount of the share must be perpetual; and

(h) the share must be non-redeemable (except it may be subject to discretionary acquisitions permitted by section 58 of the Companies Act 1993, if applicable, or the relevant incorporating legislation of the deposit taker); and

(i) no member of the capital group may create an expectation when the share is issued that it will be repaid or cancelled, and the contractual terms of the share must not provide any feature that may give rise to such an expectation; and

(j) the paid-up amount of the share, or any future payments related to the share, must not be guaranteed by any member of the capital group or a related entity, or be subject to any other arrangement that enhances the seniority of a claim under the share in a liquidation of the deposit taker.

Compare: BPR110 D1.2

60 Distribution requirements for ordinary shares to be tier 1 capital

The requirements, relating to distributions, for an ordinary share to be tier 1 capital are that—

(a) the amount that may be paid in distributions in relation to the share—

(i) must be paid out of distributable items, including retained earnings; and

(ii) must not be linked to the amount paid at issuance; and

(iii) must not be subject to a contractual cap (except to the extent that the deposit taker is unable to pay distributions that exceed the level of distributable items); and

(b) there must be no circumstances under which the distributions are obligatory and in all circumstances the deposit taker must be able to waive any distribution; and

(c) any waived distributions must not be cumulative; and

(d) non-payment of distributions must not be an event of default of the deposit taker or of any other member of the capital group; and

(e) the share must not have any preferential or predetermined right to distributions of capital or income.

Compare: BPR110 D1.3

61 Requirements relating to issue for ordinary shares to be tier 1 capital

(1) The requirements, relating to issue, for an ordinary share to be tier 1 capital are that—

(a) the share must be issued by the deposit taker and not by an SPV; and

(b) the share must not have been purchased, and the purchase must not have been funded (directly or indirectly) by—

(i) the deposit taker; or

(ii) an entity over which the deposit taker has significant influence.

(2) However, subclause (1) does not prevent—

(a) a holding entity of the deposit taker from purchasing the share; or

(b) the deposit taker undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the share.

Compare: BPR110 D1.4

Subpart 5—Requirements for mutual capital instruments to be tier 1 capital

62 General requirements for mutual capital instrument to be tier 1 capital

(1) The general requirements for a mutual capital instrument to be tier 1 capital are that—

(a) the instrument must be issued by a deposit taker that is a mutual entity; and

(b) the instrument must be classified as equity under generally accepted accounting practice; and

(c) only the paid-up amount of the instrument, irrevocably received by the deposit taker, may be included as tier 1 capital; and

(d) the holders of the instrument must have full voting rights arising from the ownership of the instrument however, a deposit taker's adoption of a rule providing for 1 vote for each member does not prevent the deposit taker from meeting this requirement; and

(e) the instrument must represent the same claim in any liquidation as an ordinary share; and

(f) in a liquidation of the deposit taker, if there are no surplus assets, the holders of the instrument must receive no return on their investment; and

(g) in a liquidation of the deposit taker, if there are surplus assets following the settlement of all senior claims, the holders of the instrument as a class and other members of the deposit taker as a class are each entitled to a proportionate share of surplus assets (expressed as a percentage), where the share of surplus assets allocated to holders as a class is calculated at the first issuance and then recalculated at each subsequent issuance or cancellation of the instrument (and each issuance or cancellation is represented as a time period, t) according to the formula in subclause (2); and

(h) the proportionate amount of surplus assets determined to be the entitlement of mutual capital instrument holders as a class (determined by multiplying surplus assets by $MCICP_t$, where t is the determination time immediately prior to liquidation) must then be shared among the holders, pro rata, based on the number of mutual capital instruments they each hold, unless the entitlement of each mutual capital instrument holder has been limited to the amount paid in by holders or an average principal amount per mutual capital instrument, and that is specified in the terms and conditions of the instrument; and

(i) the principal amount of the instrument must be perpetual; and

(j) the share must be non-redeemable (except that it may be subject to discretionary acquisitions permitted by section 58 of the Companies Act 1993 (if applicable), or the relevant incorporating legislation of the mutual entity); and

(k) no member of the capital group may create an expectation when the instrument is issued that it will be repaid or cancelled, and the contractual terms of the share must not provide any feature that may give rise to such an expectation; and

(l) the paid-up amount of the instrument, or any future payments related to the instrument, must not be guaranteed by any member of the capital group or a related entity, or be subject to any other arrangement that enhances the seniority of a claim under the instrument in a liquidation of the deposit taker; and

(m) the terms of the instrument must be governed by New Zealand law or by a permitted foreign law; and

(n) if one or more terms of an instrument is governed by a permitted foreign law, a signed foreign law opinion on the enforceability of the instrument must be provided in accordance with clause 86.

(2) For the purposes of subclause (1)(g), the formula is the following

$$MCICP_t = \frac{\text{new issuance amount}_t + (MCICP_{t-1} \times \text{total tier 1 capital}_t) - \text{cancellation share}_t}{\text{new issuance amount}_t + \text{total tier 1 capital}_t - \text{cancellation amount}_t}$$

where—

$MCICP_t$ is the proportion, expressed as a percentage, of total tier 1 capital (without disregarding any amounts per the definition below) at time t to reflect the contribution of mutual capital instrument holders to tier 1 capital

$MCICP_{t-1}$ is the proportion, expressed as a percentage, of total tier 1 capital (without disregarding any amounts per the definition of total tier 1 capital) calculated at the determination time immediately preceding t

total tier 1 capital is the amount of tier 1 capital at t, adjusted as necessary to disregard the impact of—

(i) any new issuance amount as a result of any new mutual capital instruments being issued at t:

(ii) any cancellation amount as a result of any mutual capital instrument being cancelled at t:

(iii) any mutual capital instrument held, as a result of treasury trading, by the deposit taker in its treasury function as at t, in each case having regard to the minimum capital requirements and accounting standards then applicable

cancellation share$_t$ is a dollar amount (which for the avoidance of doubt must be zero if no mutual capital instruments are being cancelled at 't') equal to:

$$(N \times Notional_t) + MCICP_{t-1}\,[\text{Cancellation Amount}_t - (N \times Notional_t)]$$

where—

N is the number of mutual capital instruments being cancelled at t

$Notional_t$ is the deemed notional contribution of each mutual capital instrument to tier 1 capital at t, calculated as follows:

$$\frac{\text{total tier 1 capital}_t \times MCICP_{t-1}}{\text{number of mutual capital instruments outstanding immediately prior to cancellation}}$$

(3) For the purposes of subclause (1)(m) and (n), the permitted foreign laws are the laws of New South Wales (Australia), Victoria (Australia), England, and New York.

Compare: BPR110 D1A.3

63 Distribution requirements for mutual capital instrument to be tier 1 capital

(1) The requirements, relating to distribution, for a mutual capital instrument to be tier 1 capital are that—

(a) the deposit taker must have an indicative discretionary distribution policy published separately to the terms of the instrument; and

(b) the amount that may be paid in distributions—

(i) must be paid out of distributable items, including retained earnings; and

(ii) must not be in any way linked to the amount paid when the instrument is issued; and

(iii) must not be subject to a contractual cap (except that the deposit taker is unable to pay distributions that exceed the level of distributable items); and

(c) there must be no circumstances under which the distributions are obligatory and in all circumstances the deposit taker must be able to waive any distribution; and

(d) any waived distributions must be non-cumulative; and

(e) non-payment of distributions must not be an event of default of the deposit taker or of any other member of the capital group; and

(f) the instrument must not have any preferential or predetermined right to distributions of capital or income.

Compare: BPR110 D1A.4

64 Requirements relating to issue for mutual capital instrument to be tier 1 capital

(1) The requirements, relating to issue, for a mutual capital instrument to be tier 1 capital are that—

(a) the instrument must be issued by the deposit taker and not by an SPV; and

(b) the instrument must not have been purchased, and the purchase must not have been funded (whether directly or indirectly) by—

(i) the deposit taker; or

(ii) an entity over which the deposit taker has significant influence.

(2) However, subclause (1) does not prevent—

(a) a holding entity of the deposit taker from purchasing the instrument; or

(b) the deposit taker undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the instrument.

Compare: BPR110 D1A.5

Subpart 6—Requirements for instruments to be tier 2 capital

65 Tier 2 capital

(1) An instrument must not be included in tier 2 capital unless the requirements in this subpart are met.

(2) However, a group 3 deposit taker may include perpetual preference shares as tier 2 capital.

(3) This clause is subject to subpart 7 in respect of a group 1 deposit taker.

Compare: BPR110 D3.1

66 General requirements for instrument to be tier 2 capital

(1) The general requirements for an instrument to be tier 2 capital are that—

(a) only the paid-up amount of the instrument, irrevocably received by the deposit taker, may be included as tier 2 capital; and

(b) claims of holders of the instrument must be subordinated to claims of depositors and general creditors of the deposit taker, and, accordingly,—

(i) if the deposit taker or any subsidiary of the deposit taker that has issued the instrument becomes subject to liquidation, claims of holders of the instrument must be subordinated to those of depositors and general creditors; and

(ii) before liquidation or the maturity date of the instrument, the deposit taker must be under no obligation to make payments of distributions or principal in the event that the deposit taker fails to satisfy the solvency requirement; and

(iii) a failure to make a payment of distributions or principal on the instrument because the deposit taker fails to meet the solvency requirement must not give rise to an event of default; and

(c) the paid-up amount of the instrument, or any future payment related to the instrument, must not be guaranteed by any member of the capital group or of any related entity, or be subject to any other arrangement that enhances the seniority of a claim under the instrument in a liquidation of the deposit taker; and

(d) the instrument must not be subject to netting or offset of claims on behalf of the holder of the instrument, except as required by law; and

(e) the terms of the instrument must be governed by New Zealand law or by a permitted foreign law; and

(f) if one or more terms of an instrument is governed by a permitted foreign law, a signed foreign law opinion on the enforceability of the instrument must be provided in accordance with clause 86.

(2) For the purposes of subclause (1)(b)(ii) and (iii), a deposit taker will satisfy the solvency requirement if the deposit taker—

(a) is solvent at the time that the relevant payment is due; and

(b) will remain solvent immediately after making the payment.

(3) For the purposes of (1)(e), the permitted foreign laws are the laws of New South Wales (Australia), Victoria (Australia), England and New York.

(4) In this clause, **solvent**, in relation to a deposit taker, means that the deposit taker satisfies the solvency test in section 4 of the Companies Act 1993, whether or not the deposit taker is a company for the purposes of that Act.

Compare: BPR110 D3.3

67 Tier 2 capital instrument must not have conversion or write-off feature

A tier 2 capital instrument—

(a) must not include any conversion feature that specifies circumstances in which a holder's interests in the instrument are replaced with interests in a different form of instrument; and

(b) must not confer any right on a holder to subscribe for new securities of the deposit taker, or to otherwise participate in the profits or property of the deposit taker, except by receiving payments as set out in the terms of the instrument; and

(c) must not include a write-off feature that specifies circumstances in which all of a holder's claims on the deposit taker arising from the instrument are irrevocably cancelled.

Compare: BPR110 D3.4

68 Redemption or call dates

(1) A tier 2 capital instrument must have a minimum original maturity date that is not earlier than 5 years after issue.

(2) A tier 2 capital instrument may provide—

(a) that it is callable or redeemable before maturity at the initiative of the deposit taker on a date that is not earlier than 5 years after the date on which the deposit taker irrevocably receives payment for the instrument:

(b) for 1 or more calls or redemptions that meet the requirements in paragraph (a):

(c) for the deposit taker to have a right to call or redeem the instrument as a result of a tax or regulatory event (including during the first 5 years of the instrument).

(3) However, a provision described in subclause (2)(c) must be drafted so that its effect is that early call or redemption is permitted only if—

(a) the tax or regulatory event could not reasonably have been anticipated at the time that the instrument was issued; or

(b) the tax or regulatory event is more than minor.

(4) A tier 2 capital instrument—

(a) must provide that the deposit taker is required to receive written approval of the Bank to make any repayment of principal before maturity (*see* clause 92); and

(b) must not include any feature that might give rise to an expectation that the instrument will be repaid prior to maturity.

(5) If a deposit taker issues a call notice before redeeming a tier 2 instrument, the deposit taker may continue to recognise the instrument as capital for the purposes of minimum capital requirements until it is redeemed.

(6) However, subclause (5) does not apply if, on issuing the call notice, the deposit taker becomes subject to an unconditional, unsubordinated obligation to redeem the instrument on the redemption date.

Compare: BPR110 D3.5; BPR120 C2.2 guidance

69 Amortisation of eligible amount of tier 2 capital instrument

The amount of a tier 2 capital instrument that may be recognised in capital ratio calculations during the final 4 years to maturity must be amortised so that the percentage recognised is,—

(a) if there is more than 3 years to maturity but not more than 4 years, 80%:

(b) if there is more than 2 years to maturity but not more than 3 years, 60%:

(c) if there is more than 1 year to maturity but not more than 2 years, 40%:

(d) if there is 1 year or less to maturity, 20%.

Compare: BPR110 D3.6

70 No step-ups or incentives to redeem

(1) A tier 2 capital instrument must provide for the dividend or interest rate to be fixed for the entire term of the instrument and must not provide for the rate to be altered or reviewed.

(2) Despite subclause (1), a tier 2 capital instrument may expressly allow—

(a) the dividend or interest payment to be cancelled, in whole or part; or

(b) a variable interest rate if the variable rate and the formula for setting the rate is fixed for the term of the debt when the instrument is issued.

(3) A tier 2 capital instrument must not contain an incentive to redeem except the following:

(a) the inclusion of a zero floor on the dividend or interest rate, so long as there is no zero-floor applied to the benchmark rate:

(b) a conversion from a fixed rate to a floating rate (or vice versa) on an optional call date without any increase in credit spread:

(c) a fixed rate being reset on an optional call date at a new fixed rate, provided that—

(i) the new rate is a benchmark rate on that date applicable to the period over which the new rate will apply, plus a margin; and

(ii) there is no change in the margin above the benchmark rate:

(d) a rate being reset to a fallback benchmark rate, provided that—

(i) the reset is triggered through the operation of contractual fallback provisions that apply if the original benchmark becomes unavailable; and

(ii) such provisions are designed, so far as possible, to produce a genuinely equivalent interest rate that does not result in a step-up in the margin over prevailing wholesale market rates.

(4) Despite subclause (2), an instrument is not a tier 2 instrument if a member of the capital group does anything that creates an expectation that a call will be exercised.

(5) In this clause, **incentive to redeem** includes—

(a) a change in the margin; or

(b) conversion from a fixed rate to a floating rate that is calculated as a benchmark rate plus a margin, if there is an increase in the margin relative to that implied for the fixed rate.

Compare: BPR110 D3.7

71 Distributions

A tier 2 capital instrument must not have a credit-sensitive distribution feature.

Compare: BPR110 D3.8

72 Other requirements for tier 2 instruments

(1) A tier 2 capital instrument must meet the following requirements:

(a) the holder of the instrument must have no rights to accelerate the repayment of future scheduled payments (whether coupon or principal), except in the event of the liquidation of the issuer:

(b) neither the deposit taker nor an entity over which the deposit taker has significant influence (including an SPV) may purchase the instrument, nor directly or indirectly fund the purchase of the instrument:

(c) the instrument must not have any terms that restrict the bank in any way from issuing, or otherwise dealing with, securities ranking junior, equal, or senior to the instrument.

(2) However, subclause (1) does not prevent—

(a) a holding entity of the deposit taker from purchasing the instrument; or

(b) the deposit taker undertaking full recourse lending to a borrower to fund the purchase of a well-diversified portfolio that may include the instrument.

(3) Subclause (1)(b) is subject to clause 73.

Compare: BPR110 D3.9

73 Exception regarding purchase of instrument

(1) Clause 72(1)(b) does not prevent a tier 2 capital instrument from being purchased by—

(a) a subsidiary of the deposit taker in its capacity as custodian for a discretionary investment management service provided by the deposit taker; or

(b) a supervisor for a managed investment scheme in respect of which a subsidiary of the deposit taker is the manager, acting as the purchaser of the instrument.

(2) Subclause (1) applies only if—

(a) third parties bear the risk and rewards associated with the investment in the instrument; and

(b) the purchase of the instrument was not funded by the deposit taker; and

(c) the decision to purchase the instrument was made independently of the deposit taker in its role as issuer and in the interests of the third parties who ultimately bear the risk and reward of the investment in the instrument.

Compare: BPR110 D3.9 guidance

Subpart 7—Requirements for instruments to be tier 2 capital: group 1 deposit takers

74 Tier 2 capital for group 1 deposit taker

[An instrument must not be included in tier 2 capital for a group 1 deposit taker unless the following requirements are met:

(a) the requirements in subpart 6, except for clauses XX, XX etc; and

(b) the requirements in this subpart.]

Subpart 8—Recognition in capital of minority interests and capital issued by SPVs

75 Capital issued to third party by subsidiary of deposit taker

(1) This clause applies if capital that meets the requirements for tier 1 or tier 2 capital is issued to a third party by a subsidiary of the deposit taker that is a member of the capital group.

(2) The capital and any interests arising from an instrument that is part of the capital may, if the requirements in this subpart are met, be used as capital for the purpose of calculating the capital ratios for the deposit taker's capital group.

(3) This subpart does not apply to the calculation of a deposit taker's solo capital ratio.

(4) This clause is subject to clause 76.

Compare: BPR110 E1.1.1, E1.1.2

76 Particular requirement if subsidiary is not deposit taker

(1) This clause applies if a subsidiary that issues capital as described in clause 75(1) is not a deposit taker.

(2) Calculations required for the purposes of this subpart must be undertaken as if the subsidiary were a deposit taker.

Compare: BPR110 E1.1.4, E1.1.5

77 Tier 1 capital: eligibility

(1) The requirements in subclause (2) must be met for minority interests arising from the issue of ordinary shares or mutual capital instruments to third-party investors by a subsidiary of the deposit taker that is a member of the capital group, and any associated retained earnings and reserves attributable to such investors, to be tier 1 capital of the capital group.

(2) The requirements are as follows:

(a) the subsidiary must be a deposit taker; and

(b) the instrument, retained earnings, or reserves attributable to the third-party investors would meet the criteria for tier 1 capital set out in clause 59(a), (c), (d), or (f).

Compare: BPR110 E1.2

78 Tier 1 capital: portion recognised

(1) The amount of minority interests that may be used as tier 1 capital of the capital group is the total capital attributable to minority shareholders that meets the requirements in clause 77, after—

(a) making the adjustments in clauses 39 to 0 that are attributable to the third parties; and

(b) subtracting the surplus tier 1 capital of the subsidiary attributable to minority shareholders, calculated in accordance with subclause (2).

(2) The surplus tier 1 capital of the subsidiary attributable to minority shareholders is calculated as the total surplus tier 1 capital of the subsidiary, calculated in accordance with subclause (3), multiplied by the percentage of the tier 1 capital of the subsidiary attributable to the minority shareholders.

(3) The total surplus tier 1 capital of the subsidiary is calculated as the tier 1 capital of the subsidiary after—

(a) making the adjustments in clauses 39 to 0; and

(b) subtracting the effective tier 1 capital requirement of the subsidiary, calculated in accordance with subclause (4).

(4) The effective tier 1 capital requirement of the subsidiary is calculated as the sum of the tier 1 capital requirement in clause 13(1) and the combined buffer (as defined in clause 17(3)), multiplied by the lesser of—

(a) the subsidiary's RWA equivalents:

(b) the RWA equivalents, in respect of the capital group, that relate to the subsidiary.

Compare: BPR110 E1.3

79 Tier 2 capital: eligibility

An instrument issued by a subsidiary of the deposit taker that is a member of the capital group and held by a third party may be included in tier 2 capital if it meets the requirements for—

(a) ordinary shares set out in subpart 4; or

(b) mutual capital instruments set out in subpart 5; or

(c) tier 2 capital instruments set out in clause 50.

Compare: BPR110 E1.6

80 Tier 2 capital: portion recognised

(1) The amount of capital that may be tier 2 capital of a deposit taker's capital group under this subpart is the total capital attributable to third parties that meets the criteria in clause 79 after—

(a) making the adjustments in clauses 39 to 0 and subpart 3 that are attributable to the third parties, as if they relate to tier 2 capital; and

(b) subtracting the surplus total capital of the subsidiary attributable to third party investors, calculated in accordance with subclauses (3) to (5).

(2) However, the portion recognised must exclude amounts recognised as tier 1 capital under clause 78.

(3) The surplus total capital of the subsidiary attributable to third party investors is calculated as the total surplus total capital of the subsidiary, calculated in accordance with subclause (4), multiplied by the percentage of total capital of the subsidiary attributable to third party investors or minority shareholders.

(4) The total surplus total capital of the subsidiary is calculated as the total capital of the subsidiary after—

(a) making the adjustments specified in clauses 39 to 0 and subpart 3 as if they relate to tier 2 capital; and

(b) subtracting the effective total capital requirement of the subsidiary, calculated in accordance with subclause (5).

(5) The effective total capital requirement of the subsidiary is calculated as the sum of the combined capital requirement in clause 14(1) and the combined buffer (as defined in clause 17(3)), multiplied by the lesser of—

(a) the subsidiary's RWA equivalents:

(b) the RWA equivalents, for the capital group, that relate to the subsidiary.

Compare: BPR110 E1.7

Subpart 9—Eligibility of capital instruments issued by SPV

81 Requirements for instruments issued by SPV to be used for minimum capital requirements

A tier 1 or 2 instrument issued under an arrangement that involves an SPV, whether as the purchaser or the issuer of the instrument, must not be used to meet minimum capital requirements unless—

(a) the SPV is required to be fully consolidated with the deposit taker for the purposes of group financial statements under generally accepted accounting practice; and

(b) the deposit taker issues an instrument to the SPV, the terms and conditions of that instrument matching, in all material respects, the terms and conditions of the instrument issued by the SPV to third-party investors; and

(c) the instrument issued by the deposit taker to the SPV meets the requirements for classification as tier 2 capital in clause 50(2)(a); and

(d) the instrument issued by the SPV would, if issued by the deposit taker, meet the requirements for classification as tier 2 capital in clause 50(2)(a); and

(e) the proceeds from the issue of the instrument by the SPV are immediately and directly invested in, and available without limitation to, the deposit taker; and

(f) the amount of capital, issued by a subsidiary to third parties, that may be included in tier 1 or total capital is determined in accordance with subpart 8, and if the subsidiary issues capital through an SPV, the requirements of this subpart must be met as if the subsidiary were the deposit taker.

Compare: BPR110 E2.1

82 Exclusion of ordinary shares

Ordinary shares issued under an arrangement that involves an SPV may not be included in tier 1 capital.

Compare: BPR110 E2.2

83 Exclusion of mutual capital instruments

Mutual capital instruments issued under an arrangement that involves an SPV may not be included in tier 1 capital.

Compare: BPR110 E2.3

Part 4
New capital and changes in capital

Subpart 1—Issue of new capital instrument to be used for capital requirements

84 Deposit taker must notify Bank of new instrument to be used for capital requirements

(1) A deposit taker must notify the Bank of its intention to issue a new instrument (a **new instrument**) that, for the purpose of meeting its minimum capital requirements, it intends to use as—

(a) tier 2 capital; or

(b) a mutual capital instrument.

(2) A deposit taker must not use the amount of a new instrument for the purpose of meeting its minimum capital requirements unless it has notified the Bank by a notice that complies with clause 85.

Compare: BPR120 B1.2.1

85 Requirements for new instrument notice

A notice required by clause 84 must—

(a) be in writing; and

(b) be accompanied by the documents required by clause 86; and

(c) be accompanied by the additional documents and other information required by clauses 87 to 90, as applicable; and

(d) be given to the Bank at least 5 working days before the issue date of the instrument.

Compare: BPR120 B1.2.2, B1.2.3

86 Documents required for new instrument notice

(1) A new instrument notice required under clause 84 must be accompanied by—

(a) a copy of the term sheet for the new instrument (if any):

(b) a signed opinion from a New Zealand law firm using the standard wording set out in Schedule 2:

(c) copies of the constituting documents for the new instrument that are listed in the opinion required under paragraph (b):

(d) a document providing evidence of compliance with this subpart in respect of the new instrument including, for that purpose, references to the relevant provisions of the constituting documents referred to in paragraph (c):

(e) a signed foreign law opinion in accordance with subclause (3), if 1 or more of the terms of the new instrument is governed by a permitted foreign law referred to in clause 62(3) or 66(3).

(2) Completion of a relevant checklist made available by the Bank for the purposes of subclause (1)(d) is sufficient compliance with that paragraph.

(3) For the purposes of subclause (1)(e),—

(a) the opinion must confirm that the permitted foreign law will not override New Zealand law; and

(b) the opinion must state whether there are any known impediments in the relevant jurisdiction (including issues of conflict of laws) that could affect the terms of the new instrument having effect as intended; and

(c) the Bank must approve the deposit taker's reliance on the opinion.

(4) When deciding whether to approve a deposit taker's reliance on an opinion under subclause (3)(c), the Bank must be satisfied that the law firm providing the opinion has sufficient experience and expertise in the area of law, and in the law of the jurisdiction, to which the opinion relates.

Compare: BPR120 B1.3

87 Additional information required: tier 2 capital instrument issued in foreign currency

(1) This clause applies to a new instrument notice for a capital instrument, to be used as tier 2 capital, that will be denominated in a foreign currency.

(2) The new instrument notice must be accompanied by the following information:

(a) a statement of the deposit taker's intended accounting treatment of the instrument and any associated swaps or other associated hedging instruments; and

(b) forecasts of the deposit taker's capital ratios, on a quarterly basis over the next 2 years, that demonstrate the sensitivity of the value of capital used to meet minimum capital requirements to fluctuations in currency values, including—

(i) a reverse stress test showing how far the exchange rate needs to change in value before the distribution restriction in clause 21(3)(b) applies to the deposit taker; and

(ii) a forecast of capital ratios based on expected changes in the exchange rate.

Compare: BPR120 B1.4

88 Additional information required: mutual capital instrument issued in foreign currency

(1) This clause applies to a new instrument notice for a mutual capital instrument, to be used to meet minimum capital requirements, that will be denominated in a foreign currency.

(2) The new instrument notice must be accompanied by the following information:

(a) a statement of the deposit taker's intended accounting treatment of the instrument and any associated swaps or other associated hedging instruments; and

(b) if the deposit taker uses hedges to smooth its future dividend payments in a foreign currency, information to demonstrate how capital values respond to gains and losses on the hedges.

89 Additional information required: capital instrument issued to related entity

(1) This clause applies to a new instrument notice for an instrument that a deposit taker intends to issue to a related entity.

(2) The new instrument notice must be accompanied by information on any related transaction to show the ultimate source of funding for the instrument.

Compare: BPR120 B1.5

90 Additional information required: new instrument issued by SPV

(1) This clause applies to a new instrument notice for an instrument, to be used as tier 2 capital, that a deposit taker intends to issue by an SPV.

(2) The new instrument notice must be accompanied by, in relation to the SPV, the information required under clause 85 in respect of—

(a) the new instrument to be issued by the SPV; and

(b) the required matching instrument issued by the deposit taker to the SPV, as if that instrument were itself subject to the new instrument notice requirements (*see* clause 81(b)).

Compare: BPR120 B1.6

Subpart 2—Capital transactions and changes

Reduction in tier 1 capital

91 Deposit taker must notify Bank if tier 1 capital reduces by more than 10% over last 12 months

(1) A deposit taker must notify the Bank in writing if—

(a) the deposit taker makes a return of tier 1 capital by doing any of the following:

(i) paying a dividend (other than a distribution to the customers of a mutual entity that the entity is contractually obliged to make):

(ii) repurchasing ordinary shares:

(iii) making any other capital return in respect of tier 1 capital; and

(b) as a result, the amount of the deposit taker's tier 1 capital is reduced by more than 10% compared to the date that is 12 months before the return of capital.

(2) A notice required under subclause (1) must given be to the Bank—

(a) at least 5 working days before the payment is made; or

(b) if the payment is made in instalments, at least 5 working days before the instalment that causes the 10% threshold to be exceeded.

Compare: BPR120 C1.1, C1.3

Restriction on redemption of capital instruments

92 Redemption of tier 2 capital restricted

(1) A deposit taker may not redeem a tier 2 capital instrument before maturity unless, before making the redemption,—

(a) the deposit taker applies for approval in accordance with clause 95; and

(b) the Bank approves the redemption under subclause (2).

(2) When deciding whether to approve a redemption before maturity, the Bank must be satisfied that,——

(a) before, or concurrent with, the redemption, the deposit taker replaced or will replace (as the case may be) the redeemed instrument with a paid-up capital instrument that,—

(i) is of the same or better quality and contributes at least the same amount of capital to meeting the minimum capital requirements applying to the deposit taker at the time; and

(ii) has terms and conditions that are sustainable for the income capacity of the capital group; or

(b) after the redemption, the capital group's ratios and combined buffer ratio would be sufficiently above their respective minimums; or

(c) the redemption results from a potential change in tax or other relevant regulatory law (including its interpretation), other than a potential change that—

(i) could reasonably have been anticipated by the deposit taker at the time that it issued the instrument; or

(ii) is minor or not applicable.

(3) For the purposes of subclause (2)(a), the replacement of a redeemed instrument is concurrent with the redemption if it is issued on the same day as the redemption.

(4) In subclause (2)(b), **sufficiently above** means above the ratio—

(a) at redemption; and

(b) for at least 1 year after redemption.

(5) For the purposes of subclause (2)(c)(i), a potential change in law could reasonably have been anticipated if, at the time the instrument was issued, there was a clearly defined and communicated policy intent to make the change.

Compare: BPR120 C2.2

93 Purchases of own capital

(1) No member of a deposit taker's capital group may purchase tier 2 capital if—

(a) the instrument was previously issued by the capital group; and

(b) the purchase would result in the capital group owning a position of more than 5% of the total outstanding value of the instruments issued as tier 2 capital instruments by the capital group.

(2) Subclause (1) does not apply if—

(a) the Bank has given prior written approval for the transaction; or

(b) the transaction is a redemption or payment on maturity under the terms of the contract.

(3) When deciding whether to approve a transaction under this clause, the Bank must be satisfied that the transaction does not adversely affect the safety and soundness of the deposit taker.

Compare: BPR120 C2.3

94 Funding of own capital

(1) No member of a deposit taker's capital group may fund, whether directly or indirectly, the purchase of an instrument if—

(a) the instrument has been issued as tier 2 capital or a mutual capital instrument for the capital group; and

(b) the funding would result in the capital group being the ultimate source of funds for more than 5% of the total amount of the instruments issued as tier 2 capital and mutual instruments by the capital group.

(2) However, subclause (1) does not apply if—

(a) the Bank has given prior written approval for the transaction; or

(b) the funding is lending by the deposit taker to a customer to fund the purchase of a diversified portfolio.

(3) When deciding whether to approve a transaction under this clause, the Bank must be satisfied that the transaction does not adversely affect the safety and soundness of the deposit taker.

Compare: BPR120 C2.4

95 Application for approval of redemption

A deposit taker's application for approval of a redemption under clause 92(1)(a) must—

(a) be in writing to the deposit taker's Bank supervisor; and

(b) contain the following documents and information:

(i) the key identifying features of the instrument to be redeemed:

(ii) the proposed date of redemption:

(iii) if the instrument is to be replaced, the documents and information set out in clause 96:

(iv) if the instrument is not to be replaced, the information set out in clause 97:

(v) any other information required by the Bank.

Compare: BPR120 C3.1

96 Additional documents and information if instrument to be replaced

(1) This clause applies if a deposit taker intends to replace a capital instrument on its redemption.

(2) The deposit taker's application under clause 95 must contain the following documents and information:

(a) in relation to the replacement instrument, the legal opinion and documentation required under clause 86:

(b) in relation to the instrument to be redeemed, details of—

(i) the interest or dividend rate that applies before redemption; and

(ii) the expected interest or dividend rate if it were not redeemed:

(c) if the replacement instrument is of a different tier from the instrument to be redeemed—

(i) projections of the deposit taker's tier 1 capital ratio, combined capital ratio, and combined buffer ratio—

(A) from the date of redemption; and

(B) for the 4 quarter ends following redemption of the instrument; and

(ii) a list of the assumptions underpinning the projections.

Compare: BPR120 C3.2

97 Additional information if instrument not to be replaced

(1) This clause applies if a deposit taker does not intend to replace a capital instrument on its redemption.

(2) The deposit taker's application under clause 95 must contain the following information:

(a) a statement of the rationale for not replacing the instrument:

(b) projections of the deposit taking group's tier 1 capital ratio, combined capital ratio, and combined buffer ratio—

(i) from the date of redemption; and

(ii) for the 4 quarter ends following redemption of the instrument:

(c) a list of the assumptions underpinning the projections.

Compare: BPR120 C3.3

Change in terms of capital instrument

98 Deposit taker must notify Bank of amendment to terms of instrument used for capital requirements

(1) A deposit taker must notify the Bank of its intention to amend the terms of an instrument (an **amended instrument**) that, for the purpose of meeting its minimum capital requirements, it uses as—

(a) tier 2 capital; or

(b) a mutual capital instrument.

(2) A deposit taker must not use the amount of an amended instrument for the purpose of meeting its minimum capital requirements unless it has notified the Bank by a notice (an **amended instrument notice**) that complies with clause 99.

Compare: BPR120 C2.5.1

99 Requirements for amended instrument notice

An amended instrument notice must be in writing and must be accompanied by—

(a) a signed opinion from a New Zealand law firm using the standard wording set out in Schedule 3:

(b) copies of the constituting documents for the amended instrument and the amending documents that are listed in the opinion required under paragraph (a).

Compare: BPR120 C2.5.2

Part 5
Total credit risk RWA

Subpart 1—General provisions

All deposit takers

100 Calculation of total credit risk RWA

(1) Total credit risk RWA for a deposit taker is the total of credit risk RWAs calculated under this Part.

(2) This clause is subject to clauses 104 to 107 in respect of an internal models deposit taker.

Compare BPR130 A1.2, B1.1

101 Scope of calculation

A deposit taker must calculate credit risk RWAs in relation to any item that is—

(a) a credit exposure on the balance sheet; or

(b) a credit exposure that arises from business carried on by a member of the capital group; or

(c) any other asset on the balance sheet not described in paragraph (a) or (b).

Compare: BPR130 A1.3.2

102 Exclusions from credit risk RWA calculations

(1) A deposit taker may recognise credit risk mitigation held against any credit risk exposure by adjusting the RWA calculation in accordance with this Part and Part 6.

(2) A deposit taker that has a loan, or commitment to lend, that is a clean transfer may exclude the corresponding credit risk exposure from the calculation of credit risk RWAs (*see* subpart 4 of Part 9).

Compare: BPR130 A1.3.2, A1.3.3

103 Credit risk RWA overlay

(1) A condition of a deposit taker's licence may specify, as a **credit risk RWA overlay,** either or both of the following:

(a) a percentage by which total credit risk RWA under clause 100 must be increased:

(b) a percentage by which a component, required under this Part or the internal models standard to calculate credit risk RWA, must be increased.

(2) The Bank, when deciding whether to specify a condition under subclause (1), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

Internal models deposit taker

104 Calculation of total credit risk RWA for internal models deposit taker

Total credit risk RWA for an internal models deposit taker is the total of—

(a) the greater of the following:

(i) 1.2 multiplied by credit risk RWAs calculated under clause 105(1):

(ii) 0.85 multiplied by standardised equivalent RWAs calculated under clause 107; and

(b) credit risk RWAs calculated using the standardised approach on all credit and other exposures calculated under clause 105(2).

Compare: BPR130 C1.4.4

105 Components of credit risk RWA calculation

(1) An internal models deposit taker must use the internal models approach to—

(a) calculate credit risk RWA for any exposure that falls within a modelled exposure class (*see* clause 106(2)) and for which the deposit taker has been approved to use the internal models approach; and

(b) recognise the benefit of any type of credit risk mitigation that applies to the calculation of credit risk RWA for the exposure.

(2) An internal models deposit taker must use the standardised approach to calculate credit risk RWAs for the following exposures:

(a) any credit, or other, exposure that falls within a non-modelled exposure class (*see* clause 106(3)):

(b) any credit exposure that falls within a modelled exposure class but for which the deposit taker has not been approved to use the internal models approach:

(c) any credit exposure—

(i) that falls within a modelled exposure class and for which the deposit taker has been approved to use the internal models approach; but

(ii) for which the deposit taker intends to recognise the benefit of a guarantee, indemnity, or credit derivative, provided by a credit protection provider, that is not a modelled exposure for the deposit taker.

(3) A deposit taker may recognise credit risk mitigation that it holds against any credit risk exposure in subclause (2) by adjusting the RWA calculation in accordance with Part 6.

Compare: BPR130 C1.2

106 Categorising exposure classes

(1) An internal models deposit taker must categorise credit exposures and other assets referred to in clause 101 as follows:

(a) corporate:

(b) retail, excluding reverse RMLs:

(c) farm lending:

(d) SME lending.

(e) sovereign:

(f) bank:

(g) equity:

(h) reverse RMLs:

(i) community housing providers:

(j) other.

(2) The exposure classes in subclause (1)(a) to (d) are each a **modelled exposure class**.

(3) The exposure classes in subclause (1)(e) to (j) are each a **non-modelled exposure class**.

(4) The exposure classes listed in subclause (1) have the meanings set out in the internal models standard.

Compare: BPR130 C1.5

107 Calculating standardised equivalents

(1) An internal models deposit taker must use the standardised approach to calculate the standardised equivalent of credit risk RWA for each credit or other exposure calculated under clause 105(1).

(2) However, a deposit taker may recognise credit risk mitigation that it holds against any credit risk exposure by adjusting the RWA calculation in accordance with Part 6.

(3) The requirements in this clause are in addition to the requirements in clause 105.

Compare: BPR130 C1.3

Subpart 2—Calculation of credit risk RWAs under standardised approach

Components of credit risk RWA calculation

108 Components of total credit risk RWA calculation

A deposit taker must, under the standardised approach, calculate total credit risk RWA as the total of the following amounts:

(a) risk-weighted credit exposures across all borrowers and counterparties, in accordance with clause 110:

(b) RWAs for all other assets on the balance sheet in accordance with clause 111:

(c) the RWA equivalent of the credit valuation adjustment capital charge, in accordance with clause 112:

(d) RWAs arising from trades settled on central counterparties, other than exposures to counterparties described in paragraph (a), in accordance with clause 113.

Compare: BPR131 A1.4

109 Deductions and exclusions

(1) A deposit taker must, when calculating total credit risk RWA, deduct—

(a) any item or portion of an item required to be deducted from capital under Part 3; and

(b) any impairment allowances attributable to the exposure.

(2) Subclause (3) applies if a net, unrealised, gain on a foreign exchange contract or an interest rate contract has been transferred to retained earnings through the statement of profit and loss.

(3) The corresponding balance sheet asset must be excluded when calculating total credit risk RWA in relation to the exposure to avoid double counting.

Compare: BPR130 A1.3.4; BPR131 A1.3

110 Risk-weighted credit exposures across all borrowers and counterparties

(1) A deposit taker must calculate risk-weighted credit exposures across all borrowers and counterparties by adding together the amounts resulting from following the steps in subclause (2).

(2) The deposit taker must, in respect of each borrower or counterparty,—

(a) allocate each borrower or counterparty that gives rise to an on- or off-balance-sheet claim to the relevant exposure class; and

(b) for any exposure other than a residential mortgage loan (**RML**), allocate a standardised rating grade to the exposure (*see* subpart 3); and

(c) determine the applicable risk weight for the exposure according to—

(i) the exposure class and rating grade (*see* subpart 4); or

(ii) in the case of an RML, the classification, loan-to-value ratio, and lender's mortgage insurance conditions (*see* subpart 5); and

(d) calculate any on-balance-sheet exposure amount for a borrower after deduction in accordance with clause 109(b); and

(e) for any off-balance-sheet exposure arising from a transaction of a type listed in clause 162(2), calculate the credit equivalent amount according to clauses 161 and 162 to identify which entity determines the applicable risk weight; and

(f) calculate the credit equivalent amount for any counterparty credit risk arising from a derivative or securities financing transaction with the counterparty (*see* subpart 7); and

(g) calculate the total risk-weighted exposure for each borrower or counterparty, by multiplying the risk-weight, determined under paragraph (c), by the sum of the on-balance-sheet amounts and off-balance-sheet credit equivalent amounts for that borrower or counterparty, determined under paragraphs (d) to (f); and

(h) if credit risk mitigation is in place on an exposure to a borrower or counterparty, apply any allowable adjustments to the risk-weight, the exposure amount, or both (as the case may be), in the calculation in paragraph (g), in accordance with Part 6.

Compare: BPR131 A1.5

111 RWAs for all other assets

(1) A deposit taker must calculate RWAs for assets on the balance sheet, that are not referred to in clause 110, in accordance with subclause (2).

(2) The deposit taker must—

(a) allocate each asset to 1 of the following categories:

(i) currency, gold, and cash items under clause 125:

(ii) equity holdings under clauses 137 and 138:

(iii) fixed assets under clause 139:

(iv) leased assets under clause 140:

(v) exposures arising for the deposit taker as lessor under clause 141:

(vi) other assets under clause 147; and

(b) multiply the amount in each category by the risk weight indicated in the applicable clause.

Compare: BPR131 A1.6

112 RWA for credit valuation adjustment capital charge

A deposit taker must calculate the RWA equivalent of the credit valuation adjustment capital charge according to the following formula:

$$12.5 \times K$$

where K is the credit valuation adjustment capital charge calculated under subpart 8.

Compare: BPR131 A1.7

113 RWAs from trades settled on central counterparties

(1) A deposit taker using the standardised approach must calculate RWAs arising from trades settled on central counterparties, other than exposures referred to in clause 110, as the total of the following amounts:

(a) if the deposit taker is a clearing member of a qualifying central counterparty (**QCCP**) clearing its own trades, the risk-weighted exposure calculated in accordance with clause 181:

(b) if the deposit taker is a non-member transacting with a QCCP using a clearing member as intermediary, the risk-weighted exposure calculated using the applicable method specified in clause 182:

(c) if the deposit taker is a clearing member of a QCCP acting for a client, the risk-weighted exposure calculated in accordance with clause 183:

(d) if the deposit taker has posted assets as collateral, as a clearing member of a QCCP or as a client of a clearing member, the risk-weighted exposure amount calculated in accordance with clause 184:

(e) for any trade settled through a central counterparty that is not a QCCP, a credit risk exposure calculated in accordance with clause 185(1) and (2), following the treatment for a non-centrally cleared bilateral trade, with the risk weight determined under clause 110(c) and the credit equivalent amount calculated under clause 110(f):

(f) if the deposit taker has contributed to a default fund of a central counterparty that is not a QCCP, a risk-weighted exposure calculated in accordance with clause 185(3).

(2) A deposit taker using the internal models approach must calculate RWAs arising from trades settled on central counterparties, other than exposures referred to in clause 110, in accordance with subclause (1).

(3) Subclause (2) does not apply to any—

(a) trade involving a trade exposure that subpart 9 specifies must be risk-weighted using the deposit taker's approach applicable to a bilateral exposure to the counterparty; or

(b) trade that is a modelled exposure for the deposit taker.

Compare: BPR131 A1.8

Subpart 3—Standardised rating grades

114 Overview

This subpart sets how a deposit taker must determine the standardised rating grades for risk-weighting exposures to credit risk under subpart 4.

Compare: BPR131 B1.1

Credit ratings

115 Rating agency credit rating

A credit rating that a deposit taker uses to determine a rating grade must be from 1 of the following agencies:

(a) Standard & Poor's:

(b) Moody's Investors Service:

(c) Fitch Ratings:

(d) AM Best, but only for risk-weighting credit risk exposures to New Zealand licensed insurers.

Compare: BPR131 B1.2

116 Credit rating must have been solicited and certain payment requirements apply

(1) A credit rating used to determine a rating grade must have been—

(a) solicited from the rating agency; and

(b) paid for by the entity giving rise to the credit exposure or a person with whom the entity enters into commercial arrangements.

(2) This clause does not apply to determining a rating grade for a sovereign (*see* clause 126).

Compare: BPR131 B1.3

117 Issue-specific credit rating

(1) This clause applies if—

(a) a deposit taker has a claim on a borrower in the form of a holding in a specific debt issue made by the borrower; and

(b) the debt issue has an issue-specific credit rating from a rating agency.

(2) The deposit taker must determine the rating grade for the claim using the issue-specific credit rating referred to in subclause (1)(b).

(3) If a debt issue has issue-specific credit ratings from 2 or more rating agencies, all the ratings apply to determining the rating grade, which must be determined in accordance with clause 119.

Compare: BPR131 B1.4

118 Inferred ratings

(1) This clause applies if a deposit taker has a claim that does not meet the requirements of clause 117(1)(a) and (b) (an **unassessed claim**).

(2) If the borrower has a long-term issuer credit rating, any of the unassessed claim that falls within that rating must be treated as having the same credit rating.

(3) If no credit rating applies to an unassessed claim under subclause (2), the deposit taker must determine the rating grade for the claim using the long-term credit rating for another claim on the issuer.

(4) However, subclause (3) applies only if—

(a) the unassessed claim ranks pari passu or senior to the other claim in all respects; or

(b) the other claim has a rating with an applicable rating grade that results in a higher risk weight than for an unrated claim of the same type.

(5) The deposit taker must not determine the rating grade for an unassessed claim on a borrower using an issue-specific short-term credit rating of another claim on the borrower.

(6) This clause is subject to clause 120.

Compare: BPR131 B1.5

119 Inferred ratings if multiple ratings

(1) This clause applies for the purposes of determining an inferred rating grade under clause 118 if there are multiple credit ratings.

(2) If 2 credit ratings apply to an unassessed claim and they correspond to different rating grades and risk weights, the deposit taker must use the credit rating that produces the higher risk weight.

(3) If 3 or more credit ratings apply to an unassessed claim and they correspond to different rating grades and more than 1 risk weight, the deposit taker must use the credit rating that produces the higher of the 2 lowest risk weights.

Compare: BPR131 B1.7

120 Restrictions on inferred ratings

A credit rating that applies to an unassessed claim under clause 118 is subject to the following restrictions:

(a) a credit rating of a claim denominated in domestic currency must not be inferred from a credit rating of a claim denominated in a foreign currency:

(b) a credit rating of a claim denominated in a foreign currency must not be inferred from a credit rating of a claim denominated in a domestic currency:

(c) a credit rating of a claim on an entity in a corporate group must not be inferred from a credit rating of a claim on another entity in the same group.

Compare: BPR131 B1.6

Rating grades

121 "Unrated" grade when no rating agency credit rating applies

A claim must be classified as having a rating grade of "unrated" if no credit rating produced by a rating agency listed in clause 115 applies to the claim.

Compare: BPR131 B2.1

122 Rating grade for short-term credit rating

The rating grade for a short-term credit rating is the short-term rating grade that corresponds to the credit rating in the following table:

Short-term rating grade	Rating agency credit rating			
	Standard & Poor's	Moody's Investors Service	Fitch Ratings	AM Best
1	A-1	P-1	F-1	AMB-1
2	A-2	P-2	F-2	AMB-2
3	A-3	P-3	F-3	AMB-3
4	Other	Other	Other	Other

Compare: BPR131 B2.2

123 Rating grade for long-term or issuer credit rating

The rating grade for a long-term or issuer credit rating is the long-term or issuer rating grade that corresponds to the credit rating in the following table:

Long-term or issuer rating grade	Rating agency credit rating			
	Standard & Poor's	**Moody's Investors Service**	**Fitch Ratings**	**AM Best**
1	AAA AA+ AA AA−	Aaa Aa1 Aa2 Aa3	AAA AA+ AA AA−	aaa aa+ aa aa−
2	A+ A A−	A1 A2 A3	A+ A A−	a+ a a−
3	BBB+ BBB BBB−	Baa1 Baa2 Baa3	BBB+ BBB BBB−	bbb+ bbb bbb−
4	BB+ BB BB−	Ba1 Ba2 Ba3	BB+ BB BB−	bb+ bb bb−
5	B+ B B−	B1 B2 B3	B+ B B−	b+ b b−
6	CCC+ CCC CCC− CC C D	Caa1 Caa2 Caa3 Ca C	CCC+ CCC CCC− CC C D	ccc+ ccc ccc− cc c

Compare: BPR131 B2.3

Subpart 4—Risk weights for credit exposures

124 Overview

This subpart sets out the risk weights to be applied for the purpose of calculating RWAs for credit exposures.

Compare: BPR131 C1.1

Risk weights for items other than RMLs

125 Currency, gold, and cash items

(1) A 0% risk weight applies to—

(a) notes and coins held by the deposit taker on site; and

(b) gold bullion held—

(i) in own vaults; or

(ii) on an allocated basis and backed by bullion liabilities.

(2) A cash item that is in the process of collection from another deposit taker or overseas bank must be treated as a claim on that deposit taker or bank with a maturity of 3 months or less.

Compare: BPR131 C2.1

126 Claims on sovereigns or central banks

(1) A 0% risk weight applies to a claim on the Crown or the Bank that is denominated in New Zealand dollars.

(2) The risk weight for a claim on the Crown or the Bank that is not denominated in New Zealand dollars, or for a claim on any other sovereign or its central bank, is determined by the rating grade for the claim as follows:

(a) if the rating grade is 1, 0%:

(b) if the rating grade is 2, 20%:

(c) if the rating grade is 3, 50%:

(d) if the rating grade is 4, 100%:

(e) if the rating grade is 5, 100%:

(f) if the rating grade is 6, 150%:

(g) if the rating grade is unrated, 100%.

(3) If there is no credit rating for a central bank, its rating grade may be determined in relation to the credit rating for its sovereign.

Compare: BPR131 C2.2

127 Claims on public sector entities

The risk weight for a claim on a public sector entity is determined by the rating grade for a claim on the sovereign in the country in which the public sector entity is located, as follows:

(a) if the sovereign rating grade is 1, 20%:

(b) if the sovereign rating grade is 2, 50%:

(c) if the sovereign rating grade is 3, 100%:

(d) if the sovereign rating grade is 4, 100%:

(e) if the sovereign rating grade is 5, 100%:

(f) if the sovereign rating grade is 6, 150%:

(g) if the sovereign rating grade is unrated, 100%.

Compare: BPR131 C2.3

128 Multilateral development banks and other international organisations

(1) A 0% risk weight applies to a claim on any of the following bodies (a **lowest-risk multilateral development bank or supranational**):

(a) World Bank Group, including the following:

(i) International Bank for Reconstruction and Development:

(ii) International Finance Corporation:

(iii) Multilateral Investment Guarantee Agency:

(iv) International Development Association:

(b) Asian Development Bank:

(c) African Development Bank:

(d) European Bank for Reconstruction and Development:

(e) Inter-American Development Bank:

(f) European Investment Bank:

(g) European Investment Fund:

(h) Nordic Investment Bank:

(i) Caribbean Development Bank:

(j) Islamic Development Bank:

(k) Council of Europe Development Bank:

(l) International Finance Facility for Immunization:

(m) Asian Infrastructure Investment Bank:

(n) Bank for International Settlements:

(o) International Monetary Fund:

(p) European Central Bank:

(q) European Union:

(r) European Stability Mechanism:

(s) European Financial Stability Facility.

(2) The risk weight for a claim on any other development bank is determined by the rating grade for the claim as follows:

(a) if the rating grade is 1, 20%:

(b) if the rating grade is 2, 50%:

(c) if the rating grade is 3, 50%:

(d) if the rating grade is 4, 100%:

(e) if the rating grade is 5, 100%:

(f) if the rating grade is 6, 150%:

(g) if the rating grade is unrated, 50%.

(3) In this standard, **other development bank** means 1 of the following

(a) Export Development Canada:

(b) Export-Import Bank of Korea:

(c) KfW Bankengruppe:

(d) Landwirtschaftliche Rentenbank:

(e) Korea Development Bank:

(f) Swedish Export Credit Corporation.

Compare: BPR131 C2.4

129 Claims on deposit takers and overseas banks

(1) The risk weight for a claim on a deposit taker or an overseas bank (**A**), other than a claim that has a short-term rating grade under clause 122, is determined by the rating grade of the claim, in accordance with the table in subclause (2), depending on whether the claim has an original maturity—

(a) not exceeding 3 months; or

(b) exceeding 3 months.

(2) The risk weight for a claim described in subclause (1) must be determined according to the following table:

Rating grade	Risk weight (%): claim with original maturity not exceeding 3 months	Risk weight (%): claim with original maturity exceeding 3 months
1	20	20
2	20	30
3	20	50
4	50	100
5	50	100
6	150	150
unrated	20	50

(3) Subclause (1) is subject to clauses 133 to 135 in relation to any instrument issued by A that has an issue-specific rating grade that is short-term.

(4) The risk weight for a claim with a rating grade of unrated under subclause (3) is subject to clauses 130 and 134.

Compare: BPR131 C2.5

130 Banks: sovereign floor for unrated claims

The risk weight for an unrated claim on a deposit taker or an overseas bank is the greater of—

(a) the risk weight for the claim under clause 129; and

(b) the risk weight of the sovereign territory in which the deposit taker or bank is incorporated.

Compare: BPR131 C2.6

131 Claims on corporates

(1) The risk weight for a claim on a corporate is determined by the rating grade for the claim as follows:

(a) if the rating grade is 1, 20%:

(b) if the rating grade is 2, 50%:

(c) if the rating grade is 3, 100%:

(d) if the rating grade is 4, 100%:

(e) if the rating grade is 5, 100%:

(f) if the rating grade is 6, 150%:

(g) if the rating grade is unrated, 100%.

(2) Subclause (1) is subject to clauses 133 and 134 in respect of a corporate that has issued an instrument that has an issue-specific short-term rating grade.

(3) Subclause (1)(g) is subject to clauses 132, 134, and 142.

(4) This clause does not apply to a claim that—

(a) has a short-term rating grade (*see* clause 122); or

(b) is for an SME exposure (*see* clause 142); or

(c) is a farm lending exposure (*see* clause 143); or

(d) is an exposure to the New Zealand Superannuation Fund (*see* clause 146).

Compare: BPR131 C2.7

132 Corporates: sovereign floor for unrated claims

The risk weight for an unrated claim on a corporate is the greater of—

(a) the risk weight determined for the claim under clause 131; and

(b) the risk weight of the sovereign territory in which the corporate is incorporated.

Compare: BPR131 C2.8

133 Banks and corporates: issue-specific short-term ratings

The risk weight for a claim on a deposit taker, overseas bank, or corporate that has an issue-specific credit rating that is a short term rating is determined by the short-term rating grade for the claim as follows:

(a) if the rating grade is 1, 20%:

(b) if the rating grade is 2, 50%:

(c) if the rating grade is 3, 100%:

(d) if the rating grade is 4, 150%.

Compare: BPR131 C2.9

134 Floor on unrated deposit taker, bank, and corporate claims

(1) Subclause (2) applies if a counterparty deposit taker or overseas bank has an outstanding debt issue that, under clause 133, has a risk weight of either 50% or 100%.

(2) A claim on the counterparty must be risk-weighted at 100% if—

(a) it is unrated; and

(b) it has an original and effective maturity of 3 months or less.

(3) Subclause (4) applies if a counterparty deposit taker, overseas bank, or corporate has an outstanding debt issue that, under clause 133, has a risk weight of 150%.

(4) A claim on the deposit taker, overseas bank, or corporate that is unrated must be risk-weighted at 150%.

Compare: BPR131 C2.10

135 Banks: unrated claims up to 3 months when other claims have short-term credit ratings

(1) This clause applies if a counterparty deposit taker or overseas bank has 1 or more debt issues outstanding that have an issue-specific credit rating that is a short-term rating.

(2) A claim on the counterparty must be risk-weighted in accordance with subclause (3) if—

(a) it is unrated; and

(b) it has an original and effective maturity of 3 months or less.

(3) The risk weight must be the greater of—

(a) the risk weight in the second column of the table in clause 129(2) that corresponds with the rating grade; and

(b) the highest risk weight applying under clause 133 to any of the debt issues with short-term rating grades.

Compare: BPR131 C2.11

136 Past due non-mortgage loan

(1) This clause applies to any 90-day past due asset other than an RML or a Kāinga Whenua loan product.

(2) The amount that must be risk-weighted is the portion of the asset that is not secured by eligible collateral or an eligible guarantee or credit derivative in accordance with Part 6, net of any allowance for expected credit losses that is attributable to the asset.

(3) The risk weight is—

(a) 150%, if the attributable allowance for expected credit losses for the loan is less than 20% of the outstanding amount of the loan; or

(b) 100%, if the attributable allowance for expected credit losses for the loan is equal to or greater than 20% of the outstanding amount of the loan.

Compare: BPR131 C2.12

137 Measure of equity exposure

(1) When risk-weighting an equity holding under clause 138, the amount that must be risk-weighted is the current book value, including revaluations, net of any allowances for impairment.

(2) A short position in an individual equity holding or a derivative, held in the banking book, is permitted to offset a long position in the same individual equity provided that the instrument—

(a) has been explicitly designated as a hedge of the specific equity holding; and

(b) has remaining maturity of at least 1 year.

(3) Any other short position in an equity holding must be treated as if it were a long position, with the relevant risk-weight applied to the absolute value of the position.

Compare: BPR131 C2.13

138 Equity

The risk weight for an equity holding is,—

(a) if the holding is in an equity instrument that is included in the S&P/NZX 50 Index or an overseas equivalent share market index, 300%; or

(b) if the holding is an equity stake in the New Zealand Business Growth Fund,—

(i) 250% for a holding up to a maximum of 2% of the deposit taker's tier 1 capital; and

(ii) 400% for any holding in excess of 2% of the deposit taker's tier 1 capital; or

(c) in all other cases, 400%.

Compare: BPR131 C2.14

139 Fixed asset

The risk weight for an investment in premises, plant, equipment, or any other fixed asset is 100%.

Compare: BPR131 C2.15

140 Leased asset

If a deposit taker has, in accordance with generally accepted accounting practice, a right-of-use asset as lessee—

(a) if the underlying asset is tangible, the asset must be risk-weighted at 100%; and

(b) if the underlying asset is intangible, it must be included in the deduction required by clause 39(1) (Deduction of goodwill and other intangible assets.

Compare: BPR131 C2.16

141 Deposit taker as lessor

(1) If a deposit taker has provided lease financing to a counterparty, the book value of the financing must be risk-weighted using the risk weight applicable to the counterparty.

(2) However, if the deposit taker is exposed to residual value risk—

(a) the discounted lease payment stream must be risk-weighted using the risk-weight applicable to the counterparty; and

(b) the residual value must be risk-weighted at 100%.

(3) In this clause, **residual value risk** is the deposit taker's exposure to potential loss due to the fair value of the equipment declining below its residual estimate at lease inception.

Compare: BPR131 C2.17

142 Exposure to small and medium enterprises

(1) A deposit taker must apply a risk weight to any SME exposure that is not a 90-day past due asset as follows:

(a) an SME retail exposure must be risk-weighted at 75%:

(b) any other SME exposure must be risk-weighted at 85%.

(2) In this clause,—

aggregated exposure means the gross amount of all exposures to the counterparty and any related parties,—

(a) excluding any credit risk mitigation in accordance with Part 6; and

(b) in the case of an off-balance-sheet exposure, after applying the applicable credit conversion under clause 162

SME counterparty means a small or medium enterprise (**SME**) or, if the SME forms part of a corporate group, the corporate group

SME exposure means an exposure to an unrated corporate counterparty (whether directly or through a related party)—

(a) that has a total annual revenue of less than $50 million; or

(b) if the counterparty is part of a corporate group, whose group has a consolidated annual revenue for the group of less than $50 million; or

SME retail exposure—

(a) means an SME exposure—

(i) that is a small business lending facility or commitment; and

(ii) in respect of which the maximum aggregated exposure to the counterparty is less than $2 million; but

(b) does not include—

(i) an exposure secured by residential property; or

(ii) a derivative; or

(iii) any other security, for example a bond or equity security.

(3) In subclause (2), a **related party** in respect of a counterparty, means—

(a) a person who has control over the counterparty; or

(b) a close family member of a person who has control over the counterparty; or

(c) a trustee of a trust if the trust beneficiaries include either or both—

(i) a person who has control over the counterparty:

(ii) a close family member of a person who has control over the counterparty; or

(d) an entity over which the counterparty has control; or

(e) an entity in relation to which a person has control over both the entity and the counterparty; or

(f) an entity over which a close family member of a person who has control over the counterparty also has control; or

(g) an entity over which a trustee to which paragraph (c) applies has control

(4) For the purposes of subclause (3), a person (**A**) has control over an entity (**B**) if—

(a) A has the power, directly or indirectly, to—

(i) exercise, or control the exercise of, 50% or more of the voting rights in B; or

(ii) appoint 50% or more of the board of directors of B; or

(b) A has, together with 1 or more connected persons, the power, directly or indirectly to—

(i) exercise, or control the exercise of, 50% or more of the voting rights in B; or

(ii) appoint 50% or more of the board of directors of B.

(5) For the purposes of subclause (4)(b), **connected person**, in relation to A, means—

(a) a person who is acting or will act jointly or in concert with A in exercising, or controlling the exercise of, a power referred to in subclause (4)(b)(i) or (ii); or

(b) a person who acts, or is accustomed to acting, in accordance with the wishes of A.

Compare: BPR131 C2.19

143 Farm lending exposure

(1) The risk weight for a farm lending exposure that is not a 90-day past due asset must be determined as follows:

(a) if the loan-to-value ratio for the farm (the **farm LVR**) does not exceed 30%, the risk weight is 50%:

(b) if the farm LVR is greater than 30% but does not exceed 50%, the risk weight is 75%:

(c) if the farm LVR exceeds 50%, the risk weight is 100%.

(2) A deposit taker may determine a risk weight under subclause (1) only if the policy used by the deposit taker for valuing farm lending exposures has been approved by the deposit taker's board and meets the requirements in clause 144.

(3) A deposit taker may, when calculating the value component of a LVR for a farm lending exposure, include the value of the land and buildings, livestock, and plant and equipment.

(4) *See* clause 159 for determining the risk weight for a farm lending exposure that is a 90-day past due asset.

(5) A farm LVR is calculated according to the following formula:

$$(\text{loan value})/(\text{property value}) \times 100$$

where—

loan value is the total amount of—

(a) all claims in respect of the farm lending exposure; and

(b) all undrawn commitments to the borrower in respect of the farm lending exposure

property value is determined in accordance with the deposit taker's valuation policy for farm lending exposures under clause 144.

(6) In this clause, **farm lending exposures** means exposures to borrowers that relate to subdivision A01 Agriculture in the *Australian and New Zealand Standard Industrial Classification 2006*, published by Statistics New Zealand.

Compare: BPR131 C2.20.1–4

144 Valuation policy for farm lending exposures

For the purposes of clause 143(2), a deposit taker's valuation policy for farm lending exposures must—

(a) require the deposit taker to value each item to be included in the value component of the LVR for a farm lending exposure using 1 of the following methods:

(i) the purchase price of the property:

(ii) a valuation provided by a valuer who meets the eligibility criteria in clause 152 and specialises in rural valuations:

(iii) estimated realisable value, if that value can be substantiated by the deposit taker; and

(b) require each item described in paragraph (a) to contribute value for the LVR calculation as follows:

(i) land and buildings, up to70%:

(ii) livestock, up to 50%:

(iii) plant and equipment, up to 25%:

(iv) other, up to 30%; and

(c) include guidance on the appropriate use of different valuation products in relation to credit risk under the policy; and

(d) include guidance on the use of the purchase price of agricultural land under the policy; and

(e) ensure that its application is invariant to the direction of movement of agricultural land prices under the policy.

Compare: BPR131 C2.20.5

145 Community housing provider

(1) The risk weight for a loan to a community housing provider must be determined as follows:

(a) if the LVR does not exceed 50%, the risk weight is 20%:

(b) if the LVR exceeds 50% but does not exceed 60%, the risk weight is 25%:

(c) if the LVR exceeds 60% but does not exceed 70%, the risk weight is 30%:

(d) if the LVR exceeds 70% but does not exceed 80%, the risk weight is 35%:

(e) if the LVR exceeds 80% but does not exceed 90%, the risk weight is 50%:

(f) if the LVR exceeds 90% but does not exceed 100%, the risk weight is 75%:

(g) if the LVR exceeds 100%, the risk weight is 100%.

(2) Subclause (1) does not apply to a loan—

(a) if the community housing provider has a long-term service provision contract with the Crown in relation to the property; or

(b) that is subject to a Crown guarantee in respect of 80% of the lender's losses; or

(c) that is a 90-day past due asset.

(3) The risk weight for a loan described in subclause (2)(a) is the lesser of the following:

(a) the applicable risk weight in subclause (1):

(b) 30%.

(4) The risk weight for a loan described in subclause (2)(b) is the applicable risk weight in subclause (1) multiplied by 20%.

(5) *See* clauses 158 and 159 for determining the risk weight for a loan described in subclause (2)(c).

(6) This clause does not apply to a loan to a community housing provider that is used to finance construction or property development.

Compare: BPR131 C2.21

146 New Zealand Superannuation Fund

The risk weight for an unrated claim on the New Zealand Superannuation Fund is 20%.

Compare: BPR131 C2.22

147 Other assets

(1) A 100% risk weight must be applied to any on-balance-sheet asset—

(a) that is within the scope specified in clause 101; and

(b) for which the deposit taker has not calculated a credit risk RWA under this Part or the internal models standard.

(2) Despite subclause (1), a risk weight of 20% applies to a Kāinga Whenua loan product if the lender's mortgage insurance covers 100% of the potential loss faced by the deposit taker.

(3) Subclause (2) applies regardless of whether the loan is past due.

Compare: BPR131 C2.18

Subpart 5—Risk weights for RMLs

Residential mortgage loans

148 Meaning of residential mortgage loan (RML)

In this standard, **residential mortgage loan** or **RML**—

(a) means a loan secured by a first ranking mortgage over a residential property used primarily for residential purposes by the mortgagor, a related party of the mortgagor, or a tenant of the mortgagor; but

(b) does not include—

(i) a loan if the mortgaged property is predominantly used for farming or commercial activities, including—

(A) if the mortgaged property would be marketed as a farm or a commercial property; or

(B) if the principal or interest payments are mainly serviced from the income generated by the use of the property for farming or commercial activity, unless that income is rental income and the property is used for a residential purpose; or

(ii) a loan to a community housing provider; or

(iii) a Kāinga Whenua loan product.

(2) In this clause, **predominantly** means more than 50%.

(3) In this clause, **related party** in respect of a mortgagor, means—

(a) a relative of the mortgagor; or

(b) a beneficiary of a trust if the mortgagor is a trustee of the trust; or

(c) a person who has control over the mortgagor; or

(d) a relative of a person who has control of the mortgagor.

(4) For the purposes of subclause (3)(c) and (d), **control** has the meaning set out in clause 142(4).

Compare: BPR131 C3.2

149 Meaning of other terms in this subpart

(1) In this subpart—

non-property investment RML means a standard RML secured over only owner-occupied residential property

owner-occupied residential property means a property that meets the following requirements:

(a) a legal or beneficial interest, or both, is held in the property by an individual or a related party of an individual:

(b) an individual referred to in paragraph (a), or their spouse, civil union partner, or de facto partner, intends to occupy the property as their principal or secondary residence; and

(c) in respect of a secondary residence, no more than minimal rental income is derived from the property

property investment RML means a standard RML other than a non-property investment RML

reverse RML means an RML for which payments of principal or interest are not due in accordance with an agreed repayment schedule, but rather on the occurrence of a specified trigger event, in which case the repayment of the loan is made from the proceeds of sale of the property

secondary residence, in relation to a person, means a holiday home or a second home that is primarily for the use of the person

standard RML means an RML that is not a reverse RML.

(2) For the purposes of the definition of **owner-occupied residential property** in subclause (1), a person (**A**) is a related party of an individual (**B**) if—

(a) A is the trustee of a trust and B is a beneficiary of that trust (including where A and B are the same person); or

(b) A is a company or an unincorporated body of persons (including a company or unincorporated body of persons that owns the property as trustee) and B is a shareholder of, or otherwise controls, A; or

(c) A is the administrator of the estate of the deceased spouse or partner (civil union or de facto) of B.

Loan-to-value ratio

150 Loan-to-value ratio (LVR) for residential mortgage loan

(1) The loan-to-value ratio (**LVR**) for an RML is, subject to subclause (2), calculated according to the following formula:

$$(\text{loan value})/(\text{property value}) \times 100$$

where—

loan value is the total amount of—

(a) all claims secured by way of a first ranking mortgage over residential property; and

(b) all undrawn commitments to the borrower that when drawn down will be secured by way of first ranking mortgage over residential property

property value is,—

(a) for a standard RML, or a reverse RML at the time of origination, the value of the residential property that is security for the loan, determined, when the loan is originated, under the deposit taker's residential property valuation policy; or

(b) for a reverse RML after origination, the value of the residential property that is security for the loan updated according to the following formula:

$$\begin{cases} \text{Max}(V_O,\ 80\% \times V_R) & \text{if } V_R > V_O, \text{ or} \\ V_R & \text{if } V_R \leq V_O \end{cases}$$

where—

V_O is the total value of the residential property that is security for the RML determined at origination under paragraph (a) of this definition

V_R is the total value determined at the most recent 3-yearly update under the deposit taker's residential property valuation policy.

(2) If the property value for an RML has not been determined under subclause (1), the LVR of the loan for risk-weighting purposes is 150%.

(3) In this clause, **residential property valuation policy** means a policy of the deposit taker that meets the requirements in clause 151.

Compare: BPR131 C3.5

Valuation

151 Requirements for residential property valuation policy

For the purposes of clause 150, a deposit taker's residential property valuation policy must—

(a) be approved by the deposit taker's board of directors; and

(b) require the deposit taker, when calculating the LVR for a loan secured by a mortgage over a residential property, to use 1 of the following methods of valuation:

(i) the purchase price of the property:

(ii) a property valuation provided by a valuer who meets the requirements in clause 152:

(iii) a property valuation that is provided by a professional valuation service that meets the requirements in clause 153; and

(c) include guidance on the appropriate credit risk-related use of different valuation products under the policy; and

(d) include guidance on the use of the purchase price of a residential property under the policy; and

(e) include guidance on the determination of the origination date under the policy; and

(f) for reverse mortgage loans, require that the property value is updated at least 3-yearly; and

(g) ensure that the policy applies in the same manner, notwithstanding the direction of movement of residential property prices.

Compare: BPR131 C3.6

152 Valuation provided by property valuer

(1) A person who carries out a valuation under clause 143 or 151(b)(ii), must be—

(a) a registered valuer (as defined in section 2 of the Valuers Act 1948); or

(b) another person approved to provide valuation services by rules made under the Rating Valuations Act 1998; or

(c) a person who meets the definition of valuer under the laws of another country, if the Bank approves the deposit taker's reliance on a valuation provided by the person.

(2) When deciding whether to approve a valuation arrangement under subclause (2)(c), the Bank must be satisfied that the laws of the other country are at least as satisfactory as the requirements in and under the Valuers Act 1948.

Compare: BPR131 C3.7

153 Valuation provided by professional valuation service

(1) A valuation, provided by a professional valuation service under clause 151(b)(iii) and used in calculating an LVR, must be—

(a) a statistical or modelled valuation based on market sales price data; or

(b) a valuation carried out by appropriately qualified valuation personnel overseen by a valuer who meets the requirements in clause 152.

(2) It must be an independent valuation.

Compare: BPR131 C3.8

154 Conditions for qualifying lender's mortgage insurance

(1) Lender's mortgage insurance (**LMI**) referred to in clause 147 and 155 must—

(a) meet the requirements in this clause; or

(b) be provided by Kāinga Ora–Homes and Communities.

(2) The insurer providing the LMI must have an insurer financial strength rating listed in the following table:

Standard & Poor's	Moody's Investors Service	Fitch Ratings	AM Best
AAA	Aaa	AAA	aaa
AA+	Aa1	AA+	aa+
AA	Aa2	AA	aa
AA−	Aa3	AA−	aa−
A+	A1	A+	a+
A	A2	A	a

(3) The LMI must cover all losses realised in a default on the mortgage up to an amount of no less than 40% of the loan value (as that term is defined in clause 150(1)).

Compare: BPR131 C3.9

155 Risk weight for standard RML not past due with lender's mortgage insurance

(1) This clause applies to an RML if—

(a) it is a standard RML; and

(b) it is not a 90-day past due asset; and

(c) lender's mortgage insurance is held in respect of the RML that meets the requirements in clause 154.

(2) The risk weight for the RML must be determined in accordance with the following table:

Loan-to-value ratio for RML	**Risk weight (%)**	
	Non-property investment RML	Property investment RML
LVR does not exceed 50%	20	25
LVR exceeds 50% but does not exceed 60%	25	30
LVR exceeds 60% but does not exceed 70%	30	40
LVR exceeds 70% but does not exceed 80%	35	40
LVR exceeds 80% but does not exceed 90%	35	50
LVR exceeds 90% but does not exceed 100%	50	75
LVR exceeds 100%	100	100

Compare: BPR131 C3.10.1

156 Risk weight for standard RML not past due with no lender's mortgage insurance

(1) This clause applies to an RML if—

(a) it is a standard RML; and

(b) it is not a 90-day past due asset; and

(c) lender's mortgage insurance, that meets the requirements in clause 154, is not held in respect of the RML.

(2) The risk weight for the RML must be determined in accordance with the following table:

Loan-to-value ratio for RML	**Risk weight (%)**	
	Non-property investment RML	Property investment RML
LVR does not exceed 50%	20	25
LVR exceeds 50% but does not exceed 60%	25	30
LVR exceeds 60% but does not exceed 70%	30	40
LVR exceeds 70% but does not exceed 80%	35	40
LVR exceeds 80% but does not exceed 90%	50	70
LVR exceeds 90% but does not exceed 100%	75	90
LVR exceeds 100%	100	100

Compare: BPR131 C3.10.1

157 Risk weight for reverse RML

(1) The risk weight for a reverse RML must be determined in accordance with the following table:

Loan-to-value ratio for RML	Risk weight (%)
LVR is less than 30%	40
LVR is equal to or exceeds 30% but does not exceed 60%	50
LVR exceeds 60% but does not exceed 80%	80
LVR exceeds 80%	100

(2) A reverse RML may only be recognised in the RML category up to the value of the residential property used as security for the loan.

(3) *See* clause 48 regarding the deduction of any excess of a loan over the property value from tier 1 capital.

Compare: BPR131 C3.10.1, C3.10.2

158 Risk weight for past due RML with lender's mortgage insurance

(1) This clause applies to an RML if—

(a) it is a 90-day past due asset; and

(b) lender's mortgage insurance is held in respect of the RML that meets the requirements in clause 154.

(2) If the RML is a non-property investment RML, the risk weight is 80%.

(3) If the RML is a property investment RML, the risk weight is 95%.

Compare: BPR131 C3.11.2, C3.11.4

159 Risk weight for past due RML with no lender's mortgage insurance

(1) This clause applies to an RML if—

(a) it is a 90-day past due asset; and

(b) lender's mortgage insurance is not held in respect of the RML.

(2) If the RML is a non-property investment RML, the risk weight is 100%.

(3) If the RML is a property investment RML, the risk weight is 120%.

Compare: BPR131 C3.11.1, C3.11.3

160 Risk weight if Kāinga ora is provider of certain lender's mortgage insurance

(1) The risk weight for an RML is 20% if—

(a) Kāinga Ora–Homes and Communities is the provider of lender's mortgage insurance (*see* clause 154(1)(b)); and

(b) the lender's mortgage insurance covers 100% of potential loss faced by the deposit taker.

(2) This clause applies despite clauses 156 to 159.

Compare: BPR131 C3.12

Subpart 6—Equivalent exposure amounts for off-balance-sheet exposures

Credit equivalent amount

161 Credit equivalent amount for off-balance-sheet exposure

(1) A deposit taker must calculate the credit equivalent amount for an off-balance-sheet exposure using the following formula:

$$a \times (b - c)$$

where—

a is the credit conversion factor for the off-balance-sheet exposure (*see* clause 162)

b is the principal amount of the off-balance-sheet exposure

c is the amount of any loss allowance for expected credit losses for the exposure.

(2) In subclause (1), the principal amount of an off-balance-sheet exposure arising from an applicable commitment or other lending facility is the undrawn amount of the facility

(3) In this clause, an **applicable commitment**, in relation to a deposit taker, means any arrangement that has been offered by the deposit taker and accepted by the borrower to extend credit, purchase assets or issue credit substitutes, and the deposit taker is considered to have made an offer when it communicates a lending limit to a client, or potential client, in writing.

Compare: BPR131 D2.1

162 Risk weight and credit conversion factor for off-balance-sheet exposure

(1) For an off-balance-sheet exposure of a type specified in the first column of the table in subclause (2),—

(a) the risk weight must be calculated according to the corresponding classification in the second column of the table; and

(b) the credit conversion factor is the corresponding percentage in the third column of the table.

(2) The table is as follows:

Type of off-balance-sheet exposure	**Classification for determining risk weight**	**Credit conversion factor (%)**
Direct credit substitute	Counterparty type	100
Asset sale with recourse	Type of asset, or issuer of securities as appropriate	100
Forward asset purchase	Type of asset	100
Commitment with certain drawdown	Counterparty type	100
Note issuance facility	Counterparty type	50
Performance-related contingent item	Counterparty type	50
Trade-related contingent item	Counterparty type	20
Placement of forward deposit	Counterparty type	100
Undrawn commitment to New Zealand Business Growth Fund	Equity exposure under clause 138(b)	20
Other commitment if original maturity is more than 1 year	Counterparty type	50

Other commitment if original maturity is less than or equal to 1 year	Counterparty type	20
Other commitment that cancels automatically when the creditworthiness of the counterparty deteriorates or that can be cancelled unconditionally at any time without prior notice	Not applicable	0

(3) In the table, a classification for determining risk weight by—

(a) **counterparty type**, means that the risk weight is the same as the risk weight that would apply, under subpart 2, to an on-balance-sheet exposure with the same counterparty:

(b) **type of asset**, means that the risk weight is the same as the risk weight that would apply, under subpart 2, to an asset of the type to which the exposure relates if the asset were on-balance-sheet:

(c) **issuer of securities**, means, in the case of an exposure in respect of an issue of securities, that the risk weight is the same as the risk weight that would apply, under subpart 2, to the issuer of the securities if the asset were on-balance-sheet.

(4) If an arrangement involves more than 1 of the types of off-balance-sheet exposure in subclause (2), the credit conversion factor is the lowest applicable credit conversion factor.

(5) A commitment to provide an off-balance-sheet facility must be assigned the lower of the credit conversion factors applicable to the commitment and to the off-balance-sheet facility, respectively.

Compare: BPR131 D2.2

Subpart 7—Counterparty credit risk (CCR)

General

163 Recognition of collateral

(1) A deposit taker that holds collateral against the counterparty credit risk exposure arising from a single derivative or bilaterally netted derivatives may adjust the credit equivalent amount calculated under subpart 6 in relation to the exposure.

(2) The adjustment, if any, must be in accordance with subpart 3 of Part 6.

Compare: BPR131 E1.2

164 Calculation of credit risk RWAs for counterparty risk

(1) A deposit taker that uses the standardised approach to calculate risk-weighted assets must calculate the RWA amount for the counterparty credit risk arising from any derivative or SFT with a counterparty in accordance with the following formula:

$$a \times b$$

where—

a is the credit equivalent amount determined under subpart 6

b is the risk weight specified in subpart 4 that applies to the counterparty.

(2) A deposit taker that uses the internal models approach to calculate risk-weighted assets must add the credit equivalent amount determined under subpart 6 of this standard to the exposure at default amount for that counterparty, as part of the calculation of total RWAs for that counterparty under subpart 4 of Part 4 and Part 5 of the internal models standard.

Compare: BPR131 E1.3

165 Other RWA calculations using credit equivalent amount

(1) A deposit taker must, when calculating—

(a) the credit valuation adjustment capital charge (*see* subpart 8), include the total credit equivalent amount for each counterparty arising from derivatives that are not cleared through a central counterparty, calculated under subpart 6; or

(b) the capital charge for counterparty credit risk arising from a derivative or SFT cleared on a central counterparty (*see* subpart 9), calculate the trade exposure as if it were a credit equivalent amount under subpart 6.

(2) To avoid doubt, this clause applies to deposit takers including internal models deposit takers.

Compare: BPR131 E1.4

Credit equivalent amount for derivative not covered by bilateral netting agreement

166 Calculation of credit equivalent amount for derivative not covered by bilateral netting agreement

(1) The credit equivalent amount for a derivative that is not covered by a bilateral netting agreement must be calculated according to the following formula:

$$a + b$$

where—

a is the current credit exposure

b is the potential future credit exposure or PFCE.

(2) In this clause,—

current credit exposure means the greater of the following amounts:

(a) zero:

(b) the current mark-to-market replacement cost for the derivative contract

future risk factor means the factor that applies under clause 167 or 168

notional principal means the notional principal amount stated in the derivative contract unless the stated amount is leveraged or enhanced by the structure of the transaction

potential future credit exposure or **PFCE** means,—

(a) for a single currency floating-to-floating interest rate swap, zero; or

(b) for any other derivative, the notional principal multiplied by the future risk factor.

Compare: BPR131 E2.1

167 Future risk factor for derivative other than certain credit derivatives

(1) The future risk factor for an exposure arising from a derivative that is of a type specified in the table in subclause (2) is the factor in the table that corresponds to the derivative's residual maturity.

(2) The table is as follows:

Type of derivative	**Future risk factor (%)**		
	Residual maturity less than or equal to 1 year	**Residual maturity more than 1 year and less than or equal to 5 years**	**Residual maturity more than 5 years**
Currency or gold derivative	1	5	7.5
Interest rate derivative	0	0.5	1.5
Equity derivative	6	8	10
Precious metal (other than gold) derivative	7	7	8
Commodity (other than precious metal) derivative	10	12	15

(3) For a derivative with multiple exchanges of principal, the applicable factor is the factor in the table that corresponds to the derivative's residual maturity, multiplied by the number of remaining payments under the derivative contract.

(4) Subclause (5) applies to a derivative that is structured to settle outstanding exposure on specified payment dates with terms that are reset so that the market value of the derivative is zero on the specified dates.

(5) For the purposes of this clause, the residual maturity for the derivative is the period until the next reset date.

Compare: BPR131 E2.2

168 Future risk adjustment for certain credit derivatives

(1) This clause sets out a deposit taker's future risk factor for an exposure arising from a total-rate-of-return swap or credit default swap (an **applicable derivative**) that a deposit taker holds in its trading book.

(2) The future risk factor for an applicable derivative—

(a) with a qualifying reference obligation is 5%; or

(b) with no qualifying reference obligation is 10%.

(3) However, if a deposit taker has sold credit protection by way of a credit default swap, the future risk factor is,—

(a) if the transaction is subject to close-out on the insolvency of the protection buyer when the reference entity is still solvent, the relevant percentage in subclause (2)

but subject to the resulting potential future credit exposure being no more than the amount of any unpaid premium in relation to the credit protection; or

(b) in all other cases, 0%.

(4) In this clause, **qualifying reference obligation** means a reference obligation that has 2 or more long-term or issuer credit ratings that give rise to a rating grade of 1, 2, or 3 under clause 123 and in accordance with the rest of subpart 3.

Compare: BPR131 E2.3

Credit equivalent amount for derivatives if bilaterally netted

169 When deposit taker may calculate credit equivalent for derivatives if bilaterally netted

(1) A deposit taker may calculate the credit equivalent amount of its credit counterparty risk exposure arising from a forward, swap, option, or similar derivative with a counterparty on a net basis if—

(a) the claims arising on the individual contracts are subject to a legally valid form of bilateral netting agreement; and

(b) the deposit taker meets the requirements in subclause (2).

(2) The requirements are as follows:

(a) the bilateral netting agreement with the counterparty must be in writing:

(b) the agreement must create a single legal obligation in relation to the counterparty for all individual derivatives able to be netted under the agreement:

(c) if the counterparty does not meet the terms of the agreement due to a default, insolvency, bankruptcy, statutory management, liquidation, or a similar circumstance, the agreement must provide that there is an exposure that is a single claim to receive, or obligation to pay, only the net total of the positive and negative mark-to-market values of the individual derivatives covered by the agreement:

(d) the deposit taker must hold legal opinions that conclude with a high degree of certainty that, if there is a legal challenge, the exposure under the agreement would be found to be the net amount under the laws of all relevant jurisdictions including—

(i) the law of the jurisdiction in which the counterparty is incorporated or chartered and, if a foreign branch of the counterparty is involved, the law of the jurisdiction in which the branch is located; and

(ii) the law that governs the individual transactions covered by the agreement; and

(iii) the law that governs any contract or agreement necessary to effect the bilateral netting agreement:

(e) the deposit taker must have procedures to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes to relevant laws:

(f) the agreement must not contain walkaway clauses that permit the non-defaulting party to make only limited or no payment to the estate of the defaulter, even if the defaulter is a net creditor under the agreement.

Compare: BPR131 E3.1

170 Calculation of net credit equivalent amount in case of bilateral netting agreement

(1) The net credit equivalent amount for the counterparty credit exposure arising from derivatives that are subject to a bilateral netting agreement must be calculated in accordance with the following formula:

$$NCCE + PFCE_{adj}$$

(2) This clause is subject to clause 171.

(3) In this clause,—

GCCE means the gross current credit exposure, meaning the sum of the mark-to-market replacement costs, across all transactions, that have positive current mark-to-market value, but subject to any special treatment required under clause 171

NCCE means the net current credit exposure, meaning the greater of the following:

(d) the net mark-to-market replacement cost of the derivatives subject to the netting agreement:

(a) zero

NGR means the net-to-gross ratio, being the ratio of NCCE to GCCE

$PFCE_{adj}$ means the result calculated using the following formula:

$$0.4 \times PFCE_{Gross} + 0.6 \times NGR \times PFCE_{Gross}$$

$PFCE_{Gross}$ means the total of the individual potential future credit exposure amounts for each of the transactions subject to the bilateral netting agreement, calculated using the formula for PFCE in clause 166(2) with the applicable future risk factor in the table in clause 167(2).

Compare: BPR131 E3.2

171 Calculation of net exposure for derivatives with same currency and maturity

(1) This clause applies if the transactions covered by a netting agreement with a counterparty include matching transactions.

(2) For the purposes of calculating, under clause 170,—

(a) $PFCE_{Gross}$, a deposit taker may treat any group of matching transactions as a single transaction with a notional principal amount equal to the net receipts at the common maturity date of that group of transactions:

(b) GCCE, a deposit taker may—

(i) treat any group of matching transactions as a single transaction; and

(ii) calculate the mark-to-market replacement cost of a group described in subparagraph (i) as the net total of the individual mark-to-market replacement costs of the transactions in the group.

(3) In this clause, 2 or more transactions are **matching transactions** if they—

(a) are forward foreign exchange contracts, or other similar contracts, in which notional principal is equivalent to the cashflow on the contract; and

(b) mature on the same date; and

(c) are denominated in the same currency.

Compare: BPR131 E3.3

Credit equivalent amount for SFT

172 Calculation of credit equivalent amount for SFT

(1) A deposit taker must calculate the credit equivalent amount of the counterparty credit exposure arising from a single SFT using—

(a) the comprehensive methodology for the recognition of collateral in clauses 195 to 202; or

(b) the simple methodology for the recognition of collateral in clauses 203 and 204.

(2) Despite subclause (1), a deposit taker may, if it meets the requirements in clause 201, calculate the credit equivalent amount of a number of SFTs covered by a master netting agreement with a given counterparty in accordance with clause 202 (as if that provision relates to the calculation of a credit equivalent amount).

(3) A deposit taker must calculate the credit equivalent amount using the methodology in subpart 6 applying a credit conversion factor of 100% if—

(a) the deposit taker lends securities under an SFT; and

(b) either—

(i) the conditions for recognition of collateral are not satisfied; or

(ii) the transaction is not collateralised.

Compare: BPR131 E4.1

Subpart 8—Credit valuation adjustment capital charge

173 Application of credit valuation adjustment capital charge

(1) This subpart applies to the calculation of the credit valuation adjustment capital charge for the purposes of clause 112.

(2) The CVA must be calculated by a deposit taker in respect of derivatives that are settled bilaterally.

(3) This subpart applies to a deposit taker whether it is using the standardised approach or internal models approach to calculate credit risk RWAs and, in each case, the calculations the deposit taker must use are the same.

(4) The requirements under this subpart do not apply to—

(a) a derivative settled by means of a qualifying central counterparty (*see* subpart 9); or

(b) an SFT that has the approval of the Bank not to comply with the requirements.

(5) When deciding whether to grant an approval in respect of an SFT under subclause (4)(b), the Bank must be satisfied that granting the approval does not adversely affect the safety and soundness of the deposit taker.

Compare: BPR131 F1.1

174 General methodology for calculating credit valuation adjustment capital charge

(1) A deposit taker must calculate the CVA across its derivatives that are settled bilaterally, whether they are exchange-traded or over-the-counter, in accordance with the following formula:

$$2.33 \times \sqrt{\left(\sum_i 0.5 w_i \left(M_i D_i CEA_i^{total} - M_i^{hedge} D_i^{hedge} B_i\right) - \sum_j w_j^{ind} M_j^{ind} D_j^{ind} B_j^{ind}\right)^2 + \sum_i 0.75 w_i^2 \left(M_i D_i CEA_i^{total} - M_i^{hedge} D_i^{hedge} B_i\right)^2}$$

where—

i is an index running through all the deposit taker's counterparties on derivatives included in the CVA

w_i is the capital risk weight applicable to counterparty i. Counterparty i must be mapped to 1 of the capital risk weights specified in clause 177. The risk weights reflect a counterparty's external credit rating. If a counterparty does not have an external credit rating, the deposit taker—

(i) must, if it uses the standardised approach, use the rating grade of 4; or

(ii) may, if it uses the internal models approach to determine an internal rating for the counterparty, use the rating grade of 4, or, subject to the Bank's approval, map the internal rating of the counterparty to another external rating

CEA_i^{total} is the total credit equivalent amount of exposure to counterparty credit risk arising on derivatives with counterparty i totalled across all netting sets and taking account of collateral. It is calculated in accordance with subpart 7

B_i is the notional value of eligible purchased single name credit default swap (**CDS**) hedges referencing counterparty i (totalled if there is more than one position) and used to hedge credit valuation adjustment risk

j is an index running through one or more index CDSs that the deposit taker has purchased to hedge credit valuation adjustment risk

B_j^{ind} is the full notional value of eligible index CDS j

w_j^{ind} is the capital risk weight for index hedge j. The deposit taker must map each index hedge to one of the capital risk weights in clause 177 based on its average spread

M_i is the weighted average of the maturities of all transactions with counterparty 'i' that are included in the calculation, using the notional amount of each transaction as the weight for that transaction

M_i^{hedge} is the maturity of the hedge instrument with notional value Bi (the quantities $M_i^{hedge} \times B_i$ are to be added together if those are several positions)

M_j^{ind} is the maturity of index hedge j.

(2) In the equation, the discount factors D are defined as follows:

$$D_i = \frac{1 - e^{-0.05M_i}}{0.05M_i}$$

$$D_j^{ind} = \frac{1 - e^{-0.05M_j^{ind}}}{0.05M_j^{ind}}$$

$$D_i^{hedge} = \frac{1 - e^{-0.05M_i^{hedge}}}{0.05M_i^{hedge}}$$

(3) The benefit of a hedge may only be reflected if the calculation of the credit valuation adjustment capital charge meets the requirements in clause 178.

(4) When deciding whether to approve the mapping of the internal rating of a counterparty to another external rating, the Bank must be satisfied that granting the approval does not adversely affect the safety and soundness of the deposit taker.

Compare: BPR131 F2.1

175 Calculating credit valuation adjustment capital charge: no eligible hedges and more than 1 counterparty

(1) If a deposit taker has exposures from derivatives with more than 1 counterparty but does not use credit valuation adjustment hedges that are eligible under clause 178, it may calculate the CVA as follows:

$$2.33 \times \sqrt{0.25\left(\sum_i w_i M_i D_i CEA_i^{total}\right)^2 + 0.75\sum_i \left(w_i M_i D_i CEA_i^{total}\right)^2}$$

(2) The variables in the formula have same meaning as in clause 173.

Compare: BPR131 F2.2

176 Calculating credit valuation adjustment capital charge: no eligible hedges and 1 counterparty

(1) If a deposit taker has exposures from derivatives with only 1 counterparty and does not use credit valuation adjustment hedges in accordance with clause 178, it may calculate the CVA as follows:

$$2.33 \times w \times M \times D \times CEA$$

where—

w is the capital risk weight applicable to the counterparty in accordance with clause 177

M is the weighted average of the maturities of all transactions with the counterparty, using the notional amount of each transaction as the weight for that transaction

CEA is the total credit equivalent amount of exposure to counterparty credit risk arising on derivatives with the counterparty, taking account of collateral. It is calculated in accordance with subpart 6.

(2) In the formula in subclause (1), the discount factor D is defined in accordance with the following formula:

$$\frac{1 - e^{-0.05M}}{0.05M}$$

Compare: BPR131 F2.3

177 Calculating credit valuation adjustment capital charge: risk weights

(1) A deposit taker must, when calculating the credit valuation adjustment capital charge, use the applicable capital risk weight in relation to a counterparty or index hedge in subclause (2).

(2) The applicable capital risk weight is the percentage that corresponds to the rating grade under clause 123 for the counterparty or index hedge as follows:

(a) for a rating grade of 1, 0.7%:

(b) for a rating grade of 2, 0.8%:

(c) for a rating grade of 3, 1.0%:

(d) for a rating grade of 4 or unrated, 2.0%:

(e) for a rating grade of 5, 3.0%:

(f) for a rating grade of 6, 10.0%.

Compare: BPR131 F2.4

178 Calculating credit valuation adjustment capital charge: conditions on hedges

(1) A deposit taker may include a credit valuation adjustment hedge in the calculation of a credit valuation adjustment capital charge under clause 174 if the hedge—

(a) is transacted with an external counterparty, used for the purpose of mitigating credit valuation adjustment risk and managed accordingly; and

(b) is 1 of the following:

(i) a single-name credit default swap, including a sovereign credit default swap:

(ii) a single-name contingent credit default swap:

(iii) an equivalent hedging instrument referencing the counterparty:

(iv) an index credit default swap.

(2) A tranched or nth-to-default credit default swap, or an instrument for which the associated payment depends on cross-default, is not eligible as a credit valuation adjustment hedge.

(3) A hedge that is included in the credit valuation adjustment capital charge calculation must not be included in the calculation of the deposit taker's market risk capital requirement under Part 7.

(4) If the deposit taker uses an index credit default swap to hedge counterparty credit risk and has a counterparty that is a constituent of the reference index for the credit default swap, the deposit taker may, with the Bank's approval, subtract the notional amount attributable to that single name (in accordance with its reference weight) from the index credit default swap notional amount (B_j^{ind}), and treat that notional amount as a single name eligible hedge (B_i) of the individual counterparty, with maturity based on the maturity of the index.

(5) When deciding whether to grant approval under subclause (4), the Bank must be satisfied that does not adversely affect the safety and soundness of the deposit taker.

Compare: BPR131 F2.5

Subpart 9—Derivative transactions and SFTs settled via central counterparties

179 Overview

(1) This subpart sets out the risk-weighting treatment for central counterparty exposures arising from derivative transactions and SFTs settled via a central counterparty.

(2) That treatment—

(a) varies depending whether the central counterparty is qualifying or non-qualifying, set out in clause 180; and

(b) applies equally to deposit takers using the standardised approach to credit risk and to those deposit takers approved to use the internal models approach to credit risk; and

(c) applies equally to derivatives that are entered into bilaterally (OTC derivatives) and exchange-traded derivatives.

Compare: BPR131 G1.1

180 Meaning of qualifying central counterparty

(1) In this standard, **qualifying central counterparty** or **QCCP**, in relation to a deposit taker, means—

(a) a central counterparty that is a designated FMI (within the meaning of section 5 of the Financial Market Infrastructures Act 2021); or

(b) any other central counterparty if the use of that counterparty by the deposit taker has been approved by the Bank.

(2) When deciding whether to approve the use of a central counterparty under subclause (1)(b), the Bank must be satisfied that the counterparty complies with *Principles for Financial Market Infrastructures* issued by the Committee on Payment and Settlement

Systems of the Bank for International Settlements and the Technical Committee of the International Organization of Securities Commissions in April 2012.

(3) For the purpose of clause (1)(b), use of a central counterparty by a deposit taker, means use in its capacity as a clearing member or a client of a clearing member of the counterparty.

Compare: BPR131 G1.2

Qualifying central counterparty capital requirements

181 Risk-weighted assets if deposit taker is qualifying central counterparty clearing member acting on own behalf

(1) A deposit taker that is a clearing member of a QCCP must calculate the RWA for the total of its—

(a) trade exposures to the QCCP that arise from the deposit taker acting for its own purposes; and

(b) exposures to the QCCP's default fund.

(2) The deposit taker must calculate the RWA for its total exposures under subclause (1) in accordance with the following formula:

$$\min\{(2\% \times TE + 1250\% \times DF), (20\% \times TE)\}$$

where—

TE is the total of the deposit taker's trade exposures to the QCCP, where the value of each trade exposure must be calculated using the method for calculating the credit equivalent amount of derivatives and SFTs, under clauses 169 to 172

DF is the deposit taker's pre-funded contribution to the QCCP's default fund.

(3) Subclause (4) applies if a default fund is shared between—

(a) products or types of business that give rise to settlement risk only; and

(b) products or types of business that give rise to CCR.

(4) The deposit taker's contribution to the default fund must be incorporated in RWAs in accordance with the formula in subclause (2), without apportioning the contribution to different classes or types of business or products.

(5) Subclause (6) applies if the default fund contributions from clearing members are segregated by product type and only accessible for specific product types.

(6) The capital requirements for the default fund exposures determined according to the formula in subclause (2) must be calculated for each specific product type giving rise to counterparty credit risk.

Compare: BPR131 G2.1

182 Risk weight if deposit taker is client of qualifying central counterparty clearing member

(1) A deposit taker must calculate the risk weight for a counterparty credit exposure in accordance with this clause if—

(a) it is a client of a clearing member of a QCCP; and

(b) it clears the contract through the QCCP by—

(i) clearing the contract indirectly, with the clearing member acting as a financial intermediary (that is, the clearing member completes an offsetting transaction with the QCCP); or

(ii) entering into a transaction directly with the QCCP with the clearing member guaranteeing the deposit taker's performance.

(2) The deposit taker must, if the requirements set out in subclause (3) are met, calculate the RWA for the exposure as follows:

$$2\% \times TE$$

(3) The requirements are as follows:

(a) the offsetting transactions are identified by the QCCP as client transactions:

(b) the collateral to support the transactions described in paragraph (a) is held by the QCCP, the clearing member, or both, under arrangements that prevent any losses to the deposit taker due to—

(i) the default or insolvency of the clearing member or any of the clearing member's other clients; or

(ii) the joint default or insolvency of the clearing member and any of its clients:

(c) the deposit taker has conducted a legal review (and any further review that is necessary to ensure continuing enforceability) and has a well-founded basis to conclude that, in the event of legal challenge, the relevant courts and administrative authorities would find that the arrangements referred to in paragraph (a) would be legal, valid, binding and enforceable under relevant law, including—

(i) the law of the jurisdictions of the deposit taker, the clearing member deposit taker, and the QCCP; and

(ii) the law of the jurisdictions of any foreign branches of the deposit taker, clearing member, or QCCP involved in the trade; and

(iii) the law that governs the individual transactions and collateral; and

(iv) the law that governs any contract or agreement necessary to meet this condition:

(d) the relevant laws, regulations, rules, and contractual or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent clearing member are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP, should the clearing member default or become insolvent.

(4) However, if all the requirements in subclause (3) are met except that the deposit taker is not protected from losses in a situation described in subclause (3)(b)(ii), the deposit taker must calculate the RWA for the exposure as follows:

$$4\% \times TE$$

(5) However, if a deposit taker does not meet the requirements in subclause (3) or (4) (as the case may be), the deposit taker must calculate the RWA for the exposure as if it were a bilateral trade with the clearing member.

(6) In this clause, **TE** means the deposit taker's trade exposure to the clearing member, calculated using the method for calculating the credit equivalent amount of derivatives and SFTs in clauses 169 to 172.

Compare: BPR131 G2.2

183 Risk weight if deposit taker is qualifying central counterparty clearing member acting for client

(1) A deposit taker must calculate the risk weight for a counterparty credit exposure in accordance with this clause if the deposit taker is a clearing member of a QCCP and enables a client to carry out a trade involving the QCCP by either—

(a) acting as intermediary between the client and the QCCP; or

(b) guaranteeing the client's trade.

(2) The deposit taker must calculate the RWA for its counterparty credit exposure to the client using the same approach as for a bilateral trade with the client, except that the deposit taker must multiply the credit equivalent amount of the exposure by a scalar of 71%.

Compare: BPR131 G2.3

184 Risk weight if deposit taker has posted assets as collateral

(1) This clause applies to a deposit taker that is—

(a) a clearing member of a QCCP; or

(b) a client of a clearing member of a QCCP.

(2) If the deposit taker has posted assets as collateral in relation to trades carried out across the QCCP, the deposit taker must,—

(a) in all cases, calculate RWAs for the credit risk on those assets in accordance with the deposit taker's required capital adequacy treatment of those assets; and

(b) calculate RWAs to reflect the risk of default of the entity holding the collateral, in accordance with subclauses (3) to (5), as applicable.

(3) If the deposit taker is a clearing member of a QCCP and posts collateral in relation to a trade carried out across the QCCP,—

(a) the deposit taker may apply a zero risk-weight to all posted collateral that is held by a custodian and is bankruptcy-remote from the QCCP; and

(b) the deposit taker must apply a 2% risk-weight to all posted collateral that is held by the QCCP and is not bankruptcy-remote from the QCCP.

(4) If the deposit taker is a client of a clearing member of a QCCP and the conditions in 1 of subclauses (a) to (c) are met, it must calculate RWAs by multiplying the value of the

posted collateral by the risk weight specified in the following paragraphs (whichever applies):

(a) 0%, if the collateral is held by a custodian, and is bankruptcy-remote from the QCCP, the clearing member and the clearing member's other clients:

(b) 2%, if the collateral is held by the QCCP on behalf of the client and is not bankruptcy-remote from the QCCP, and the requirements in clause 182(3) are met:

(c) 4%, if the collateral is held by the QCCP on behalf of the client and is not bankruptcy-remote from the QCCP, and the requirements in clause 182(3) are met.

(5) If the deposit taker is a client of a clearing member of a QCCP and none of the subclause (4)(a) to (c) applies, the deposit taker must calculate the RWA by including the value of the posted collateral in its risk-weighting approach applicable to the entity holding the collateral.

Compare: BPR131 G2.4

Non-qualifying central counterparty capital requirements

185 Requirements for exposures to non-qualifying central counterparties

(1) A deposit taker, whether using the standardised or the internal models approach, must calculate the RWA for the counterparty default risk from a trade exposure to a non-qualifying central counterparty according to the following equation:

$$a \times b$$

where—

a is the risk weight for the central counterparty calculated under subpart 4

b is the credit equivalent amount of the trade exposure.

(2) The deposit taker must also, if the trade meets the requirements in clause 173, include the credit equivalent amount of the trade exposure in the credit valuation adjustment capital charge in accordance with subpart 8.

(3) A deposit taker that is a clearing member of a non-qualifying central counterparty and is exposed to the central counterparty's default fund must apply a risk weight as follows:

$$1250\% \times DF$$

where—

DF is the deposit taker's contribution to the central counterparty's default fund, being the total of—

(a) the full amount of the deposit taker's pre-funded contribution to the central counterparty's default fund; and

(b) if there is an unfunded contribution, an amount approved by the Bank.

(4) When deciding whether to approve an amount under paragraph (b) of the definition of DF in the formula in subclause (3), the Bank must be satisfied that approval does not adversely affect the safety and soundness of the deposit taker.

(5) In subclause (3), **unfunded contribution** means that the central counterparty may require the deposit taker to make additional contributions.

Compare: BPR131 G3.1

Part 6
Credit risk mitigation

Subpart 1—Preliminary

186 Overview of this Part

(1) This Part relates to the recognition of credit risk mitigation by a deposit taker when calculating credit risk RWAs.

(2) Subpart 2 specifies which requirements in this Part apply to the recognition of credit risk mitigation when a deposit taker calculates credit risk RWAs, depending on whether it uses the standardised approach or internal models approach.

(3) Subparts 3 to 5 sets out requirements for the types of credit risk mitigation available to a deposit taker using the standardised approach when calculating a credit risk as follows:

(a) collateral posted by a counterparty or a third party on behalf of the counterparty:

(b) on-balance-sheet netting of loans and deposits:

(c) a guarantee provided to, or a credit derivative purchased by, the deposit taker.

(4) Subpart 6 sets out requirements for credit risk mitigation relating to a guarantee provided to, or a credit derivative purchased by, a deposit taker using the internal models approach when calculating a credit risk RWA.

(5) Subpart 7 provides for adjustments to the amount of a credit risk mitigant provided for in subparts 3 to 6 if there is a maturity mismatch between the underlying credit exposure and relevant credit risk mitigant.

(6) *See* the internal models standard, which provides that a deposit taker that is approved to use the internal models approach may, when this Part does not apply, take account of credit risk mitigation as part of its credit risk modelling of credit risk RWAs according to that standard.

(7) *See* the internal models standard, which requires calculations under this Part to be used in the calculations of internally modelled exposures if there is a standardised component to the calculation.

Compare: BPR132 A1.1, A1.2

Subpart 2—General requirements for recognising credit risk mitigation

Recognising credit risk mitigation

187 Recognising credit risk mitigation: standardised approach

(1) A deposit taker using the standardised approach to calculate the RWA for a credit risk exposure may recognise credit risk mitigation on that exposure only if the mitigation meets the requirements in this Part, excluding subpart 6.

(2) This clause is subject to clause 189 in respect of a group 3 deposit taker.

Compare: BPR132 A2.1

188 Recognising credit risk mitigation: internal models approach

(1) A deposit taker using the internal models approach to calculate the RWA for a credit risk exposure may recognise credit risk mitigation on the exposure only if the mitigation—

(a) is for 1 or more of the purposes in subclause (2); and

(b) meets the requirements in this Part.

(2) The purposes are as follows:

(a) to recognise collateral held to mitigate the counterparty credit risk on a derivative, in calculating the EAD for the exposure (*see* subpart 3):

(b) to recognise collateral in calculating the net exposure amount for a single SFT, or a number of SFTs covered by a master netting agreement, as part of the EAD calculation for the counterparty (*see* subpart 3):

(c) to recognise on-balance-sheet netting of loans and deposits as part of the EAD calculation for the exposure (*see* subpart 4):

(d) to recognise a guarantee or credit derivative in the RWA calculation for the exposure (*see* subpart 5).

(3) A deposit taker calculating the RWA for a credit exposure under the internal models approach for any other purpose may recognise credit risk mitigation only in accordance with the internal models standard.

Compare: BPR132 A2.2

189 Recognising credit risk mitigation: group 3 deposit taker

(1) A group 3 deposit taker that has a loan for which it holds a deposit as collateral may choose to comply with this clause instead of the rest of this Part.

(2) A deposit taker that chooses to comply with this clause must do so in respect of all loans described in subclause (1).

(3) The deposit taker may recognise the deposit as credit risk mitigation under clause 102 by deducting the deposit from the book value of the loan.

(4) However, subclause (3) applies only if there is a written contractual agreement between the deposit taker and the depositor that provides that the deposit taker has direct, unconditional, and irrevocable recourse to the deposit security.

(5) If the deposit taker has, in respect of the loan or any part of the loan, entered into a sub-participation, the deposit taker may only make a deduction in the calculation of its RWA for on-balance-sheet exposures under subclause (3) if the requirements in subclause (6) are met (in addition to the requirements in subclause (4)).

(6) The requirements are that—

(a) there are no terms or conditions in the underlying loan agreement that would prevent the deposit taker or guaranteeing subsidiary from entering into the sub-participation, and all necessary consents have been obtained; and

(b) the deposit taker or guaranteeing subsidiary, whether under the terms of the sub-participation agreement or any other agreement or arrangement,—

(i) is not under an obligation to assume all or any part of the risk of the sub-participant under the sub-participation in any circumstances; and

(ii) has no liability for any losses suffered by the sub-participant under the sub-participation as a result of default by the borrower under the underlying loan agreement; and

(c) the sub-participant has given written acknowledgement to the deposit taker or guaranteeing subsidiary, confirming the matters in paragraph (b); and

(d) the deposit taker or guaranteeing subsidiary is not under an obligation to repay any amount to the sub-participant unless and until an equivalent amount is received by the deposit taker or guaranteeing subsidiary under the underlying loan agreement, including if payments under the underlying loan agreement are rescheduled; and

(e) if the sub-participation does not apply to the whole of the underlying loan, the parts of the loan that are subject to the sub-participation must rank equally with the parts of the loan that are not subject to the sub-participation in the event of default by the borrower.

(7) In this clause, **sub-participation** means a transaction in which a person (the **sub-participant**) places a deposit with the deposit taker or the guaranteeing subsidiary (**A**) in the amount of its participation in respect of a loan (the **underlying loan**) by A to a third party (the **borrower**) on terms under which A's obligation to repay the sub-participant depends on the borrower repaying A under the underlying loan agreement, and **sub-participation agreement** has a corresponding meaning.

Compare: SR 2010/167 rr 12(2), 20

Other requirements

190 Supporting documentation

Credit risk mitigation may be recognised in calculating the RWA for a credit risk exposure only if—

(a) documentation in respect of the credit risk mitigation is binding on all parties and legally enforceable in all relevant jurisdictions; and

(b) compliance with paragraph (a) is verified through periodic legal reviews.

Compare: BPR132 A2.3

191 Other general requirements

(1) A deposit taker may ignore credit risk mitigation in an RWA calculation if recognising the mitigation would result in a higher RWA amount than otherwise.

(2) The effects of credit risk mitigation must not be double counted.

Compare: BPR132 A2.3

Subpart 3—Collateral

Approaches and general requirements

192 Simple and comprehensive methodologies

(1) This clause applies when a deposit taker is recognising collateral as credit risk mitigation for the purposes of calculating the RWA for a credit risk exposure.

(2) A deposit taker using the standardised approach must,—

(a) for exposures in the banking book,—

(i) choose either the comprehensive methodology (*see* clauses 195 to 202) or the simple methodology (*see* clauses 203 and 204); and

(ii) apply the chosen approach consistently when recognising eligible collateral in respect of those exposures; and

(b) for exposures in the trading book, use the comprehensive methodology when recognising eligible collateral in respect of those exposures.

(3) A deposit taker using the internal models approach when calculating credit RWAs must use the comprehensive methodology.

Compare: BPR132 B1.1

193 Eligible collateral

(1) Cash is eligible collateral for credit risk mitigation by a deposit taker if it is—

(a) a balance on deposit with the deposit taker; or

(b) a certificate of deposit or other similar instrument issued by the deposit taker.

(2) A debt security is eligible collateral for credit risk mitigation by a deposit taker if—

(a) it has an issue-specific credit rating and is—

(i) a claim on a sovereign, lowest-risk multilateral development bank or supranational or other development bank, a public sector entity, a deposit taker or an overseas bank, or corporate, that has an issue-specific short-term rating grade of 1, 2, or 3 (*see* clause 122); or

(ii) a claim on a sovereign that has an issue-specific long-term rating grade of 1, 2, 3, or 4, or a claim on another entity that has an issue-specific long-term rating grade of 1, 2 or 3 (*see* clause 123); or

(b) it has no issue-specific credit rating and is—

(i) issued by a deposit taker that has other rated issues of the same seniority that have an issue-specific short- or long-term rating grade of 1, 2, or 3; and

(ii) listed on a recognised exchange; and

(iii) classified as senior debt.

(3) An equity instrument that is listed on the S&P/NZX 50 Index or an overseas equivalent share market index is eligible collateral for credit risk mitigation.

(4) However, eligible collateral does not include the following:

(a) a security issued by the counterparty, an entity associated with the counterparty, or by any other person whose credit quality has a material positive correlation with the credit quality of the original counterparty:

(b) a re-securitisation, irrespective of its credit ratings.

Compare: BPR132 B1.2

194 Minimum requirements to recognise eligible collateral

(1) A deposit taker may recognise eligible collateral as credit risk mitigation for RWA purposes if the requirements in subclauses (2) and (3) are met.

(2) The deposit taker must—

(a) have a written contract with the counterparty, or the third party lodging the collateral, that provides that the deposit taker has direct, unconditional, and irrevocable recourse to the collateral; and

(b) have, under the contract or other arrangement by which collateral is pledged or transferred, the right to liquidate or take possession of it immediately—

(i) in the event of the default, insolvency, statutory management, voluntary administration, receivership, or bankruptcy of the counterparty or custodian of the collateral; or

(ii) if any other event occurs that is defined in the transaction documentation as permitting enforcement of collateral; and

(c) take all steps necessary to fulfil requirements under the law applicable to the deposit taker's interest in the collateral for obtaining and maintaining an enforceable security interest; and

(d) have clear and robust procedures for prompt liquidation of the collateral.

(3) The following requirements must also be met:

(a) subject to paragraph (b), the deposit taker must hold the collateral if it is cash:

(b) in the case of cash collateral in the form of a certificate of deposit or bank bill issued by the deposit taker, the deposit taker must hold that certificate or bill until the collateral obligations have been extinguished:

(c) in the case of collateral, other than cash collateral, it must be held by the deposit taker or an independent custodian or other third party and, if it is not held by the deposit taker, the deposit taker must ensure that the holder segregates the collateral from the holder's own assets:

(d) in the case of collateral lodged on behalf of the counterparty by a third party, there must be collateral agreements in place with the third party that satisfy the requirements of subclause (2).

(4) Under the comprehensive methodology, collateral that is lodged for a shorter period than that of the underlying exposure may be recognised, but only if the requirements for maturity mismatch are satisfied (*see* subpart 7).

Compare: BPR132 B1.3

Treatment of collateral: comprehensive methodology

195 Adjustments to exposure amount

(1) Under the comprehensive methodology for recognising collateral for credit risk mitigation, the deposit taker must calculate the adjusted exposure amount after credit risk mitigation (**E***) as follows:

(a) unless paragraph (b) applies, according to clause 196:

(b) if the exposure is one of multiple SFTs with the counterparty and the SFTs are subject to a master netting agreement under clause 201, according to clause 202.

(2) The adjustments are subject to the requirements in clauses 197 to 200.

(3) Under the standardised approach, E* must be risk-weighted using the risk weight that applies to the underlying counterparty.

(4) Under the internal models approach, E* forms part of the deposit taker's total net EAD for that counterparty.

Compare: BPR132 B2.1

196 Calculation of adjusted exposure amount for transaction with eligible collateral

(1) For the purpose of clause 195(1)(a), in relation to a transaction with eligible collateral, a deposit taker must calculate the adjusted exposure amount after credit risk mitigation (**E***) using the following formula:

$$\max\{0, [E \times (100\% + H_E) - C \times (100\% - H_C - H_{FX})]\}$$

where—

E is the current value of the exposure

H_E is the haircut that applies to the exposure under clause 197(1)(a) or (b) adjusted under clauses 198 and 199

C is the current value of the collateral

H_C is the haircut that applies to the collateral under clause 197(1)(a) or (b) adjusted under clauses 198 and 199

H_{FX} is the haircut that applies to any currency mismatch between the collateral and exposure under clause 197(1)(d).

(2) If the exposure arises from the counterparty credit risk on a single derivative or bilaterally netted derivatives within the scope of subpart 7 of Part 5, the deposit taker must calculate the collateralised exposure amount using the following formula:

$$\max\{0, [CEA - C \times (100\% - H_C - H_{FX})]\}$$

where—

CEA is the credit equivalent amount of the derivative or netted derivatives calculated in accordance with subpart 7 of Part 5

other terms have the meanings given in subclause (1).

(3) Subclause (4) applies to an exposure arising from 2 or more SFTs with a given counterparty that are subject to a master netting agreement meeting the requirements in clause 201.

(4) The adjusted exposure amount must be calculated according to clause 202.

Compare: BPR132 B2.2

197 Standard supervisory haircuts

(1) The standard supervisory haircuts that must be made to exposures and collateral for the purposes of clause 196(1) are as follows:

(a) for debt securities, according to the following table:

External rating grade for debt securities	Residual maturity	Sovereigns (%)	Other issuers (%)	Securitisation exposures (%)
1 (long- and short-term)	less than or equal to 1 year	0.5	1	2
	greater than 1 year but less than or equal to 5 years	2	4	8
	greater than 5 years	4	8	16
2 or 3 (long- and short-term) and unrated bank securities	less than or equal to 1 year	1	2	4
	greater than 1 year but less than or equal to 5 years	3	6	12
	greater than 5 years	6	12	24
4 (long-term)	all	15	not applicable	not applicable

(b) for equities in the S&P/NZX 50 Index or an overseas equivalent, 15%:

(c) for cash in the same currency, 0%:

(d) if there is a currency mismatch, 8% in addition to the applicable haircut in paragraph (a) or (b).

(2) In the table in subclause (1)(a),—

(a) **sovereigns** includes any lowest-risk multilateral development bank or supranational that qualifies for a zero risk weight under clause 128; and

(b) **other issuers** includes any deposit taker or overseas bank, public sector entity, or corporate; and

(c) **external rating grades** are the grades that apply under clauses 121 to 123; and

(d) **unrated bank securities** refers to collateral that is eligible under clause 193(1)(c).

(3) In subclause (1)(c), cash in the same currency relates to eligible cash collateral described in clause 193(1).

(4) Subclause (5) applies to a transaction in which a deposit taker lends an instrument that is not eligible as collateral under clause 193.

(5) For the purposes of clause 195(1)(a), the deposit taker must calculate the adjusted exposure amount after credit risk mitigation (E*) using the formula in clause 196(1), with the haircut (H_E) on the exposure set at 25%.

Compare: BPR132 B2.3

198 Adjustments to standard supervisory haircuts where standard assumptions do not apply

(1) A standard supervisory haircut made to exposures and collateral under clause 197 must be adjusted as follows:

(a) if re-margining or revaluation is not undertaken daily, the haircut must be scaled up, depending on the actual number of working days between re-margining or revaluations:

(b) if the transaction is an SFT or secured lending, the haircut must be scaled up or down as applicable.

(2) The formula for carrying out the adjustments described in this clause is set out in clause 199, and the adjustments must be made to any of the applicable haircuts in the formula for E* in clause 196 (that is, to H_E, H_C, or H_{FX}).

Compare: BPR132 B2.4

199 Other adjustments to supervisory haircuts

(1) A supervisory haircut (**H**) made to exposures and collateral under clause 197 must be adjusted according to the following formula:

$$H_M \times \sqrt{\frac{N_R + (T_M - 1)}{10}}$$

where—

H is the supervisory haircut to be used for HE, HC, or HFX, as applicable, in the formula for E* in clause 196

H_M is the standard supervisory haircut that applies under clause 197

T_M is the minimum holding period specified in subclause (2) for the transaction type to which the collateralised exposure belongs (that is, 5, 10, or 20 working days, as the case may be)

N_R is the number of working days between, for capital market transactions, re-margining, or, for secured transactions, revaluation.

(2) The minimum holding periods are as follows:

(a) for SFTs, 5 working days:

(b) for other capital market transactions, 10 working days:

(c) for secured lending, 20 working days.

Compare: BPR132 B2.5

200 Zero haircut in respect of SFT

(1) This clause applies to an SFT if the counterparty is a core market participant.

(2) A haircut of zero applies to the SFT if the following requirements are met:

(a) each of the exposure and the collateral is either cash, or a sovereign security qualifying for a 0% risk weight under clause 126:

(b) the exposure and the collateral are denominated in the same currency:

(c) either the transaction is overnight or both the exposure and collateral are marked to market daily and are subject to daily re-margining:

(d) the collateral agreement specifies that, in the event of the counterparty's failure to re-margin, the period between the last mark to market before that event and the liquidation of the collateral is not more than 4 working days:

(e) the transaction is settled across a settlement system that is regularly used by core market participants for that type of transaction:

(f) the documentation covering the agreement is standard documentation from the International Swaps and Derivatives Association for SFTs in the securities concerned:

(g) the transaction is governed by documentation specifying that, if the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver a margin call or otherwise defaults, then the transaction is immediately terminable:

(h) upon any default event, regardless of whether the counterparty is insolvent or bankrupt, the bank has an unequivocal, legally enforceable, right to immediately seize and liquidate the collateral for its own benefit.

Compare: BPR132 B2.6

201 Recognition of SFTs covered by master netting agreements

(1) This clause applies to a bilateral netting agreement covering SFTs with a given counterparty.

(2) For the purposes of clause 195(1)(b), the bilateral netting agreement is recognised as credit risk mitigation for RWA purposes if, in all relevant jurisdictions, it—

(a) is legally enforceable in the event of default, regardless of whether or not the counterparty is insolvent, bankrupt, or under statutory management; and

(b) gives the non-defaulting party the right to immediately terminate and close out all transactions under the agreement in the event of default, including in the event of insolvency, bankruptcy, or statutory management; and

(c) provides for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other; and

(d) allows for the immediate liquidation or set-off of collateral in the event of default, including in the event of insolvency, bankruptcy, statutory management, or other similar forms of administration.

Compare: BPR132 B2.8

202 Formula for calculating exposure under master netting agreement

(1) This clause applies, for the purposes of clause 195(1)(b), to a deposit taker's calculation of the capital requirement for multiple SFTs subject to a master netting agreement.

(2) The formula for calculating the exposure value after credit risk mitigation (**E***), is as follows:

$$Max\left\{0, \sum_{i=1}^{n} E_i - \sum_{i=1}^{n} C_i + \sum_{j=1}^{m} H_j \times Abs\left(S_j\right) + \sum_{r=1}^{R} H_{FX} \times Abs\left(S_r^{fx}\right)\right\}$$

where—

E_i is the current value of the exposure (cash or securities lent) on transaction i (i = 1 to n)

C_i is the current value of the collateral amount (cash or securities borrowed) on transaction I (I = 1 to n)

S_j is the net position in any security j (j = 1 to m), where individual positions in the security may arise either from lending the security (positive amount) or receiving the security as collateral (negative amount)

Abs is absolute value

H_j is the haircut applicable to security j, determined in accordance with clause 197 to 200

S_r^{fx} is the net position in any security denominated in a currency different from the settlement currency (r = 1 to R), which is a subset of the full set of m securities (so that $R \leq m$, and R may be zero)

H_{FX} is the foreign currency haircut applicable to security r determined in accordance with clauses 197 to 199.

Compare: BPR132 B2.9

Treatment of collateral: simple methodology

203 Recognition of collateral

(1) Under the simple methodology to recognising collateral for credit risk mitigation, collateral is recognised only if the collateral is pledged for at least the life of the exposure, and is marked to market at least every 6 months.

(2) The release of collateral must be conditional on the repayment of the exposure.

(3) However, collateral may be reduced in proportion to the amount of any reduction in the exposure amount.

Compare: BPR132 B3.1

204 Risk weighting of collateralised transaction

(1) Subject to subclauses (2) and (3), the portion of an exposure collateralised by eligible collateral must be risk-weighted at the greater of the following:

- (a) the risk weight applicable to the collateral under subparts 4 and 5 of Part 5:
- (b) 20%.

(2) A 0% risk weight may be applied to the portion of an exposure collateralised by eligible collateral if the transaction is—

- (a) a collateralised transaction where the exposure and the collateral are denominated in the same currency, and either—
  - (i) the collateral is cash on deposit with the deposit taker; or
  - (ii) the collateral is in the form of sovereign securities eligible for a 0% risk weight, provided that the market value of the collateral used to determine the collateralised portion has been discounted by 20%; or
- (b) an SFT that fulfils the conditions for a zero haircut set out in clause 200 and is with a core market participant; or
- (c) a derivative transaction in the banking book that is—
  - (i) marked to market on a daily basis; and
  - (ii) fully collateralised by cash; and
  - (iii) denominated in the same currency as the collateral.

(3) A 10% risk weight may be applied to the portion of an exposure collateralised by eligible collateral if the transaction is—

- (a) an SFT that fulfils the conditions for a zero haircut set out in clause 200, but is not with a core market participant; or
- (b) a derivative transaction collateralised by sovereign securities that qualify for a 0% risk weight.

(4) For determining the portion of the claim to be treated as collateralised in this clause, the deposit taker must use the market value of the collateral at its most recent revaluation.

Compare: BPR132 B3.2

Subpart 4—On-balance-sheet netting

Recognition of on-balance-sheet netting

205 Requirements for on-balance-sheet netting

A deposit taker may recognise on-balance-sheet netting as credit risk mitigation in calculating the RWA for a credit exposure when the following requirements are met:

(a) the bilateral netting agreement is enforceable in each relevant jurisdiction, regardless of whether the counterparty is insolvent or bankrupt:

(b) the deposit taker must be able to identify the loans and deposits that are subject to the bilateral netting agreement:

(c) the deposit taker must monitor and control its roll-off risks:

(d) the deposit taker must monitor and control the relevant exposure on a net basis.

Compare: BPR132 C1.2

Calculation of exposure value

206 Treatment of loans and deposits

(1) The net exposure value in respect of bilateral on-balance-sheet netting of loans and deposits must be calculated under 207(1).

(2) No haircuts apply to the loan and deposit amounts unless they are denominated in different currencies, in which case the standard supervisory haircut for a currency mismatch under clause 197(1)(d) applies to the deposit, scaled up if daily mark to market is not conducted.

Compare: BPR132 C2.1

207 Formula for calculating exposure

(1) The formula for calculating the exposure value for loans after risk mitigation (**E***) that are netted against deposits under a recognised bilateral netting agreement is as follows:

$$\max\{0, [E - C_A \times (100\% - H_{FX})]\}$$

where—

E is the current value of the exposure to the counterparty subject to the bilateral netting agreement

H_{FX} is the supervisory haircut for a currency mismatch, specified in clause 197(1)(d), adjusted, if revaluation takes place less frequently than daily (*see* clause 198), in accordance with the formula in clause 199, with the minimum holding period TM set at 10 days

C_A is—

(i) the value of the collateral if there is no maturity mismatch between the deposits and the loans; or

(ii) if there is a maturity mismatch, the value determined in accordance with, and subject to the conditions in subpart 7.

(2) Under the standardised approach, the exposure value after recognising on-balance-sheet netting is multiplied by the risk weight applicable to the counterparty.

(3) Under the internal models approach,—

(a) the exposure value E is the deposit taker's own estimate of EAD for the counterparty exposure before allowing for netting; and

(b) the value E* after adjusting for on-balance-sheet netting forms part of the deposit taker's total net EAD for that counterparty.

Compare: BPR132 C2.2

Subpart 5—Treatment of guarantees, indemnities, and credit derivatives: standardised approach

General provisions about substituting risk weight

208 Requirements for recognition of guarantee, indemnity, or credit derivative

(1) A deposit taker that uses the standardised approach to calculate RWA in respect of an exposure may recognise a guarantee, indemnity, or credit derivative as credit risk mitigation in calculating an RWA by substituting the risk weight applicable to the credit protection provider for the risk weight that applies to the exposure.

(2) Recognition of a guarantee, indemnity, or credit derivative under subclause (1) must be in accordance with this subpart.

Compare: BPR132 D1.1

209 Credit protection provider

(1) The credit protection provider in respect of the guarantee, indemnity, or credit derivative must be 1 of the following:

(a) a sovereign or central bank:

(b) a public sector entity:

(c) a lowest-risk multilateral development bank or supranational, or other development bank:

(d) a deposit taker or an overseas bank:

(e) a corporate with an issuer rating corresponding to a rating grade of 1 or 2 under subpart 3 of Part 5.

(2) The credit protection provider may not be a related party of the deposit taker.

(3) In this clause, **related party** has same meaning as in clause 4 of the Deposit Takers (Related Party Exposures) Standard 2027.

Compare: BPR132 D1.2.1

210 Nature of guarantee, indemnity, or credit derivative

The guarantee, indemnity, or credit derivative must—

(a) represent a direct claim on the protection provider; and

(b) be explicitly referenced to a specific exposure, or to a pool of exposures (the **underlying exposure** in this subpart); and

(c) be legally enforceable; and

(d) be irrevocable; and

(e) be unconditional; and

(f) meet the requirements in—

(i) clause 211, in the case of a guarantee or indemnity; or

(ii) clauses 212 to 215, in the case of a credit derivative.

Compare: BPR132 D1.2.2

Requirements to be met

211 Other requirements for guarantee or indemnity

For the purposes of clause 210(f)(i), a guarantee or indemnity must—

(a) cover all types of payment the obligor is required to make under the documentation for the underlying exposure; and

(b) provide that, on the qualifying default of, or non-payment by, the obligor, any monies outstanding on the underlying exposure can be pursued immediately, without the need for legal action to be taken.

Compare: BPR132 D1.3

212 Eligible types of credit derivative

(1) For the purposes of clause 210(f)(ii), a credit derivative must be—

(a) a credit default swap referenced to a single reference entity, that provides credit protection equivalent to a guarantee; or

(b) a total return swap that provides credit protection equivalent to a guarantee; or

(c) a cash-funded credit-linked note.

(2) A total return swap described in subclause (1)(b) must not be recognised if the deposit taker—

(a) buys credit protection through a total return swap; and

(b) records the net payments received on the swap as net income; and

(c) does not record offsetting deterioration in the value of the asset that is protected, either through reductions in fair value or by an addition to reserves.

(3) In this clause, **total return swap** means a credit derivative under which a protection buyer, during the term of the contract,—

(a) pays a protection seller all cash flows arising from a reference obligation together with any appreciation in the market value of the reference obligation; and

(b) receives, in return, a spread over a specified index together with any depreciation in the value of the reference obligation.

Compare: BPR132 D1.4

213 Credit events covered under terms of credit derivative

(1) For the purposes of clause 210(f)(ii), the credit events under the contractual terms of a credit derivative must cover the following circumstances:

(a) a failure to pay an amount due under the terms of the underlying exposure that are in effect at the time of such failure (with a grace period in the credit derivative contract that is closely in line with the grace period of the underlying obligation):

(b) the bankruptcy, insolvency, statutory management, administration, or receivership of the obligor of the underlying exposure, the inability or failure of the obligor to pay its debts, the obligor's admission in writing that it is unable to pay its debts as those debts become due, or any other analogous event:

(c) the restructuring of the underlying exposure, including forgiveness or postponement of principal, interest, or fees, that results in a credit loss event (that is, charge-off, allowance for impairment, or similar debit to the profit and loss account).

(2) However, if the terms of a credit derivative cover the matters specified in subclause (1)(a) and (b), but do not cover the matters specified in subclause (1)(c), partial recognition of the credit derivative is allowed as follows:

(a) if the amount of the protection provided by the credit derivative is less than or equal to the amount of the underlying exposure, 60% of the credit derivative protection amount may be recognised:

(b) if the amount of the credit protection provided is larger than the amount of the underlying exposure, a maximum of 60% of the value of the underlying exposure may be recognised as protected.

Compare: BPR132 D1.5

214 Cash-settled credit derivatives

For the purposes of clause 210(f)(ii), in relation to a credit derivative allowing for cash settlement, the deposit taker must have implemented—

(a) a valuation process that will estimate loss reliably; and

(b) a clearly specified period for obtaining a post-credit-event valuation of the underlying exposure.

Compare: BPR132 D1.6

215 Asset mismatch in relation to credit derivatives

(1) For the purposes of clause 210(f)(ii), in relation to a credit derivative which includes an asset mismatch, the following requirements must be met:

(a) the reference obligation must rank pari passu with, or junior to, the underlying exposure:

(b) either—

(i) the underlying exposure and the reference obligation must be obligations of the same legal entity; or

(ii) the underlying exposure must be an obligation of an entity that is unconditionally and irrevocably guaranteed or indemnified by the reference entity specified in the derivative contract:

(c) legally enforceable cross-default or cross-acceleration clauses must be in place.

(2) An asset mismatch occurs when—

(a) a deposit taker has purchased credit protection by way of a credit derivative; and

(b) the underlying exposure protected by the credit derivative is different from the reference obligation specified in the derivative contract.

(3) In this clause, **reference obligation** means any of the following in relation to a credit derivative:

(a) the deliverable obligation:

(b) in the case of a cash-settled credit derivative, the obligation used for the purposes of determining cash settlement:

(c) the obligation used for the purposes of determining whether a credit event has occurred.

Compare: BPR132 D1.7

216 Treatment of cash-funded credit-linked notes

(1) This clause applies if—

(a) a deposit taker purchases credit protection against an exposure in the banking book; and

(b) that protection is purchased by way of a credit-linked note; and

(c) that note is funded by cash.

(2) The deposit taker must—

(a) treat the note as a cash-collateralised transaction; and

(b) apply the treatment and conditions set out in subpart 3.

Compare: BPR132 D1.8

Adjustments

217 Currency mismatch adjustment

(1) A currency mismatch occurs when a guarantee, indemnity, or credit derivative is denominated in a different currency to the underlying exposure.

(2) If there is a currency mismatch, the amount of the exposure deemed to be protected (**GA**) must be reduced by an adjustment according to the following formula:

$$G \times (100\% - H_{FX})$$

where—

G is the nominal amount of the credit protection

H_{FX} is the haircut for the currency mismatch between the credit protection and the underlying exposure, calculated under subclause (3).

(3) The adjustment for a currency mismatch is—

(a) 8% if the credit protection is marked to market on an daily basis; or

(b) if the credit protection is marked to market less frequently than daily, 8% scaled up according to the frequency of revaluation using the following formula:

$$8\% \times \sqrt{\frac{N_R + 9}{10}}$$

where N_R is the number of working days between revaluations.

Compare: BPR132 D1.9

218 Maturity mismatch adjustment

If the effective residual maturity of the guarantee, indemnity, or credit derivative is less than that of the underlying exposure, the amount of protection provided must be reduced in accordance with subpart 7.

Compare: BPR132 D1.10

Recognition in RWA calculation

219 Method of recognition in RWA calculation

(1) If, after making all required adjustments, the amount of protection provided by the guarantee, indemnity, or credit derivative is greater than, or equal to, the underlying exposure, the exposure may be assigned the risk weight of the protection provider.

(2) Where the amount of protection provided is less than the underlying exposure, the following provisions apply:

(a) if the protected portion of the exposure ranks equal, or senior, to the unprotected portion, the following treatment applies:

(i) the protected portion of the exposure may be assigned the risk weight of the protection provider; and

(ii) the unprotected portion of the exposure must be assigned the risk weight applicable to the underlying obligor:

(b) however, if the deposit taker takes the first loss on the exposure, the deposit taker may not recognise the credit protection for RWA purposes, and the underlying exposure must be assigned the risk weight applicable to the underlying obligor.

Compare: BPR132 D1.11

Subpart 6—Treatment of guarantees, indemnities, and credit derivatives: internal models approach

220 Use of guarantees, indemnities, and credit derivatives under internal models approach

(1) The approach under this subpart for recognising credit risk mitigation in the form of guarantees, indemnities, and credit derivatives may be used for calculating the RWA of any exposure that is part of a portfolio that the Bank has approved to be risk-weighted using an internal model, provided that the credit protection provider is also subject to an internal model.

(2) The deposit taker must comply with the requirements of clauses 215 and 217, and subpart 7, as applicable.

Compare: BPR132 D2.1

221 Recognising guarantees, indemnities, and credit derivatives for RWA calculation under internal models approach

(1) A guarantee, indemnity, or credit derivative issued by a party who is a related party of the deposit taker must not be recognised as credit risk mitigation for RWA calculation purposes.

(2) The deposit taker must have clearly documented criteria for the types of credit protection providers it recognises for RWA calculation purposes.

(3) A guarantee, indemnity, or credit derivative must—

(a) be in writing and must not be able to be cancelled by the credit protection provider; and

(b) remain in force until the obligations of the credit protection provider under the guarantee or credit derivative are satisfied in full (to the extent of its amount and tenor); and

(c) be legally enforceable against the credit protection provider in a jurisdiction where—

(i) the protection provider has sufficient assets to meet its obligations under the credit protection arrangement; and

(ii) the deposit taker has a legal ability to access those assets if the protection provider fails to comply with a judgement against it; and

(d) in the case of a credit derivative, meet the additional requirements set out in clause 227.

(4) Despite subclause (3)(a) to (c), a conditional guarantee or conditional indemnity may be recognised if the deposit taker is able to demonstrate that the deposit taker's methodology for adjusting PD or LGD estimates under clause 222 adequately addresses any potential reduction in the effect of the credit risk mitigation.

(5) In subclause (1) **related party** has the same meaning as in clause 4 of the Deposit Takers (Related Party Exposures) Standard 2027.

Compare: BPR132 D2.2

222 Guarantees, indemnities, and credit derivatives: reflection in PD or LGD estimates

(1) A deposit taker may reflect the risk-mitigating effect of a guarantee, indemnity, or credit derivative in an RWA calculation by adjusting PD or LGD estimates.

(2) However, the adjustments must be made consistently—

(a) across types of guarantees, indemnities, or credit derivatives, as the case may be; and

(b) over time.

(3) An LGD estimate must not be adjusted if it is for either of the following exposure classes:

(a) farm lending:

(b) residential mortgage lending.

(4) If, after making the adjustments, the amount of protection provided by the guarantee, indemnity, or credit derivative is less than the underlying exposure, the following treatment applies:

(a) if the protected portion of the exposure ranks equal or senior to the unprotected portion, the deposit taker may calculate the RWAs for the protected and unprotected portions in accordance with subclauses (5) to (8):

(b) however, if the deposit taker takes the first loss on the exposure, the deposit taker may not recognise the credit protection for RWA purposes, and the underlying exposure must be assigned the risk weight applicable to the underlying obligor.

(5) When adjusting an LGD estimate, the deposit taker must use the PD estimate and risk-weight function applicable to the underlying obligor for both the protected and unprotected portions of the exposure.

(6) When adjusting a PD estimate, the deposit taker must determine the capital charge for the protected portion of the exposure according to the following:

(a) the deposit taker must calculate the capital charge using the risk-weight function appropriate to the credit protection provider:

(b) the deposit taker may, subject to the requirements in the internal models standard, use a value of PD that is—

(i) the PD associated with the deposit taker's internal obligor grade for the credit protection provider; or

(ii) if the deposit taker considers that full substitution is not warranted, the PD associated with a grade between that of the underlying obligor and the credit protection provider; and

(c) the deposit taker may replace the LGD of the underlying exposure with the LGD applicable to the guarantee, indemnity, or credit derivative, taking into account its seniority and any eligible collateral.

(7) When adjusting a PD estimate, the deposit taker must determine the capital charge for the unprotected portion of the exposure by calculating the risk weight in the same manner as for a direct exposure to the underlying obligor.

(8) The value for maturity (**M**) that a deposit taker uses in any formula under subclauses (4) to (7) must be the same M that the deposit taker would use for calculating the RWA for the underlying exposure without a guarantee, indemnity, or credit derivative.

Compare: BPR132 D2.3

223 Ratings of obligor and credit protection provider

(1) In any adjustment referred to in clause 222, both the obligor and all recognised credit protection providers must be assigned an obligor rating at all times, beginning with the initiation of the deposit taker's relationship with those parties and on a continuing basis.

(2) All minimum requirements for assigning and maintaining obligor ratings in the internal models standard must be complied with, including the regular monitoring of the credit protection provider's condition and ability and willingness to honour its obligations.

Compare: BPR132 D2.4

224 Guarantees, indemnities, and credit derivatives: retention of information

(1) In relation to any adjustment made by a deposit taker under clause 222, the deposit taker must retain all relevant information regarding the obligor, and that information must be retained in the same way as it would be if the credit protection was not in place.

(2) In the case of retail exposures, the requirements in subclause (1) also apply to the assignment of an exposure to a pool and the estimation of PD.

Compare: BPR132, D2.5

225 Guarantees, indemnities, and credit derivatives: limits on adjustments of PD or LGD

(1) An exposure covered by a guarantee, indemnity, or credit derivative must not be assigned an adjusted PD or LGD that would result in the adjusted risk weight being lower than that of a comparable direct exposure to the credit protection provider.

(2) When assigning ratings and estimating PDs for RWA calculation purposes, the deposit taker must not take into account the possibility of risk being reduced by imperfect expected correlation between default events for the obligor and credit protection provider.

Compare: BPR132 D2.6

226 Criteria for adjusting PD or LGD

(1) To reflect the impact of guarantees, indemnities, and credit derivatives under this subpart, a deposit taker must have clearly specified and documented criteria—

(a) for adjusting PD or LGD estimates; and

(b) in the case of retail exposures or eligible purchased receivables, for the process of allocating exposures to pools.

(2) The adjustment criteria must, as a minimum, contain the detail required under Schedule 1 of the internal models standard for assigning exposures to grades, and must follow all minimum requirements for assigning borrower or facility ratings under that standard.

(3) The adjustment criteria must—

(a) address the credit protection provider's ability and willingness to perform under the guarantee, indemnity, or credit derivative; and

(b) address the likely timing of any payments and the degree to which the credit protection provider's ability to perform under the guarantee, indemnity, or credit derivative is correlated with the obligor's ability to repay; and

(c) consider the extent to which residual risk to the obligor remains.

(4) In adjusting PD and LGD estimates, all relevant material information must be taken into account.

Compare: BPR132 D2.7

227 Criteria for adjusting PD or LGD: further requirements applying to credit derivatives

The criteria used for assigning adjusted PD or LGD estimates for exposures covered by credit derivatives must—

(a) require that the exposure on which the protection is based (the reference obligation in clause 215(3)) cannot be different from the underlying exposure unless the conditions detailed in clause 215 are met; and

(b) address the pay-out structure of the credit derivative, and conservatively assess the impact that has on the level and timing of recoveries; and

(c) consider the extent to which other forms of residual credit risk remain; and

(d) require that the terms of the credit derivative cover all the credit events specified in clause 213(1), unless the restructuring of the underlying exposure is not covered, in which case the adjustment criteria may provide for partial recognition as detailed in clause 213(2).

Compare: BPR132 D2.8

228 Effect of adjustment on expected loss calculation

In calculating the expected loss (**EL**) for an exposure that is wholly or partly protected by a guarantee or credit derivative, the deposit taker must use the same estimates of PD, LGD, and EAD as those used in calculating the RWA for unexpected loss (**UL**), after taking account of any adjustments provided for in clause 222.

Compare: BPR132 D2.9

Subpart 7—Maturity mismatch

Meaning and adjustments

229 Overview of this subpart

This subpart sets out the method for adjusting the amount of the credit risk mitigants provided for in subparts 3 to 6 where there is a maturity mismatch between the underlying credit exposure and relevant credit risk mitigant.

Compare: BPR132 E1.1.1

230 Meaning of maturity mismatch

In this Part, a **maturity mismatch** exists if the effective residual maturity of a credit risk mitigant is less than the effective residual maturity of the underlying exposure.

Compare: BPR132 E1.1.2

231 Effective residual maturity

(1) For the purposes of calculating the maturity mismatch adjustment, the deposit taker must determine the effective residual maturity of both the underlying exposure and the credit risk mitigant conservatively.

(2) The effective residual maturity of the underlying exposure is, taking the most conservative view, the longest possible remaining period before the obligor is required to fulfil its obligation.

(3) The effective residual maturity of the mitigant is the shortest possible period remaining on the term of that mitigant, taking into account any clause in the transaction agreement that may reduce that term.

Compare: BPR132 E1.2

232 Limitations on recognition of credit risk mitigants with maturity mismatch

(1) For RWA calculation purposes, a deposit taker must not recognise a credit risk mitigant that has—

(a) an effective original maturity of less than 12 months; and

(b) a maturity mismatch with the underlying exposure.

(2) In this subpart, effective original maturity means the length of the period—

(a) beginning on the day on which the credit risk mitigant was first put in place; and

(b) ending on the day that was specified, when the mitigant was first put in place, as that mitigant's date of maturity.

Compare: BPR132 E1.3

233 Maturity mismatch adjustment

(1) If the effective original maturity of the credit risk mitigant is 12 months or more, credit risk mitigation with a maturity mismatch may be recognised for RWA calculation purposes.

(2) However, the amount of credit protection must be adjusted using the following formula:

$$P \times \text{Max}\,[0, (t - 0.25) / (T - 0.25)]$$

where—

P is the amount of credit protection that may be recognised after making the relevant adjustments required by subparts 3 to 5 but before taking into account the maturity mismatch

t is the lesser of T and the effective residual maturity of the mitigant, expressed in years

T is the lesser of 5 and the effective residual maturity of the underlying exposure expressed in years.

Compare: BPR132 E1.4

Part 7
Capital requirement for market risk

Subpart 1—Preliminary provisions

234 Interpretation in this Part

In this Part,—

core rate-insensitive asset means a rate-insensitive asset, or part of that asset, the value of which does not temporarily increase and decrease with a regular seasonal pattern, and **core rate-insensitive liability** has a corresponding meaning

core rate-insensitive product means a product that is either or both a core rate-insensitive asset or core rate-insensitive liability

rate-insensitive asset means a financial asset, or part of a financial asset, that is required to be treated as a rate-insensitive asset under clause 252(1), and **rate-insensitive liability** has a corresponding meaning

rate-insensitive product means a product that is either or both a rate-insensitive asset or rate-insensitive liability

seasonal rate-insensitive asset means a rate-insensitive asset, the value of which temporarily increases and decreases with a regular seasonal pattern, **and seasonal rate-insensitive liability** has a corresponding meaning

seasonal rate-insensitive product means either or both of a seasonal rate-insensitive liability or a seasonal rate-insensitive liability.

Compare: BPR140 A1.3

235 Restrictions on including own equity and fixed assets in calculations

(1) A deposit taker must, when making calculations under this Part,—

(a) exclude its own equity; or

(b) include its own equity, but only for the purposes of subpart 3, using a maturity profile approach as if it were an interest-bearing liability with a series of maturity dates.

(2) A deposit taker must not include fixed assets (for example, land or buildings) in the calculations.

(3) In this clause, **maturity profile approach**, means an approach to including equity for the purposes of subpart 3 that treats the equity as if it matures over time so that an equivalent amount may be invested in a series of maturing interest-bearing assets without generating interest rate risk.

Compare: BPR140 A1.2.2

236 When exposures must be calculated

Exposures required under this Part must be end-of-day exposures and must be calculated—

(a) at least quarterly in respect of the banking book:

(b) daily in respect of the trading book.

Compare: BPR140 A1.2.3

Subpart 2—Calculation of capital requirement for market risk

237 Calculation of capital requirement for market risk

(1) A deposit taker's capital requirement for market risk is the total of—

(a) the capital charge for market risk in the deposit taker's banking book (*see* clause 238); and

(b) the capital charge for market risk in the deposit taker's trading book, if any (*see* clause 239).

(2) This clause is subject to clause 240 in respect of a group 3 deposit taker.

238 Capital charge for market risk: banking book

A deposit taker must calculate the capital charge for market risk in its banking book as the total of—

(a) the capital charge for interest rate risk (*see* subpart 3); and

(b) the capital charge for currency risk (*see* subpart 4) or the capital requirement for foreign exchange risk in respect of the banking book calculated under a methodology referred to in clause 239; and

(c) the capital charge for equity risk (*see* subpart 5).

Compare: BPR140 A2.1

239 Capital charge for market risk: trading book

(1) A deposit taker must calculate the capital charge for market risk in its trading book, if any, by using a methodology approved by the Bank.

(2) When deciding whether to approve a deposit taker's proposed methodology, and any conditions of the approval, the Bank must be satisfied that the methodology is consistent with *Calculation of RWA for market risk MAR 40: Simplified standard approach* prepared by the Basel Committee on Banking Supervision, effective 1 January 2023.

(3) A deposit taker may amend its methodology if the Bank approves the proposed amended methodology in accordance with subclause (2).

240 Capital requirement for market risk for group 3 deposit takers

(1) A group 3 deposit taker must calculate the capital requirement for market risk according to the following formula:

$$[(a + b) \div 2] \times 0.05$$

where—

a is the deposit taker's total assets

b is the deposit taker's total credit risk RWAs.

(2) Subclause (3) applies to a group 3 deposit taker if it has a trading book in respect of which 95% of its 1-day value-at-risk, or 95% of its 1-month value-at risk, exceeds the threshold that is 2% of its risk-weighted assets for credit risk (the **VAR threshold**).

(3) The deposit taker must—

(a) calculate the capital charge for market risk in its trading book under clause 239; and

(b) add the amount calculated under paragraph (a) to the amount calculated under subclause (1).

(4) A deposit taker is not required to comply with subclause (3) until—

(a) its trading book has exceeded the VAR threshold twice, with the second occurrence between 1 month and 6 months after the first occurrence; and

(b) 12 months have elapsed since the first occurrence referred to in paragraph (a).

(5) However, subclause (4) does not apply to a deposit taker if the deposit taker's trading book exceeds the VAR threshold at the time that it commences business under the Act.

(6) Clause 239 does not apply to a group 3 deposit taker except as provided in this clause.

(7) Clause 238 does not apply to a group 3 deposit taker.

Compare: SR 2010/167 r 21

241 Market risk overlay

(1) A condition of a deposit taker's licence may specify, as a **market risk overlay**, either or both of the following—

(a) a percentage by which the capital requirement for market risk under clause 237(1) must be increased:

(b) a percentage by which a capital charge or a component of a capital charge, required to calculate the capital requirement for market risk in the banking book or the trading book under this Part, must be increased.

(2) The Bank, when deciding whether to specify a condition under subclause (1), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

Subpart 3—Capital charge for interest rate risk in banking book

General provisions

242 Capital charge for interest rate risk in banking book

(1) To calculate the capital charge for interest rate risk in the banking book, a deposit taker must first,—

(a) calculate the total interest rate exposure in each currency in which the deposit taker has that exposure, in accordance with clause 243; and

(b) in relation to the amounts resulting from paragraph (a), calculate—

(i) the total of the positive amounts; and

(ii) the total of the negative amounts.

(2) The capital charge is the greater of the following amounts:

(a) the total in subclause (1)(b)(i):

(b) the absolute value of the total in subclause (1)(b)(ii).

Compare: BPR140 B1.1

243 Calculation of interest rate exposure in each currency

(1) A deposit taker must, for the purposes of calculating the capital charge for interest rate risk in the banking book under clause 242(1)(a), calculate the interest rate exposure in each currency in accordance with this clause.

(2) A deposit taker must—

(a) decompose any compound or hybrid financial instrument that comprises more than 1 notional underlying financial instrument into those instruments; and

(b) decompose any derivative, including a derivative that arises from decomposition under paragraph (a), into underlying or notional underlying instruments (as the case may be); and

(c) exclude matched short and long positions in accordance with clauses 247 to 250.

(3) The deposit taker must then, for each financial instrument including an instrument resulting from decomposition under subclause (2)(a) or (b),—

(a) allocate the value of the instrument to the specified time band, in accordance with clauses 251 to 255, in the currency in which the instrument is denominated; or

(b) if applicable, allocate portions of the value of the instrument to—

(i) more than 1 of the specified time bands:

(ii) more than 1 currency.

(4) The deposit taker must, using the amounts allocated under subclause (3), calculate total interest rate exposure in each currency as the total of—

(a) the directional interest rate risk, calculated in accordance with clause 256; and

(b) the basis risk exposure within each time band for the currency, calculated using the vertical disallowance methodology set out in clauses 257 to 259; and

(c) the yield curve risk exposure for the currency, calculated using the methodology of horizontal disallowance across time bands set out in clauses 260 to 265.

Compare: BPR140 B1.2

244 Valuation of financial instrument

(1) The value of a financial instrument (which must be expressed in NZD) for the purposes of calculating the capital charge for interest rate risk in the banking book is,—

(a) for an option, the value determined by the deposit taker in accordance with clause 246; or

(b) for a derivative other than an option, the principal amount after decomposition under clause 243(3)(b), of underlying or notional underlying instruments, updated in line with the current market valuation of corresponding actual instruments; or

(c) for any other financial instrument, including any instrument arising from decomposition under 243(3)(a)—

(i) if it is recognised in accordance with NZ IFRS 9, the principal amount of the instrument updated in line with the current market valuation (if any) of corresponding instruments; or

(ii) if it is not recognised in accordance with NZ IFRS 9, the face or contract amount of the financial instrument.

Compare: BPR140 B1.3

245 Treatment of derivatives for interest rate risk

(1) If a deposit taker could allocate a derivative to more than 1 time band, it must allocate the derivative to the time band that would be the most prudent in the circumstances.

(2) An interest rate swap in which the deposit taker agrees to swap fixed rate interest payments (or receipts) for floating rate payments (or receipts) must be treated as—

(a) a financial asset (or liability) with a maturity equivalent to the term of the underlying fixed rate agreement; and

(b) a financial liability (or asset) with a maturity equivalent to the term of the underlying floating rate agreement.

(3) A forward rate agreement under which a deposit taker agrees to invest (or borrow) funds for a fixed term, at an agreed interest rate, after a specified elapsed period (spanning today and the agreed future start date) must be treated as—

(a) an interest-bearing financial asset (or liability) with a maturity equal to the fixed term plus the specified elapsed period; and

(b) an interest-bearing financial liability (or asset) with maturity equal to the specified elapsed period.

(4) If different underlying financial instruments or notional financial instruments of a derivative are in different currencies, each of those instruments must be allocated to the time band and currency applicable to that component, and then included in the calculation of the capital charge for interest rate risk for that currency.

Compare: BPR140 B1.4

246 Treatment of interest rate risk on options

A deposit taker may determine the value of options, for the purposes of calculating the capital charge for interest rate risk in the banking book, by—

(a) determining the interest rate risk in a single currency arising from options, using its own methodology, and then adding that risk to the total interest rate risk in the currency; or

(b) using 1 of the methods for measuring risk on options in *Amendment to the Capital Accord to Incorporate Market Risks* by the Basel Committee on Banking Supervision in January 1996 (https://www.bis.org/publ/bcbs24.pdf) and incorporating that exposure into its calculation of total interest rate risk in accordance with the chosen method.

Compare: BPR140 B1.5

Exclusion of matched positions

247 Excluding matched long and short position

For the purposes of clause 243(2), a deposit taker may exclude a matched long and short position if the matched position—

(a) relates to financial instruments with the same issuer, coupon, currency, and maturity; or

(b) is—

(i) of a kind referred to in clause 248, 249, or 250, as the case may be; and

(ii) meets the conditions specified in whichever of those clauses applies.

Compare: BPR140 B2.1

248 Futures contract

For the purposes of clause 243(2), a deposit taker may exclude a matched position in a futures contract if the underlying financial instruments to which the contract relates—

(a) are for the same product; and

(b) have the same value or notional value; and

(c) are denominated in the same currency; and

(d) matures within seven days of each other.

Compare: BPR140 B2.2

249 Swap or forward rate agreement

(1) For the purposes of clause 243(2), a deposit taker may exclude a matched position in swaps (including separate legs of different swaps) or forward rate agreements.

(2) A matched position may be excluded if the underlying financial instruments to which the swaps or forward rate agreements relate—

(a) are for the same product; and

(b) have the same value or notional value; and

(c) are denominated in the same currency; and

(d) have reference rates (for floating rate positions) that are identical; and

(e) have coupons that are—

(i) identical; or

(ii) do not differ by more than 15 basis points; and

(f) have future interest rate repricing dates within the relevant period specified in subclause (3).

(3) If the shortest period to the next repricing date in respect of any of the instruments is—

(a) 1 month or less, all the instruments must be repriced on the same day; or

(b) more than 1 month but less than 1 year, the instruments must be repriced within 7 days of each other; or

(c) 1 year or more, all the instruments must be repriced within 30 days of each other.

Compare: BPR140 B2.3

250 Forward contract

(1) For the purposes of clause 243(2), a deposit taker may exclude a matched position in a forward contract if the underlying financial instruments to which the forward contract relates—

(a) are for the same product; and

(b) have the same value or notional value; and

(c) are denominated in the same currency; and

(d) have maturity dates within the relevant period specified in subclause (2).

(2) If the shortest period to maturity in respect of any of the instruments is—

(a) 1 month or less, all the instruments must mature on the same day; or

(b) more than 1 month but less than 1 year, all the instruments must mature within 7 days of each other; or

(c) 1 year or more, all of the instruments must mature within 30 days of each other.

Compare: BPR140 B2.4

Allocating instruments to time bands

251 Use of interest rate repricing schedules

For the purposes of clause 243(3)(a), a deposit taker must allocate financial instruments to specified time bands—

(a) in a manner that a reasonable deposit taker would consider reflects its assessment of the interest rate repricing date of those instruments; and

(b) in accordance with methods of allocation as follows:

(i) rate-insensitive products must be allocated according to clauses 252 and 253:

(ii) other financial instruments must be provided according to clauses 254 and 255.

Compare: BPR140 B3.1

252 Determination of rate-insensitive products

(1) A deposit taker must treat an applicable product as a rate-insensitive product, if it considers that it does not need to promptly adjust the interest rate it earns or pays in respect of the product to maintain customer balances in response to a change in the general level of interest rates.

(2) For the purposes of clause 243(3)(a), a deposit taker may allocate—

(a) up to 20% of its total rate-insensitive assets in any 1 currency to the seasonal rate-insensitive asset category; and

(b) up to 20% of its total rate-insensitive liabilities in any 1 currency to the seasonal rate-insensitive liability category.

(3) Any applicable product that the deposit taker has determined is a rate-insensitive product but not a seasonal rate-insensitive product must be treated as a core rate-insensitive product (*see* clause 253).

(4) In this clause, **applicable product** means a financial asset or financial liability, or part of a financial asset or financial liability, in respect of which the deposit taker earns, or pays, the interest rate.

Compare: BPR140 B3.2

253 Time bands for rate-insensitive products

(1) A deposit taker must allocate the total value of all core rate-insensitive products to the time bands, by percentage of aggregate value, according to the following table:

Time band	Percentage of aggregate value
1 month or less	5
More than 1 month but not more than 3 months	2.5
More than 3 months but not more than 6 months	2.5
More than 6 months but not more than 1 year	10
More than 1 year but not more than 2 years	20
More than 2 years but not more than 3 years	20
More than 3 years but not more than 4 years	20
More than 4 years but not more than 5 years	10
More than 5 years but not more than 7 years	10

(2) A deposit taker must also allocate the total value of all seasonal rate-insensitive products to the time bands specified in subclause (3), with the percentage allocated to each time band reflecting the dates on which the deposit taker expects seasonal increases and decreases to occur.

(3) The time bands, which relate to the time in the future when the seasonal peak is expected to occur, are as follows:

(a) 1 month or less:

(b) 1 to 3 months:

(c) 3 to 6 months:

(d) 6 to 12 months.

Compare: BPR140 B3.3

254 Interest rate repricing bands for other instruments

(1) This clause applies to a financial instrument that—

(a) is not excluded from calculation of the capital charge for interest rate risk in the banking book under clauses 247 to 250; and

(b) is not a rate-insensitive product.

(2) A deposit taker must, for the purposes of clause 243(3)(a), allocate the value of the instrument, or a proportion of the value relating to part of the instrument, to 1 of the time bands specified in subclause (3) in accordance with clause 255 and in a manner that reflects the earlier of—

(a) the date on which the interest rate applicable to the financial instrument, or the part of the financial instrument, can be reset; or

(b) the date at which the principal, or part of the principal, is payable or repayable.

(3) The time bands are as follows:

(a) 1 month or less:

(b) more than 1 month but not more than 3 months:

(c) more than 3 months but not more than 6 months:

(d) more than 6 months but not more than 1 year:

(e) more than 1 year but not more than 2 years:

(f) more than 2 years but not more than 3 years:

(g) more than 3 years but not more than 4 years:

(h) more than 5 years but not more than 7 years:

(i) more than 7 years but not more than 10 years:

(j) more than 10 years.

Compare: BPR140 B3.4

255 Allocating other financial instruments to time bands

(1) A deposit taker must, for the purposes of clause 243(3)(a), allocate an instrument referred to in clause 254(1) to relevant time bands according to its assessment of the interest rate repricing dates of the instrument, subject to the following:

(a) a deposit taker may treat an impaired asset as non-interest bearing, and may make its own judgement about the time band for the asset:

(b) the time band for an asset that is not impaired must be determined,—

(i) if a deposit taker has discretion in applying interest rate changes to the asset, in accordance with its own judgement about the effect that any lag in adjusting the interest rate has on the time band for the asset; or

(ii) in any other case, by its contractual repricing date or residual maturity, whichever is earlier:

(c) in the case of an embedded option,—

(i) that has been hedged by the deposit taker, the deposit taker may treat the overall hedged position as the contractual position; or

(ii) in any other case, the embedded option must not be taken into account:

(d) a deposit taker must treat a term deposit or other term liability according to its contractual term.

(2) If a deposit taker has a near-hedge arrangement, under which an asset and liability are in adjacent time bands in clause 254(3), and their repricing dates are at most 7 days apart, it may allocate the asset and liability to the same time band by carrying whichever of the asset or liability is in the nearer time-band forward to the longer time-band.

(3) A deposit taker may allocate a financial instrument to the time bands after adjusting the duration of the instrument for its sensitivity to interest rate changes using the assumed interest rate change in clause 256(2).

Compare: BPR140 B3.5

Directional interest rate risk in each currency

256 Calculation of net open interest rate risk exposure

(1) For the purposes of clause 243(4)(a), the net asset or net liability position in each time band for a given currency is the total of—

(a) the positive values for the value of each asset instrument or portion of an asset instrument allocated to that time band in accordance with clauses 251 to 255; and

(b) the negative values for the value of each liability instrument or portion of a liability instrument allocated to that time band in accordance with clauses 251 to 255.

(2) The risk-weighted net position in each time band is calculated by multiplying the net asset or liability position in each time band, calculated in accordance with subclause (1), by the percentage risk-weight for the time band specified in the following table:

Time band	Assumed interest rate change (%)	Risk weight (%)
1 month or less	1.0	0
More than 1 month but not more than 3 months	1.0	0.2
More than 3 months but not more than 6 months	1.0	0.4
More than 6 months but not more than 1 year	1.0	0.7
More than 1 year but not more than 2 years	0.9	1.25
More than 2 years but not more than 3 years	0.8	1.75
More than 3 years but not more than 4 years	0.75	2.25
More than 4 years but not more than 5 years	0.75	2.75
More than 5 years but not more than 7 years	0.7	3.25
More than 7 years but not more than 10 years	0.65	3.75
More than 10 years	0.6	4.4

(3) The net open interest rate risk exposure in the currency is the total of the risk-weighted net positions in each time band, calculated under subclause (2).

Compare: BPR140 B4.1

Basis risk in each currency

257 Calculation of basis risk exposure

A deposit taker must, for the purpose of clause 243(4)(b), calculate the total exposure to basis risk in each currency by,—

(a) adding together the basis risk exposure determined for each time band for that currency in accordance with clause 258; and

(b) if required by clause 259, changing the sign of the total calculated under paragraph (a).

Compare: BPR140 B5.1

258 Calculation of basis risk in each time band

(1) For the purpose of clause 257(a), the basis risk exposure for each time band under clause 256(2) must be calculated using the vertical disallowance methodology set out in subclauses (2) and (3).

(2) A deposit taker must determine for each time band—

(a) the matched position, which is the lesser of—

(i) the total of the absolute values of the financial assets in the time band; and

(ii) the total of the absolute values of the financial liabilities in the time band; and

(b) the absolute value of the rate-insensitive products, which is the total of—

(i) the absolute values of the rate-insensitive assets in the time band; and

(ii) the absolute values of the rate-insensitive liabilities in the time band.

(3) The vertical disallowance amount for the time band is calculated by multiplying the risk weight for the time band specified in clause 256(2) by the total of—

(a) 20% multiplied by the absolute value of rate-insensitive products; and

(b) zero, or 5% multiplied by the matched position less the absolute value of the rate-insensitive products, whichever is greater.

Compare: BPR140 B5.2

259 Basis risk to have same sign as directional interest rate risk

If the directional interest rate risk calculated under clause 256(3) is negative, the measure of basis risk calculated in accordance with clauses 257 and 258 must be given a negative sign.

Compare: BPR140 B5.3

Yield curve risk in each currency

260 Horizontal disallowance in single currency

(1) A deposit taker must, for the purpose of clause 243(4)(c), use the horizontal disallowance methodology in this clause and clauses 261 to 265 to calculate yield curve risk in respect of a currency.

(2) The time bands in clause 256(2) must be grouped into 3 time zones according to the following table:

Time band	Time zone
1 month or less	Zone 1
More than 1 month but not more than 3 months	
More than 3 months but not more than 6 months	
More than 6 months but not more than 1 year	

More than 1 year but not more than 2 years	Zone 2
More than 2 years but not more than 3 years	
More than 3 years but not more than 4 years	
More than 4 years but not more than 5 years	
More than 5 years but not more than 7 years	Zone 3
More than 7 years but not more than 10 years	
More than 10 years	

(3) The total horizontal disallowance in a currency is calculated by—

(a) first, adding together—

(i) the within-zone disallowances calculated for each of the 3 time zones in accordance with clause 261; and

(ii) the across-zone disallowances for each of the 3 pairs of time zones calculated in accordance with clauses 262 to 265; and

(b) then, giving the total calculated under paragraph (a) the same sign (positive or negative) as the deposit taker's directional interest rate risk in the currency calculated in accordance with clause 256(3).

Compare: BPR 140 B6.1

261 Calculation of amount of within-zone disallowance and residual position

(1) For the purposes of clause 260(3)(a)(i), the within-zone disallowance in each time zone in a single currency is the risk-weighted matched position multiplied by the disallowance factor for that time zone as follows:

(a) for zone 1, the disallowance factor is 40%:

(b) for zone 2, the disallowance factor is 30%:

(c) for zone 3, the disallowance factor is 30%.

(2) The residual position in each time zone (*see* clauses 263 and 264) is the sum of—

(a) the aggregate risk-weighted long position; and

(b) the aggregate risk-weighted short position.

(3) In this clause, in relation to a time zone,—

aggregate risk-weighted long position is the sum of the risk-weighted net positions, calculated under clause 256(2), for each time band within the time zone for which that net position is a long position (a positive number)

aggregate risk-weighted short position is the sum of the risk-weighted net positions, calculated under clause 256(2), for each time band within the time zone for which that net position is a short position (a negative number).

risk-weighted matched position is the lesser of—

(a) the absolute value of the aggregate risk weighted long position; and

(b) the absolute value of the aggregate risk weighted short position.

Compare: BPR140 B6.2

262 Order of calculation of across-zone disallowances

(1) For the purposes of clause 260(3)(a)(ii), the across-zone disallowances between each of the 3 pairs of zones specified in subclause (2) must be calculated in accordance with this clause and clauses 263 to 265.

(2) Across-zone disallowances must be determined in the following order:

(a) first, disallowance across zones 1 and 2:

(b) second, disallowance across zones 2 and 3:

(c) third, disallowance across zones 1 and 3.

(3) The residual position in each time zone that is used for calculating the across-zone disallowances in each currency is the amount calculated in clause 261(2).

Compare: BPR140 B6.3

263 Zone 1–zone 2 disallowance

(1) If the zone 1 residual position and zone 2 residual position—

(a) have the same sign,—

(i) the matched position between zones 1 and 2 is nil (no matching); and

(ii) the zone 1–zone 2 across-zone horizontal disallowance is nil; or

(b) have different signs,—

(i) the zone1–zone 2 matched position is the lesser of the absolute values of the two residual positions; and

(ii) the zone 1–zone 2 across-zone horizontal disallowance is the matched position multiplied by 40%.

(2) For the purposes of subclause (1)(b)(i),—

zone 1 net residual position, means the value calculated by—

(a) first, taking the difference between the absolute value of the zone 1 residual position and the zone 1–zone 2 matched position; and

(b) then, if the zone 1 residual position is a short position (negative number), giving the answer a minus sign

zone 2 net residual position, means the value calculated by—

(a) first, taking the difference between the absolute value of the zone 2 residual position and the zone 1–zone 2 matched position between time zones 1 and 2; and

(b) then, if the Zone 2 residual position is a short position (negative number), giving the answer a minus sign.

Compare: BPR140 B6.4

264 Zone 2–zone 3 disallowance

(1) If the zone 2 net residual position and the zone 3 residual position—

(a) have the same sign,—

(i) the matched position between zones 2 and 3 is nil (no matching); and

(ii) the zone 2–zone 3 across-zone horizontal disallowance is nil; or

(b) have different signs,—

(i) the zone 2–zone 3 matched position is the lesser of the absolute values of the zone 2 net residual position and the zone 3 residual position; and

(ii) the zone 2–zone 3 across-zone horizontal disallowance is the matched position multiplied by 40%.

(2) For the purposes of this clause,—

zone 2 net residual position has the meaning set out in clause 263(2)

zone 3 net residual position, means the value calculated by—

(a) first, taking the difference between the absolute value of the zone 3 residual position and the zone 2–zone 3 matched position; and

(b) then, if the zone 3 residual position is a short position (negative number), giving the answer a minus sign.

Compare: BPR140 B6.5

265 Zone 1–zone 3 disallowance

(1) If the zone 1 net residual position and the zone 3 net residual position—

(a) have the same sign,—

(i) the matched position between zones 1 and 3 is nil (no matching); and

(ii) the zone 1–zone 3 across-zone horizontal disallowance is nil; or

(b) have different signs,—

(i) the zone 1–zone 3 matched position is the lesser of the absolute values of the zone 1 net residual position and the zone 3 net residual position; and

(ii) the zone 1–zone 3 across-zone horizontal disallowance is the matched position multiplied by 100%.

(2) For the purposes of this clause,—

zone 1 net residual position has the meaning set out in clause 263(2)

zone 3 net residual position has the meaning set out in clause 264(2).

Compare: BPR140 B6.6

Subpart 4—Capital charge for currency risk in banking book

266 Capital charge for currency risk in banking book

(1) A deposit taker must calculate the capital charge for its currency risk by—

(a) adding together the currency exposures in the foreign currencies for which the exposure is a net long position (positive number); and

(b) adding together the currency exposures in the foreign currencies for which the exposure is a net short position (negative number); and

(c) taking the greater of the amount calculated in paragraph (a) and the absolute value of the amount calculated in paragraph (b) and multiplying the result by 0.08.

(2) The deposit taker must—

(a) include foreign currency assets and liabilities in accordance with clause 267; and

(b) value those assets and liabilities in accordance with clause 268.

(3) In this clause, a **currency exposure**, in relation to a foreign currency, is determined by subtracting the aggregate value of financial liabilities in the currency from the aggregate value of the financial assets in the currency.

Compare: BPR140 C1.1

267 Scope of calculation

(1) For the purpose of clause 266(2)(a), a deposit taker must include all financial instruments (whether recognised or unrecognised) that give rise to an identifiable and definite foreign currency risk the measure of exposure, except for those described in subclause (2).

(2) A deposit taker must—

(a) first, decompose any compound or hybrid financial instrument that comprises more than 1 notional underlying financial instrument into those instruments; and

(b) then decompose any derivative, including a derivative that arises from decomposition under paragraph (a), into underlying or notional underlying instruments (as the case may be).

(3) The following items must not be included:

(a) a financial instrument that has been included in the capital of the capital group or has been issued by a related entity of any member of the capital group:

(b) an investment in premises:

(c) any structural position, denominated in a foreign currency.

(4) In this clause, **unrecognised**, in relation to a financial instrument, includes an instrument that is—

(a) a written, but undelivered, spot purchase or sale contracted for receipt or delivery within 2 business days after the calculation date; or

(b) a forward purchase or sale, contracted for receipt or delivery more than 2 business days after the calculation date; or

(c) a futures contract or option contract that is outstanding at the calculation date.

Compare: BPR140 C1.2

268 Valuation of financial instrument

(1) The value of a financial instrument (which must be expressed in NZD) for the purposes of clause 266(2)(b) is,—

(a) for an option contract in a single foreign currency, the delta-equivalent value; or

(b) for a derivative other than an option, the principal amount after decomposition under clause 267(2)(b) of underlying or notional underlying instruments, updated in line with the current market valuation of corresponding actual instruments; or

(c) for any other financial instrument, including any instrument arising from decomposition under clause 267(2)(a)—

(i) if it is recognised in accordance with NZ IFRS 9, the principal amount of the instrument updated in line with the current market valuation (if any) of corresponding instruments; or

(ii) if it is not recognised in accordance with NZ IFRS 9, the face or contract amount of the financial instrument.

(2) Despite subclause (1), a deposit taker that has appropriate expertise to value financial instruments on a present value basis may do so for the purposes of calculating its exposure to currency risk in a particular currency.

Compare: BPR140 C1.3

Subpart 5—Capital charge for equity risk in banking book

269 Capital charge for equity risk in banking book

(1) The capital charge for equity risk in the banking book is calculated by—

(a) first, adding together the equity exposure across all currencies for which the exposure is a net long position; and

(b) second, adding together the equity exposure across all currencies for which the exposure is a net short position; and

(c) third, adding the amount calculated in paragraph (a) and the absolute value of the amount calculated in paragraph (b), and then multiplying the result by 0.08.

(2) A deposit taker must—

(a) include long and short positions in equity in accordance with clause 270; and

(b) value those positions following the valuation approach specified in clause 271.

(3) In this clause, **equity exposure** in a single currency is calculated by subtracting the total value of all equity instruments in that currency that are financial liabilities from the total value of all equity instruments in that currency that are financial assets.

Compare: BPR140 D1.1

270 Scope of calculation

(1) For the purposes of clause 269(2)(a), a deposit taker must include all financial instruments that give rise to equity risk.

(2) Examples of financial instruments that give rise to equity risk are—

(a) voting and non-voting ordinary shares:

(b) warrants that give the holder the right to acquire equity instruments:

(c) convertible securities under the terms of which the holder has the right to convert the security into an equity instrument at a fixed conversion price:

(d) commitments and other rights or obligations to buy or sell equity instruments:

(e) equity futures contracts:

(f) equity swaps (treated as two notional positions in the same manner as currency swaps):

(g) equity options.

(3) A deposit taker must—

(a) first, decompose any compound or hybrid financial instrument that comprises more than 1 notional underlying financial instrument into those instruments; and

(b) then decompose any derivative, including a derivative that arises from decomposition under paragraph (a), into underlying or notional underlying instruments (as the case may be).

(4) The following items must not be included in the calculation of the equity risk capital requirement:

(a) any structural position, such as an equity investment in a related entity of a member of the capital group:

(b) non-convertible preferred shares that are included in the calculation of the capital charge for interest rate risk in the banking book.

Compare: BPR140 D1.2

271 Valuation of equity instruments

The value of an equity instrument (which must be expressed in NZD) for the purposes of clause 269(2)(b) is,—

(a) for a net equity option position, the delta equivalent value; or

(b) for a net equity futures position, the market-to-market value of the notional underlying equity position; or

(c) for a derivative other than an option or future, the principal amount after decomposition under clause 270(3)(b) of underlying or notional underlying instruments, updated in line with the current market valuation of corresponding actual instruments; or

(d) for any equity instrument not covered under paragraphs (a) to (c), including any instrument arising from decomposition under clause 270(3)(a)—

(i) if it is recognised in accordance with NZ IFRS 9, the principal amount of the instrument updated in line with the current market valuation (if any) of corresponding instruments; or

(ii) if it is not recognised in accordance with NZ IFRS 9, the face or contract amount of the financial instrument.

Compare: BPR140 D1.3

Subpart 6—Designation of instruments as trading book or banking book

Designation of instrument

272 Instrument must be designated as trading book instrument or banking book instrument

(1) A deposit taker must designate any applicable instrument as a trading book instrument or banking book instrument in accordance with this subpart.

(2) The deposit taker must make the designation when it first recognises the instrument in accordance with NZ IFRS 9.

(3) However, a deposit taker must not designate an instrument as a trading book instrument unless it is capable of being sold or fully hedged.

(4) In this clause, **applicable instrument** means—

(a) a financial instrument, including a derivative; or

(b) foreign exchange; or

(c) commodities.

Trading book instruments

273 Instrument held for certain purposes must be included in trading book

A deposit taker must designate an instrument described in clause 272(4) as a trading book instrument if it is held by the deposit taker for 1 or more of the following purposes:

(a) resale in the short term:

(b) profiting from short-term price movements:

(c) securing a guaranteed profit from price differences:

(d) hedging risks that arise from holding the instrument for a purpose in any of paragraphs (a) to (c).

274 Certain instruments must be included in trading book

(1) A deposit taker must designate an instrument described in clause 272(4) as a trading book instrument if it is—

(a) an instrument that is in the deposit taker's correlation trading portfolio; or

(b) an instrument that would give rise to a net short position for credit risk or equity risk in the deposit taker's banking book; or

(c) an instrument that results from an underwriting commitment in respect of securities that are expected to be purchased by the deposit taker on the settlement date.

(2) A deposit taker must, subject to 276(2) and 277(1), designate an instrument described in clause 272(1) as a trading book instrument if it is—

(a) an instrument held as an accounting trading asset or liability; or

(b) an instrument resulting from market-making activities; or

(c) an equity investment in a fund; or

(d) equity securities that are listed on a share market; or

(e) an instrument that is a trading-related repo transaction; or

(f) an option that includes an embedded derivative from a banking book instrument of the deposit taker that relates to credit or equity risk.

(3) This clause applies to an instrument whether or not it is held for 1 or more of the purposes in clause 273.

275 Valuation of trading book instruments

A deposit taker must, daily, determine the fair value of each trading book instrument and recognise any change in value in the profit and loss account.

Banking book instruments

276 Certain instruments must be included in banking book

(1) A deposit taker must designate an instrument described in clause 272(4) as a banking book instrument if it is—

(a) an instrument not designated as a trading book instrument; or

(b) an instrument described in subclause (2) (whether or not it also meets the requirements to be a trading book instrument).

(2) The following instruments must be designated as banking book instruments:

(a) equity securities that are not listed on a share market:

(b) instruments designated for securitisation warehousing:

(c) real estate holdings, including derivatives in relation to direct holdings of real estate:

(d) retail and small or medium enterprise credit:

(e) equity investments in a fund, unless the deposit taker meets at least 1 of the following conditions:

(i) the deposit taker can look through the fund to its individual components and there is sufficient and frequent information, verified by an independent third party, provided to the deposit taker regarding the fund's composition:

(ii) the deposit taker obtains daily price quotes for the fund and it has access to the information required to be provided by the fund's governing documents or under regulatory requirements relating to the fund:

(f) interests in hedge funds:

(g) derivatives that have any of the instruments described in paragraphs (a) to (f) as underlying assets:

(h) instruments held for the purpose of hedging a particular risk of a position in any of the instruments described in paragraphs (a) to (g).

277 Deposit taker may get approval to include certain instruments in banking book

(1) A deposit taker may, with the Bank's written approval, designate an instrument listed in clause 274(2) as a banking book instrument.

(2) The Bank may give its approval if it is satisfied that that the instrument is not held for any of the purposes in clause 273.

Policy and procedures regarding trading book

278 Deposit taker must have policy and procedures regarding trading book

(1) A deposit taker must—

(a) establish, implement, maintain, and comply with a policy and procedures for determining which instruments, if any, are trading book instruments under this subpart; and

(b) conduct ongoing evaluation of instruments in the banking book and trading book to assess whether they are categorised correctly in accordance with this subpart.

(2) The deposit taker must, at least yearly, undertake an internal audit of compliance with the policy and procedures required under subclause (1)(a).

279 Restricted movement of instruments between books

(1) A deposit taker must not, without the Bank's approval, redesignate a trading book instrument as a banking book instrument (or vice versa).

(2) When deciding whether to approve redesignation of an instrument under subclause (1), the Bank must be satisfied that the deposit taker will not gain a capital benefit from the redesignation.

(3) This clause is subject to any change in designation required under this subpart.

Internal risk transfer

280 Meaning of internal risk transfer

In this standard, **internal risk transfer** means a deposit taker's record of a transfer of risk—

(a) between its banking book and its trading book (if any); or

(b) within its banking book; or

(c) within its trading book (if any).

281 Internal risk transfer from trading book to banking book

(1) This clause applies to an internal risk transfer from a deposit taker's trading book to its banking book.

(2) The risk must continue to be treated as risk in respect of the trading book for the purposes of calculating the deposit taker's capital requirements.

282 Internal transfer of credit risk or equity risk from banking book to trading book

(1) This clause applies if a deposit taker hedges a banking book credit risk exposure or an equity risk exposure using an internal risk transfer from its trading book.

(2) The credit or equity risk exposure (as the case may be) in the banking book is hedged for the purposes of calculating capital requirements if,—

(a) there is a hedge with a counterparty with a lower risk weight in respect of the trading book that exactly matches the internal risk transfer (an **external hedge**); and

(b) in the case of—

(i) a credit risk exposure, the external hedge meets the requirements of subpart 5 of Part 6 in relation to the exposure in the banking book:

(ii) an equity risk exposure, the external hedge is designated as a hedge in accordance with NZ IFRS 9.

(3) If the requirements in subclause (2) are met,—

(a) the banking book exposure may, for the purposes of calculating the deposit taker's capital requirements, be treated as hedged by the banking book leg of the internal risk transfer; and

(b) both the trading book leg of the internal risk transfer and the third-party external hedge must be included when calculating capital requirements for market risk.

(4) If the requirements in subclause (2) are not met,—

(a) the banking book exposure must not, for the purposes of calculating the deposit taker's capital requirements, be treated as hedged by the banking book leg of the internal risk transfer; and

(b) the third-party external hedge must be included when calculating capital requirements for market risk.

(5) In this clause, an **external hedge** may comprise more than 1 transaction and more than 1 counterparty so long as the aggregate external hedge and the internal risk transfer match each other exactly.

283 Short position created by internal risk transfer

(1) This clause applies to a short credit position or short equity position in a deposit taker's banking book that is—

(a) created by an internal risk transfer; and

(b) not included when calculating capital requirements for market risk in respect of the banking book.

(2) The short position must be included when calculating capital requirements for market risk in respect of the trading book.

Example

A bank's trading desk buys an index derivative to hedge a loan held in the bank's banking book, which creates a short credit position in the banking book.

284 Internal risk transfer relating to dedicated internal risk transfer trading desk

(1) This clause applies if a deposit taker hedges an interest rate risk exposure on the banking book using an internal risk transfer conducted by a dedicated internal risk transfer trading desk approved by the Bank.

(2) The leg of the internal risk transfer relating to the trading book is to be treated as a trading book instrument if the internal risk transfer is documented with respect to the banking book interest rate risk that is being hedged and the sources of that risk.

(3) The Bank must, when deciding whether to approve a dedicated internal transfer desk, be satisfied that the desk meets capital requirements in respect of market risk on a stand-alone basis, separate from any other general interest rate risks or other market risks generated by activities in the trading book.

(4) The banking book leg of the internal risk transfer must be included in the banking book's measure of interest rate risk when calculating capital requirements for market risk.

285 Further provision regarding dedicated internal risk transfer trading desk

(1) A dedicated internal risk transfer trading desk approved under clause 284 (**desk A**) may trade instruments purchased from parties other than a member of the capital group.

(2) A trade may be carried out—

(a) directly between desk A and the other party; or

(b) by desk A obtaining the external hedge from the other party by way of a separate desk that is not an internal risk transfer desk (**desk B**) acting as an agent.

(3) Desk A may carry out a trade under subclause (2)(b) only if the internal risk transfer entered into with desk B exactly matches the external hedge from the other party.

(4) If a trade is carried out under subclause (2)(b), the respective legs of the internal risk transfer are included in relation to desk A and desk B.

Part 8
Capital requirement for operational risk

Preliminary matters

286 Interpretation in this Part

(1) A bar above a term in a formula in this Part indicates that the term is calculated as an average over, in relation to a deposit taker,—

(a) the last 12-month period (**t**); and

(b) the 12-month period immediately before t (**t-1**); and

(c) the 12-month period immediately before t-1 (**t-2**).

(2) The average must be calculated by—

(a) first, calculating the absolute value for each of t, t-1, and t-2; and

(b) then, determining the average of the results calculated under paragraph (a).

(3) A deposit taker that does not have information needed to calculate a value under subclause (2)(a) must,—

(a) calculate the value using available information, which may result in a value for a period that is less than 12 months; or

(b) if no information is available for a 12-month period, calculate the average under subclause (2)(b) without including that 12-month period.

Calculating capital requirement for operational risk

287 Capital requirement for operational risk calculated under this Part

(1) A deposit taker's capital requirement for operational risk is the operational risk capital charge calculated under this Part.

(2) Subclause (1) does not apply to a group 3 deposit taker.

(3) The capital requirement for operational risk for a group 3 deposit taker is calculated in accordance with the following formula:

$$[(a + b) \div 2] \times 0.125$$

where—

a is the deposit taker's total assets

b is the deposit taker's risk-weighted amount for credit risk.

288 Operational risk capital charge

(1) A deposit taker's operational risk capital charge is calculated by—

(a) multiplying the amount of each dollar of the deposit taker's business indicator in each applicable range by the marginal coefficient for that range; and

(b) adding together the totals calculated under paragraph (a).

(2) The marginal coefficients for a deposit taker's business indicator apply according to the ranges in the following table:

Range of business indicator (in NZD billions)	Marginal coefficient (%)
Less than or equal to 1.75	12
Greater than 1.75 but less than or equal to 50	15
Greater than 50	18

(3) This clause is subject to clause 295 (operational risk overlay).

289 Business indicator

(1) A deposit taker's business indicator is the total of—

(a) the interest, finance lease, and dividends component calculated in accordance with clause 290; and

(b) the services component calculated in accordance with clause 291; and

(c) the financial component calculated in accordance with clause 292.

(2) However, the calculations must not include the following items:

(a) income and expenses from insurance or reinsurance businesses of the deposit taker and its subsidiaries:

(b) premiums paid and reimbursements and other payments received from insurance or reinsurance policies:

(c) administrative expenses, including the following:

(i) staff expenses:

(ii) outsourcing fees paid for the supply of non-financial services (for example, logistical, human resources, or information technology services):

(iii) other administrative expenses (for example, information technology, utilities, telephone, travel, office supplies, or postage):

(d) recovery of administrative expenses including recovery of payments on behalf of customers:

(e) expenses of premises and fixed assets, except when those expenses result from an event causing operational loss:

(f) depreciation or amortisation of tangible or intangible assets, except depreciation related to operating lease assets:

(g) a liability of uncertain timing or amount (a **provision**), such as a pension, commitment, or guarantee; or a reversal of a provision, except a provision or reversal of a provision related to an event causing operational loss:

(h) expenses that are due to share capital repayable on demand:

(i) the amount of impairment in respect of an impaired asset, and the amount of any reversal of an impairment:

(j) changes in goodwill recognised in accounting of profits and losses:

(k) income tax on profits (including deferred tax).

290 Interest, finance lease, and dividends component

(1) For the purposes of calculating the business indicator, the interest, finance lease, and dividends component must be calculated in accordance with the following formula:

$$\min\left(\overline{\text{abs (interest income - interest expense)}}, 2.25\% \times \overline{\text{interest-earning assets}}\right) + \overline{\text{dividend income}}$$

(2) In the formula,—

abs means absolute value

dividend income must be determined in accordance with generally accepted accounting practice

interest-earning assets means assets that generate interest income measured at the end of each period required by the formula

interest expense includes expenses relating to finance leases and must be determined in accordance with generally accepted accounting practice

interest income, includes income from finance leases and must be determined in accordance with generally accepted accounting practice

min means the smaller of the values to which the term applies.

(3) This clause is subject to clause 295 (operational risk overlay imposed by licence condition).

291 Services component

(1) For the purposes of calculating the business indicator, the services component must be calculated in accordance with the following formula:

$$max\left(\overline{other\ operating\ income}, \overline{other\ operating\ expense}\right) + max\left(\overline{fee\ income}, \overline{fee\ expense}\right)$$

(2) In the formula,—

fee expense—

(a) means expenses for receiving a financial service; and

(b) includes outsourcing fees paid by the deposit taker for the supply of a financial service

fee income means income, not otherwise included in the business indicator, from providing a financial service (including income received by the deposit taker as an outsourcer of a financial service)

financial service has the meaning set out in section 5(1) of the Financial Service Providers (Registration and Dispute Resolution) Act 2008

max means the larger of the values to which the term applies

other operating expense means expenses and losses from ordinary deposit-taking operations not otherwise included in an item included in the business indicator

other operating income means income from ordinary deposit-taking operations that is not otherwise included in an item included in the business indicator.

(3) This clause is subject to clause 295 (operational risk overlay imposed by licence condition).

292 Financial component

(1) For the purposes of calculating the business indicator, the financial component must be calculated in accordance with the following formula:

$$\overline{Abs\left(Net\ P\ \&\ L\ trading\ book\right)} + \overline{Abs\left(Net\ P\ \&\ L\ banking\ book\right)}$$

(2) In the formula,—

Net P & L banking book means, in relation to a deposit taker's banking book,—

(a) the net profit or loss on financial assets and liabilities measured at fair value through profit and loss; and

(b) realised gains and losses on financial assets and liabilities not measured at fair value through profit and loss; and

(c) the net profit or loss from hedge accounting; and

(d) the net profit or loss from exchange differences

Net P & L trading book means, in relation to a deposit taker's trading book,—

(a) the net profit or loss on trading assets and trading liabilities; and

(b) the net profit or loss from hedge accounting; and

(c) the net profit or loss from exchange differences.

(3) This clause is subject to clause 295 (operational risk overlay imposed by licence condition).

Miscellaneous provisions

293 Bank may approve exclusion of transferred business from business indicator

(1) A deposit taker may, with the Bank's approval, exclude a transferred business when calculating its business indicator.

(2) The Bank must, when deciding whether to grant approval, be satisfied that all risk associated with the transferred business has been transferred with the business.

In this clause, **transferred business**—

(a) means the business, or a part of the business, of a deposit taker or its subsidiary that has been transferred to another person; but

(b) does not include the transfer of the business, or part of the business, within the deposit taker's capital group.

294 Mergers and acquisitions must be reflected in operational risk capital requirement

(1) This clause applies for the purpose of calculating the business indicator when a deposit taker has acquired a business or merged with an entity.

(2) The amounts used in calculating the components of the deposit taker's business indicator must include amounts relating to the business or entity for the three 12-month periods immediately before the acquisition or merger.

295 Operational risk overlay

(1) A condition of a deposit taker's licence may specify, as an **operational risk overlay**, either or both of the following:

(a) a percentage by which the total requirement for operational risk under clause 287 must be increased:

(b) a percentage by which a component of the business indicator calculated under any of clauses 290 to 292 must be increased.

(2) The Bank, when deciding whether to specify a condition under subclause (1), must be satisfied that the condition is necessary or desirable to—

(a) promote the safety and soundness of the deposit taker; or

(b) avoid or mitigate the adverse effects of—

(i) a risk to the stability of the financial system:

(ii) a risk arising from the financial system that may damage the broader economy.

Part 9
Funds management, securitisation, insurance, and loan transfers

Subpart 1—Funds management or securitisation

296 Meaning of terms in this subpart

In this subpart,—

associated, in relation to a funds management or securitisation SPV, means any relationship other than the provision of normal banking or commercial services on a fully arm's length basis

funds management or securitisation—

(a) includes the following activities:

(i) originating or supplying assets to an SPV:

(ii) marketing funds management and securitisation products through a branch network:

(iii) acting as a servicing agent:

(iv) acting as a manager of a managed investment scheme (as both terms are defined in section 6(1) of the FMCA):

(v) sponsoring or establishing arrangements described in any of subparagraphs (i) to (iv); but

(b) does not include normal deposit-taking or commercial services on a fully arm's length basis.

Compare: BPR160 A1.1.

297 Deposit taker must consolidate SPV in capital group when calculating capital requirements

A deposit taker must, for the purposes of calculating capital requirements, consolidate a funds management or securitisation SPV in its capital group if—

(a) the SPV is required to be consolidated for the purposes of group financial statements under generally accepted accounting practice; or

(b) the SPV is a covered bond SPV for a covered bond issued by the deposit taker; or

(c) the deposit taker or a subsidiary has provided credit enhancement to the SPV—

(i) in the form of a full or partial guarantee; or

(ii) in a form such that the maximum extent of the liability cannot be quantified; or

(d) the minimum separation requirements in clause 298 are not met; or

(e) the SPV is a securitisation SPV and—

(i) the securities issued by the SPV have a shorter maturity profile than the assets against which they have been issued; and

(ii) the deposit taker's role in the securitisation means there is a risk that it will have to fund some of the assets when the securities mature.

Compare: BPR160 A2.1

298 Minimum separation requirements

For the purposes of clause 297(d), the minimum separation requirements, in relation to an SPV, are—

(a) that each prospectus or brochure for a funds management or securitisation product includes clear, prominent disclosures that the securities issued—

(i) do not represent deposits or other liabilities of the deposit taker; and

(ii) are subject to investment risk including possible loss of income and principal invested; and

(iii) are not guaranteed (in full or part) by the deposit taker in respect of their capital value or performance; and

(b) that, in relation to a securitisation SPV or a managed investment scheme, there is—

(i) an independent trustee; or

(ii) a clear, prominent, disclosure in each prospectus, brochure, or application form—

(A) stating whether there is a trustee; and

(B) if there is a trustee that is not independent of the deposit taker, stating that fact; and

(c) that any purchase by the deposit taker or a subsidiary from the SPV takes place at fair value and on arm's length terms and conditions; and

(d) that any funding or liquidity support provided by the deposit taker or a subsidiary to an associated SPV, or the purchase of securities issued by an associated SPV, meets the following requirements:

(i) the transactions involved take place at fair value and on arm's length terms and conditions:

(ii) the funding (including funding provided by purchase of securities issued by the SPV) does not exceed 5% of the value of securities issued by the SPV.

Compare: BPR160 A2.2

299 Treatment of credit enhancement where not otherwise required to consolidate

(1) This clause applies to a deposit taker that—

(a) has provided a credit enhancement to a securitisation or funds management SPV; and

(b) is not required to consolidate the SPV in the deposit taker's capital group under clause 297.

(2) The deposit taker must treat the credit enhancement as a 100% risk-weighted exposure of the deposit taker for the purposes of calculating credit risk RWAs if—

(a) the deposit taker and any related entity is not associated with the SPV; and

(b) the credit enhancement is provided on arm's length terms and conditions and at market prices.

(3) If the circumstances in subclause (2) do not apply, the deposit taker must, in relation to the credit enhancement,—

(a) deduct from tier 1 capital the full amount of the credit enhancement; or

(b) expense the full amount of the credit enhancement at the time that its relationship with the SPV commences; or

(c) for the purposes of calculating capital requirements, consolidate the SPV in the deposit taker's capital group.

Compare: BPR160 A2.3

Subpart 2—Affiliated insurance business

General provisions

300 Interpretation in this subpart

(1) In this subpart,—

affiliated insurance entity means any insurance entity, other than the deposit taker or its subsidiary,—

(a) that is 1 of the following:

(i) the ultimate holding entity of either the deposit taker or a subsidiary:

(ii) a subsidiary of the ultimate holding entity of either the deposit taker or a subsidiary:

(iii) an insurance entity in which the ultimate holding entity of the deposit taker or a subsidiary has an interest as an associate, or a direct or indirect interest as a party to a joint venture; and

(b) whose financial products are distributed or marketed by the deposit taker or a subsidiary

affiliated insurance group means any affiliated insurance entity and all the entity's subsidiaries

funding or liquidity support means—

(a) the policyholder liabilities of the deposit taker or a subsidiary, as the case may be; or

(b) claims against the deposit taker or a subsidiary that represent senior credit exposures, other than credit exposures arising from derivatives; or

(c) the undrawn portion of any commitments by the deposit taker or a subsidiary to provide funding or purchase assets; or

(d) the full amount of direct credit substitutes provided by the deposit taker or a subsidiary.

(2) For the purposes of subclause (1)(a)(iii), **interest as an associate** must be determined in accordance with New Zealand Equivalent to International Accounting Standard 28, *Investments in Associates and Joint Ventures* (NZ IAS 28).

Compare: BPR160 B1.2, B3.2

301 Requirements if deposit taker provides credit enhancement to affiliated insurance group

(1) This clause applies if a deposit taker or its subsidiary has provided a credit enhancement to any member of an affiliated insurance group.

(2) The deposit taker or subsidiary, as the case may be, must—

(a) deduct from tier 1 capital the full amount of the credit enhancement; or

(b) expense the full amount of the credit enhancement.

Compare: BPR160 B2.1

302 Deposit taker must deduct funding exposure to affiliated insurance group

(1) This clause applies if—

(a) a deposit taker or its subsidiary has a funding exposure to an affiliated insurance group; and

(b) the minimum requirements in clause 303 are not met.

(2) The deposit taker must deduct, from the calculation of its tier 1 capital, the whole amount of any funding exposure that the deposit taker or a subsidiary has to the affiliated insurance group.

Compare: BPR160 B3.1

303 Minimum requirements

For the purposes of clause 302(1)(b), the minimum requirements in relation to a funding exposure to an affiliated insurance group are—

(a) that each investment statement, prospectus, or brochure for an insurance product that gives rise to the exposure includes clear, prominent disclosures that the deposit taker and its subsidiaries do not guarantee the following:

(i) the affiliate that is the issuer of the product:

(ii) any of the affiliated insurance entity's subsidiaries:

(iii) any of the products issued by that affiliated insurance group; and

(b) that each product disclosure statement under the FMCA, register entry, and advertisement clearly and prominently discloses that—

(i) the product does not represent deposits or other liabilities of the deposit taker or its subsidiaries; and

(ii) the product is subject to investment risk, including possible loss of income and principal; and

(iii) the deposit taker and its subsidiaries do not guarantee the capital value or performance of the product; and

(c) that any asset purchase by the deposit taker or a subsidiary from the affiliated insurance group takes place on arms-length terms and conditions, and at fair value:

(d) that any funding or liquidity support provided by the deposit taker or a subsidiary to the affiliated insurance group does not exceed 5% of the total consolidated assets of that group, and is provided on arm's length terms and conditions, and at fair value.

Compare: BPR160 B3.1

Subpart 3—Treatment of funding exposure across subparts 1 and 2

304 Deduction from tier 1 capital

(1) This clause applies if applicable funding exposure exceeds 10% of a deposit taker's tier 1 capital.

(2) The deposit taker must deduct the applicable funding exposure from tier 1 capital.

(3) In this clause, **applicable funding exposure** means funding by a deposit taker's capital group to—

(a) any funds management and securitisation SPV that is not consolidated in the capital group under clause 297 or 299(3)(c); and

(b) any affiliated insurance group.

Compare: BPR160 C1.1

Subpart 4—Loan transfers

305 Meaning of clean transfer

(1) In this standard, a **clean transfer** means the transfer of a loan, or commitment to lend, originated by a deposit taker or another member of the capital group, if—

(a) the loan or commitment has been transferred from the originating entity to the deposit taker's ultimate parent deposit taker or to another party that is not a related entity; and

(b) the transfer is achieved using a method specified in clause 306; and

(c) the transfer meets the requirements in clause 307.

(2) In this clause, **ultimate parent deposit taker,** in relation to a deposit taker (**A**), means the deposit taker or overseas bank that—

(a) is A's holding entity; and

(b) is not itself a subsidiary of another deposit taker or overseas bank.

Compare: BPR160 D1.1, D1.2

306 Methods of clean transfer

(1) For a loan, the methods of a clean transfer are as follows:

(a) transfer through novation:

(b) transfer by notified assignment:

(c) transfer through silent assignment:

(d) loan sub-participation.

(2) For a commitment to lend, the methods for a clean transfer are as follows:

(a) transfer through novation:

(b) transfer by assignment, if accompanied by a formal acknowledgement from the borrower.

(3) In this clause, **sub-participation** means a contractual arrangement under which the deposit taker transfers the whole or part of the credit risk of a loan exposure to another party while retaining legal ownership of the loan and the direct relationship with the borrower.

Compare: BPR160 D1.3

307 Requirements for clean transfer

To achieve a clean transfer,—

(a) the transfer must not contravene the terms and conditions of the underlying loan agreement, and all necessary consents must have been obtained; and

(b) the seller must have no residual beneficial interest in the principal amount of the loan (or the part of the loan that has been transferred) and the buyer must have no recourse to the seller for losses; and

(c) the seller must have no obligation to repurchase the loan, or any part of it at any time; and

(d) the seller must have notified the buyer that the seller is under no obligation to repurchase the loan or support any losses suffered by the buyer, and the buyer must have provided written acknowledgement to that effect; and

(e) the terms of the transfer must provide that if the loan is rescheduled or renegotiated, the buyer and not the seller would be subject to the rescheduled or renegotiated terms; and

(f) if payments are routed through the seller, the seller must be under no obligation to transfer funds to the buyer unless and until they are received from the borrower; and

(g) if the buyer is subject to a trust arrangement, the trustees of that trust must be independent of the seller or a related entity of the seller, both during and after the sale negotiations.

Compare: BPR160 D1.4

cl 4

Schedule 1
Transitional, savings, and related provisions

Part 1
Provisions relating to this standard as made

1 Interpretation

In this Part, unless the context otherwise requires,—

additional tier 1 capital means capital of a deposit taker that meets the requirements to be included in Additional Tier 1 Capital (AT1 Capital) in BPR 110 and BPR 120

BPR 110 means *BPR 110, Capital Definitions* issued by the Bank on [date October 2026]

BPR 120 means *BPR 120, Capital Adequacy Process Requirements* issued by the Bank on [date October 2026].

2 Additional tier 1 capital may be included when calculating capital base

(1) A group 1 or group 2 deposit taker may, when calculating a capital base under clause 12, include additional tier 1 capital as if it were tier 1 capital.

(2) This clause ceases to apply on the close of 30 November 2031.

3 Additional tier 1 capital may be included when calculating capital ratios

(1) A group 1 or group 2 deposit taker may, when calculating a capital ratio under clause 13 of the standard, use additional tier 1 capital as if it were tier 1 capital.

(2) The amount of additional tier 1 capital that may be used under subclause (1) is the lesser of the following amounts:

(a) additional tier 1 capital on issue when the ratio is calculated:

(b) an amount that is—

(i) 100% of the additional tier 1 capital on issue on 1 October 2026, if the ratio is calculated in the period 1 December 2028 to 30 November 2029; or

(ii) 67% of the additional tier 1 capital on issue on 1 October 2026, if the ratio is calculated in the period 1 December 2029 to 30 November 2030; or

(iii) 33% of the additional tier 1 capital on issue on 1 October 2026 if the ratio is calculated in the period 1 December 2030 to 30 November 2031.

(3) This clause ceases to apply on the close of 30 November 2031.

4 Capital conservation buffer for group 3 deposit taker

(1) Clause 18 does not apply to a group 3 deposit taker during the years beginning on 1 December 2028, 2029, and 2030.

(2) A group 3 deposit taker's capital conservation buffer during those years is,—

(a) for the year beginning on 1 December 2028, 1%:

(b) for the year beginning on 1 December 2029, 2%:

(c) for the year beginning on 1 December 2030, 3%.

(3) This clause ceases to apply on the close of 30 November 2031.

5 Distribution restrictions in respect of additional tier 1 capital

(1) Any distribution restriction that applies under clause 21 or 22 in respect of a deposit taker's tier 1 capital applies in the same manner to any additional tier 1 capital.

(2) This clause ceases to apply on the close of 30 November 2031.

6 Group 1 deposit taker may use existing tier 2 capital as if it were tier 2 capital

(1) A group 1 deposit taker may, when calculating a capital ratio under clause 14, use existing tier 2 capital as if it were tier 2 capital.

(2) However, the existing tier 2 capital may be used only to the following extent:

(a) [transition pathway]:

(b) [etc].

(3) In this clause, **existing tier 2 capital** means capital that meets the requirements for tier 2 capital in BPR 110 and BPR 120 and was issued by the deposit taker before the commencement of this clause.

(4) This clause ceases to apply on the close of [date].

7 Group 3 deposit taker may use perpetual preference shares as tier 1 capital

(1) A group 3 deposit taker may, when calculating a capital ratio under clause 13 of the standard, use perpetual preference shares, as if they were tier 1 capital.

(2) However, the share may be used only to the following extent:

(a) until the close of 30 November 2029, the shares must not comprise more than a 3.5% tier 1 capital ratio:

(b) in the period 1 December 2029 to 30 November 2030, the shares must not comprise more than a 4% tier 1 capital ratio:

(c) in the period 1 December 2030 to 30 November 2032, the shares must not comprise more than a 2.5% tier 1 capital ratio.

(3) This clause ceases to apply on the close of 30 November 2032.

8 Amortisation of eligible amount for short-dated instruments

(1) This clause applies to an instrument that—

(a) was issued in accordance with section D3.5 of BPR 110; and

(b) does not have an original maturity of at least 5 years.

(2) The amount of the instrument that may be recognised in calculations for capital requirements is,—

(a) if the instrument has more than 12 months to maturity, 100%; or

(b) if the instrument has 12 months or less to maturity, 80%.

(3) This clause applies despite clause 68(1).

(4) This clause ceases to apply on the close of 30 November 2031.

Compare: BPR110 D3.6A

9 Redemption and other restrictions relating to additional tier 1 capital

(1) The requirements in clauses 92 to 99 apply to additional tier 1 capital.

(2) This clause ceases to apply on the close of 30 November 2031.

cl 86

Schedule 2
Legal opinion regarding issue of new tier 2 or mutual capital instrument

[*External law firm letterhead*]

Reserve Bank of New Zealand
2 The Terrace
Wellington

[Name of issuer]—proposed issue of [perpetual preference shares/perpetual non-cumulative preference shares/subordinated notes/mutual capital instruments]

1 Introduction

We are acting for [*name of issuer*] (the **issuer**) in relation to a proposed issue of [*perpetual preference shares/perpetual non-cumulative preference shares/subordinated notes/ mutual capital instruments*] (the **capital instruments**) [having an aggregate [*issue price/face value*] of [*specify currency*][*specify amount*]][*]

The issuer intends that the capital instruments will constitute [*tier 2 capital/ tier 1 capital only in the case of mutual capital instruments*] for the purposes of the Deposit Takers (Capital) Standard 2027 (the **standard**).

2 Checklist and constituting documents

Checklist

We attach to this opinion as Appendix 1 a copy of the Reserve Bank's checklist, completed for the capital instruments.

Constituting Documents

The terms of the capital instruments are set out in the following documents (together, the **constituting documents)**:

(a) [*list document*][**]

(b) […]

(c) […]

We attach to this opinion as Appendix 2 a copy of each constituting document.[***]

3 Our confirmations and opinions

We confirm that—

(a) we accept responsibility to the Reserve Bank for the confirmations and opinions set out below; and

(b) we have not acted for the Reserve Bank in relation to the issue of capital instruments; and

(c) notwithstanding the provisions of this opinion, we reserve the right to represent and advise the issuer (if instructed) in relation to any matters relating to the issue at any time in the future, and the fact that we provided the opinion to the Reserve Bank will not be deemed to have caused any conflict of interest in relation to the giving of such advice; and

(d) we have reviewed, and are familiar with, the checklist and each of the constituting documents; and

(e) [the issuer has confirmed to us that], the constituting documents are the only documents that prescribe the terms of the capital instruments; and

(f) [each constituting document is] / [[*insert names of constituting documents are] governed by New Zealand law*.]

[AND *(if applicable)*:

the [*insert names of constituting documents*] are governed by the laws of [*insert permitted foreign law*]. In accordance with the requirement set out in the standard, the issuer has confirmed to us that a separate opinion will be provided to the Reserve Bank in respect of the capital instruments under [*insert governing law*]; and****

(g) In our opinion,—

(i) the checklist accurately reflects in all respects the relevant terms of the capital instruments as prescribed in the constituting documents; and

(ii) the terms of the capital instruments as set out in the constituting documents comply in all respects with the requirements for [*tier 2 capital/ tier 1 capital only in the case of mutual capital instruments*] in the standard; and

(iii) there are no matters in the constituting documents that raise issues reasonably capable of dispute or differing interpretation as to compliance with the standard [other than [*identify*]].

4 Basis on which our confirmations and opinions are given

Our confirmations and opinions above are given on the following basis:

(a) they are given solely for the benefit of the Reserve Bank and are not to be relied upon by any other person without our prior written consent:

(b) they do not extend to any subsequent or amended versions of the constituting documents:

(c) they relate solely to New Zealand law in force at the date of this opinion and are given on the basis that they will be construed in accordance with New Zealand law:

(d) we provide no opinion as to whether the constituting documents contain appropriate restrictions or provisions for the protection of holders of the capital instruments:

(e) they are based on the standard in effect at the date of this opinion, and do not extend to subsequent or amended versions of the standard:

(f) we provide no opinion as to whether the constituting documents comply with financial markets law or any other applicable laws:

(g) they are strictly limited to the matters stated in this letter and do not extend by implication to any other matter.

Yours faithfully
[*Law firm*]

[Appendix 1—Completed copy of checklist]

[Appendix—Constituting documents]

* The issue amount is only required if it is known when the opinion is issued. Otherwise please adjust accordingly.

**Describe the executed (as applicable) final versions of the documents.

***If any of the constituting documents are attached in draft (eg, due to the issue amount not being known as at the date of this opinion), please add a paragraph to provide that the final executed copies will be provided to the Reserve Bank within three (3) business days of becoming available, together with a written confirmation from the law firm (or issuer) to the Reserve Bank that the signed versions are in the same form as the drafts attached to this opinion (subject to the issue amount being inserted). That confirmation can be provided in a memorandum or email form.

**** If one or more of the constituting documents contains a hybrid governing law clause, please adapt this paragraph, as necessary.

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Schedule 3
Legal opinion regarding amendments to terms of tier 2 or mutual capital instrument

[External law firm letterhead]

Reserve Bank of New Zealand
2 The Terrace
Wellington

[Name of issuer]—proposed amendment to terms of [perpetual preference shares/perpetual non-cumulative preference shares/subordinated notes/mutual capital instruments]

1 Introduction

We are acting for [*name of issuer*] (the **issuer**) in relation to a proposed issue of [*perpetual preference shares/perpetual non-cumulative preference shares/subordinated notes/ mutual capital instruments*] (the **capital instruments**) issued by it on [*date*].

The issuer intends that, once these amendments are in effect, the capital instruments will continue to constitute [*tier 2 capital/ tier 1 capital only in the case of mutual capital instruments*] for the purposes of the Deposit Takers (Capital) Standard 2027 (the **standard**).

2 Constituting and amending documents

Constituting Documents

The terms of the capital instruments are set out in the following documents (together, the **constituting documents**):

(a) [*list document*]*

(b) […]

(c) […]

We attach to this opinion as Appendix 1 a copy of each constituting document.

Amending documents

The proposed amendments to the capital instruments are set out in the following documents (together the **amending documents**):

(a) [*list document*]*

(b) […]

(c) […]

We attach to this opinion as Appendix 2 a copy of each amending document.

3 Our confirmations and opinions

We confirm that—

(a) we accept responsibility to the Reserve Bank for the confirmations and opinions set out below; and

(b) we have not acted for the Reserve Bank in relation to the issue of capital instruments; and

(c) notwithstanding the provisions of this opinion, we reserve the right to represent and advise the issuer (if instructed) in relation to any matters relating to the issue at any time in the future, and the fact that we provided the opinion to the Reserve Bank will not be deemed to have caused any conflict of interest in relation to the giving of such advice; and

(d) we have reviewed, and are familiar with, each of the constituting documents and the amending documents; and

(e) [*the issuer has confirmed to us that*] the constituting documents and, once executed and in effect, the amending documents comply in all respects with the requirements for [*tier 2 capital/tier 1 capital in the case of mutual instruments*] in the standard; and

(f) in our opinion,—

(i) the terms of the capital instruments as set out in the constituting documents and, once executed and in effect, the amending documents comply in all respects with the requirements for [*tier 2 capital/ tier 1 capital only in the case of mutual capital instruments*] in the standard; and

(ii) there are no matters in the constituting documents or amending documents that raise issues reasonably capable of dispute or differing interpretation as to compliance with the standard [other than [*identify*]].

4 Basis on which our confirmations and opinions are given

Our confirmations and opinions above are given on the following basis:

(a) they are given solely for the benefit of the Reserve Bank and are not to be relied upon by any other person without our prior written consent:

(b) they do not extend to any subsequent or amended versions of the constituting documents, other than the amending documents:

(c) they relate solely to New Zealand law in force at the date of this opinion and are given on the basis that they will be construed in accordance with New Zealand law:

(d) we provide no opinion as to whether the constituting documents contain appropriate restrictions or provisions for the protection of holders of the capital instruments:

(e) we provide no opinion as to whether the constituting documents or the amending documents contain appropriate restrictions or provisions for the protection of the holders of the capital instruments:

(f) they are based on the standard in effect at the date of this opinion, and do not extend to subsequent or amended versions of the standard:

(g) we provide no opinion as to whether the constituting documents or the amending documents comply with financial markets law or any other applicable laws:

(h) they are strictly limited to the matters stated in this letter and do not extend by implication to any other matter.

Yours faithfully
[*Law firm*]

[Appendix 1—Constituting documents]

[Appendix 2—Amending documents]

*Describe the executed (as applicable) final versions of the documents.

Made at Wellington on [day month year].

Reserve Bank of New Zealand

Explanatory note

This note is not part of the standard but is intended to indicate its general effect.

Explanatory note

This note is not part of the standard but is intended to indicate its general effect.

This standard is issued under the Deposit Takers Act 2023 (the **Act**). The standard prescribes matters relating to capital, as contemplated by sections 79(a), 85, and 90(1)(d) of the Act. It comes into force on 1 December 2028.

The standard applies to any licensed deposit taker that is incorporated in New Zealand.

The standard does not apply to a licensed deposit taker that is incorporated outside New Zealand. In that case, the capital requirements are generally those that apply in the deposit taker's home jurisdiction.

Part 1

Part 1 of the standard sets out preliminary provisions including definitions for the terms related entity and significant influence.

Part 2

Part 2 sets out minimum capital requirements in respect of a deposit taker.

Subpart 1 sets out general provisions, including about the scope of calculations for capital requirements.

A deposit taker must comply with the *Part 2* requirements in respect of its capital group, which comprises the deposit taker and its subsidiaries, any funds management or securitisation SPV, and any entity or class of entities that the deposit taker's licence conditions specify must be included in the capital group.

A deposit taker's licence conditions may also require the deposit taker to comply with *Part 2* requirements on a solo basis, which means that the deposit taker must comply in respect of the deposit taker and certain types of subsidiaries. A deposit taker that has a banking subsidiary in an overseas jurisdiction must also comply with the *Part 2* requirements in respect of the capital group excluding the overseas subsidiary.

Subpart 2 prescribes capital requirements for deposit takers. In summary, they are—

- that the deposit taker must have a particular capital base or restrict distributions; and
- that capital must meet or exceed the tier 1 capital requirements; and
- that capital must meet or exceed the combined capital requirements; and
- that the deposit taker's capital must meet or exceed any combined buffer (or the deposit taker must restrict distributions).

A deposit taker must have a capital base comprising tier 1 capital of at least $5 million or it must refrain from making distributions in respect of tier 1 securities.

A deposit taker must have a tier 1 capital ratio that meets or exceeds the total of 6% and any capital overlay. A capital overlay is a percentage that is specified to apply to a deposit taker by licence condition. The Bank must be satisfied of certain matters before imposing it.

The tier 1 capital ratio is calculated by dividing tier 1 capital by RWA equivalents and then expressing the result as a percentage.

RWA equivalents is a measure of a deposit taker's assets after weighting to reflect risk in respect of those assets (RWA is a commonly used term for risk-weighted assets). The RWA equivalents for a deposit taker are the sum of—

- its total credit risk RWAs (calculated under *Parts 5 and 6*); and
- its capital requirement for market risk (calculated under *Part 7*) multiplied by 12.5; and
- its capital requirement for operational risk (calculated under *Part 8*) multiplied by 12.5.

A deposit taker must have a combined capital ratio that meets or exceeds the total of 9%, any capital overlay, and any loss-absorbing capacity.

Loss-absorbing capacity applies only to a group 1 deposit taker and is 6%, or a lower percentage if specified in the deposit taker's licence conditions. A **group 1 deposit taker** (or a **group 2** or **group 3 deposit taker**, as the case may be) is a deposit taker that is identified as such in the document setting out the deposit taker's licence conditions provided by the Reserve Bank of New Zealand (the **Bank**).

The combined capital ratio is calculated by dividing tier 1 and 2 capital by RWA equivalents and then expressing the result as a percentage.

A deposit taker may be subject to 1 or more buffers specified as a percentage and imposed by licence condition. The buffers that may be imposed are—

- a capital conservation buffer of at least 4% but no more than 5%:
- a counter-cyclical buffer of not more than 1%:
- a buffer overlay, which is not subject to a specified range, but the Bank must be satisfied of certain matters before imposing it.

A deposit taker that is subject to 1 or more buffers must have a combined buffer ratio that meets or exceeds the total percentage of the buffers, or it must restrict distributions to the holders of tier 1 securities in accordance with requirements in the standard.

The combined buffer ratio is tier 1 capital that has not been used to meet the tier 1 capital requirements or combined capital requirements, divided by RWA equivalents, and then expressed as a percentage.

The Bank may also, if satisfied of certain matters, impose distribution restrictions by licence condition.

Subpart 3 imposes a requirement on a deposit taker's board to ensure that the deposit taker and its capital group have adequate capital in relation to all the risks in their businesses.

A deposit taker must also have a board-approved internal capital adequacy assessment process (an **ICAAP**) to identify and measure risks that are not covered by the capital requirements in the standard and determine an internal capital allocation for each of those risks.

A deposit taker must ensure that its ICAAP is documented and reviewed according to the requirements in the standard. Further requirements, including independent review, apply in respect of a group 1 or group 2 deposit taker's ICAAP.

Particular requirements apply in respect of a group 3 deposit taker's ICAAP, which are similar to those under the Non-bank Deposit Takers Act 2013.

Part 3

Part 3 is about the required components of a deposit taker's capital used for purposes under the standard.

Subpart 1 sets out the definition of perpetual preference share.

Subpart 2 provides the meaning of key terms in determining a deposit taker's capital.

A deposit taker's total capital comprises its tier 1 capital and tier 2 capital.

The main components of tier 1 capital are paid-up ordinary shares issued by the deposit taker, related share premiums, retained earnings, other reserves, and paid-up mutual capital instruments issued by the deposit taker that meet certain requirements. Tier 1 capital is subject to deductions and exclusions set out in *subpart 2* and deductions required under the corresponding deductions approach in *subpart 3*.

The main components of tier 2 capital are—

- instruments issued by the deposit taker or an SPV of the deposit taker that are not tier 1 capital and that meet certain requirements in the case of a group 1 deposit taker or if they are issued by an SPV:
- related share premiums:
- certain instruments issued by a subsidiary that are held by a third party:
- revaluation reserves.

A deposit taker that uses the approach to calculating capital in the internal models standard may include certain other amounts. Tier 2 capital is subject to deductions required under the corresponding deductions approach in *subpart 3.*

Subpart 3 provides for corresponding deductions in respect of instruments used for capital ratio calculations. However, if a deduction is required in respect of an instrument under *subpart 2*, no further deduction is required under *subpart 3*.

The subpart requires a deposit taker to make, in respect of certain instruments, a corresponding deduction from the category of capital to which the instrument would belong if it were issued by a member of the deposit taker's capital group.

Subpart 4 sets out the requirements for an ordinary share to be included in tier 1 capital. The share must be classified as equity under generally accepted accounting practice and must meet other requirements, including in relation to issue of the share and distributions in respect of the share.

Subpart 5 sets out the requirements for a capital instrument to be included in tier 1 capital if it is issued by a deposit taker that is a building society, co-operative company, or credit union. The instrument must be classified as equity under generally accepted accounting practice and must meet other requirements, including in relation to the issue of the instrument and distributions in respect of the instrument.

Subpart 6 sets out the requirements for an instrument to be included in tier 2 capital. In addition, a group 3 deposit taker may include perpetual preference shares as tier 2 capital.

Subpart 7 sets out requirements in addition to those in *subpart 6* that must be met for a group 1 deposit taker to include an instrument as tier 2 capital.

Subpart 8 sets out requirements to be met for a deposit taker to include, in tier 1 or tier 2 capital, an instrument that is issued to a third party by a subsidiary of the deposit taker.

The instrument must meet the requirements for inclusion in the relevant category of capital in *subpart 4, 5, or 6* and other requirements. The subpart sets out what deductions and other adjustments must be made to the amount of the instrument that may be included in the capital.

Subpart 9 sets out requirements that must be met for instruments issued by an SPV of the deposit taker to be included in tier 1 or 2 capital. The SPV must be required to be fully consolidated with the deposit taker for the purposes of group financial statements and other requirements must be met. Ordinary shares and mutual capital instruments issued under an arrangement that involves an SPV must not be included in tier 1 capital.

Part 4

Part 4 regulates the issue of new capital by a deposit taker and changes in its capital.

Subpart 1 sets out requirements for the issue of new capital that is to be used for capital requirements. A deposit taker must notify the Bank that it intends to issue certain new capital and must provide specified documents, including a legal opinion containing required information. Additional information is required for a tier 2 capital instrument, or mutual capital instrument, that is to be denominated in foreign currency, a capital instrument issued to a related entity, or an instrument issued out of an SPV.

Subpart 2 provides that a deposit taker must notify the Bank if it makes a return of tier 1 capital that reduces its tier 1 capital by more than 10% of the amount it held 12 months previously.

A deposit taker may only redeem a tier 2 capital instrument before maturity if the Bank approves the redemption.

A deposit taker needs Bank approval to purchase capital issued by the capital group if it would result in the capital group owning more than 5% of its total tier 2 capital. A deposit taker also needs Bank approval to fund the purchase of its own tier 2 capital instrument or mutual capital instrument if it would result in the capital group being the ultimate source of funds for 5% of tier 2 and mutual capital instruments issued by the capital group. However, this restriction does not apply if the funding is to purchase a diversified portfolio.

A deposit taker must notify the Bank if it intends to amend the terms of an instrument that is tier 2 capital or a mutual capital instrument for the purposes of capital requirements.

Part 5

Part 5 provides for the calculation of total credit risk RWA, which is a key component of the RWA equivalents amount required to calculate capital ratios under the standard.

Subpart 1 sets out general provisions about the calculation of total credit risk RWA. A deposit taker calculates each ratio by dividing the relevant capital by RWA equivalents of which total credit risk RWA is a component. The result is expressed as a percentage.

Total credit risk RWA is calculated in relation to—

- credit exposures and other assets on the deposit taker's balance sheet; and
- credit exposures that arise from business carried on by a member of the deposit taker's capital group.

Total credit risk RWA is the total of credit risk RWAs calculated under *subpart 2,* except if the deposit taker is approved by the Bank to use the internal models approach.

Total credit risk RWA for a deposit taker using the internal models approach is, in general terms,—

- the total of credit risk RWAs calculated using the internal models approach; and
- credit risk RWAs for other exposures calculated under *Part 5*.

However, the credit risk RWAs amount calculated using the internal models approach must be adjusted so that it is the greater of—

- that amount multiplied by a scalar of 1.2:
- equivalent credit risk RWAs calculated under *Part 5* multiplied by 0.85 (also known as a standardised floor).

Under the internal models approach, a deposit taker categorises credit exposures and other assets into exposure classes. It uses its own ratings in respect of the following exposure classes:

- corporate:
- retail, excluding reverse mortgage loans:
- farm lending:
- lending to small and medium enterprises.

Key requirements of the internal models approach are set out in the Deposit Takers (Internal Models) Standard 2027.

A deposit taker may recognise credit risk mitigation held against a credit exposure by adjusting the credit risk RWAs calculation. The key provisions about credit risk mitigation are in *Part 7*.

The Bank may, by licence condition, impose a credit risk RWA overlay on a deposit taker, which may be an increase to either total credit risk RWAs or a component of the calculations used to determine that amount.

Subpart 2 provides for the calculation of total credit risk RWAs by a deposit taker that does not use the internal models approach. The amount is the total of credit risk RWAs calculated under the subpart. The provisions must also be used, by a deposit taker that uses the internal models approach,—

- when it calculates credit risk RWAs for exposures not covered by the approach:
- when it calculates equivalent credit risk RWAs for the purpose of the standardised floor.

Total credit risk RWA is, subject to deductions and exclusions, calculated as the total of—

- credit exposures, calculated across all borrowers and counterparties, multiplied by applicable risk weights:
- amounts for other assets on the deposit taker's balance sheet multiplied by applicable risk weights:
- the credit valuation adjustment capital charge in respect of derivatives, calculated under subpart 8, multiplied by 12.5:
- amounts in respect of trades settled on central counterparties multiplied by applicable risk weights.

The main deductions and exclusions are set out in *Part 3* and also include any impairment allowance attributable to the exposure.

Subpart 3 sets out how a deposit taker must ascertain rating grades for the purpose of determining RWAs for credit exposures under *subpart 4*. The rating grades are derived from credit ratings from specified rating agencies as follows:

- a credit rating specific to a debt issue:
- if there is no credit rating specific to a debt issue, an inferred rating.

Subpart 4 sets out the risk weights that a deposit taker must use when calculating risk-weighted assets, including for—

- currency, gold, and cash:
- claims on sovereigns and various international entities:
- claims on deposit takers and overseas banks:
- claims on corporates, including particular risk weights for small or medium enterprises:

- farm lending:
- community housing providers:
- equity holdings:
- fixed assets and leased assets.

Subpart 5 sets out provisions for calculating credit risk weights for residential mortgage loans. The risk weight that applies to a particular loan depends on whether it is a standard mortgage or a reverse mortgage, to what extent (if any) it is past due, and whether the deposit taker holds lender's mortgage insurance.

Subpart 6 provides for a credit equivalent amount to be determined for off-balance-sheet exposures. The amount relies on risk weights that apply to equivalent on-balance-sheet exposures less any applicable loss allowance, multiplied by a specified percentage (referred to as a credit conversion factor).

Subpart 7 sets out provisions for calculating credit risk RWAs for counterparty credit risk exposure. The credit risk RWAs amount is the credit equivalent amount in respect of the transaction, multiplied by the risk weight specified in *subpart 4* that applies to the counterparty.

A deposit taker that uses the internal models approach must add the credit equivalent amount to its exposure at default amount for the counterparty, as calculated under that approach. Special rules for derivatives that are settled bilaterally and derivatives and securities financing transactions that are settled via central counterparties are set out in *subparts 8 and 9*, respectively.

Subpart 8 provides methodologies for calculating the credit valuation adjustment capital charge, which is calculated in respect of derivatives that are settled bilaterally. The charge is multiplied by 12.5 to result in a component of total credit risk RWAs under *subpart 2*. The requirements also apply to deposit takers who use the internal models approach.

Subpart 9 sets out how to calculate credit risk RWAs for central counterparty exposures arising from derivative transactions and SFTs settled via a central counterparty. The same requirements apply to derivatives that are entered into bilaterally and exchange-traded derivatives but the requirements differ depending on whether the central counterparty is classified as qualifying or non-qualifying under the subpart.

The requirements also apply to deposit takers who use the internal models approach.

A qualifying central counterparty is a central counterparty that is a designated FMI under the Financial Market Infrastructures Act 2021 or whose use by the deposit taker has been approved by the Bank.

Part 6

Part 6 relates to credit risk mitigation, in respect of which a deposit taker may adjust its credit risk RWAs.

Subpart 1 sets out an overview of the risk mitigation provisions.

Subpart 2 provides that a deposit taker may recognise credit risk mitigation only if the mitigation meets the requirements in the subpart. However, in the case of a deposit taker that uses the internal models approach, the mitigation must also be for 1 or more of the specified purposes.

A group 3 deposit taker that has a loan for which it holds a deposit as collateral may choose to comply with requirements in terms of credit risk mitigation that are simpler than the general requirements.

Credit risk mitigation may only be recognised if there is sufficient documentation, and the effects of credit risk mitigation must not be double counted.

Subpart 3 sets out a simple and a comprehensive methodology for recognising collateral as credit risk mitigation.

A deposit taker, other than a deposit taker using the internal models approach, may use either the simple or the comprehensive approach for exposures in its banking book. However, it must apply the chosen approach consistently. It must use the comprehensive methodology in respect of all exposures in its trading book. The distinction between the banking book and the trading book is set out in *subpart 6 of Part 7.*

A deposit taker using the internal models approach must use the comprehensive methodology in respect of all of its exposures.

The provisions set out requirements for cash, debt securities, and equity instruments to be eligible collateral for credit risk mitigation.

The key minimum requirements that must be met to recognise collateral as credit risk mitigation are that the deposit taker must—

- have direct, unconditional, and irrevocable recourse to the collateral; and
- have the right to liquidate or take possession of the collateral immediately in the event of a default or other specified event; and
- take all necessary steps to maintain an enforceable security interest; and
- have clear procedures for prompt liquidation of the collateral.

The comprehensive methodology comprises calculations to determine an adjusted exposure amount that is then subject to certain haircuts and other adjustments.

Under the simple methodology, collateral may only be recognised for credit risk mitigation if the collateral is pledged for at least the life of the exposure and is marked to market at least every 6 months. A risk weighting is then applied.

Subpart 4 provides calculations for the recognition of on-balance-sheet netting for credit risk mitigation.

Subpart 5 provides that a deposit taker may recognise a guarantee, indemnity, or credit derivative as credit risk mitigation if requirements in the subpart are met. The key requirement is that the party providing the guarantee, indemnity, or credit derivative must be a sovereign, central bank, public sector entity, development bank, deposit taker, overseas bank, or large corporate entity. Only certain types of credit derivative are eligible to be recognised as credit risk mitigation.

A mismatch adjustment is required to be made if there is a currency mismatch because a guarantee, indemnity, or credit derivative is denominated in a different currency to the underlying exposure.

Subpart 6 sets out different requirements that apply to using guarantees, indemnities, and credit derivatives as credit risk mitigation in the case of a deposit taker using the internal models approach.

Subpart 7 sets out adjustments required to the amount of credit risk mitigation determined under *subparts 3 to 6* where there is a maturity mismatch between the underlying exposure and the applicable mitigation.

Part 7

Part 7 sets out provisions for calculating the capital requirement for market risk, which is a component of total credit risk RWA.

Subpart 1 sets out preliminary provisions.

Subpart 2 provides for the calculation of the capital requirement for market risk. In general terms, it is the total of the capital charge for market risk in the banking book and trading book, respectively. It is similar to the approach in *Calculation of RWA for market risk MAR 40: Simplified standard approach, prepared by the Basel Committee on Banking Supervision, effective 1 January 2023 (***MAR 40***)*. However, the capital requirement for market risk for a group 3 deposit taker must be determined in accordance with requirements similar to regulation 21 of the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010.

The capital charge for market risk in the banking book comprises the capital charges for interest rate risk, currency risk, and equity, determined in accordance with relevant provisions in the Part.

The capital charge for market risk in the trading book must be determined in accordance with a methodology approved by the Bank. The Bank may only approve a methodology if it is satisfied that it is consistent with MAR 40.

The Bank may, by licence condition, impose a market risk overlay on a deposit taker, which may be an increase to either the capital requirement for market risk or a component of the calculations used to determine that amount.

Subpart 3 provides for the calculation of the capital charge for interest rate risk in the banking book. It includes requirements for determining the interest rate risk arising in respect of different types of instruments, including options and derivatives.

Subpart 4 provides for the calculation of the capital charge for currency risk in the banking book. Compound and hybrid financial instruments must be decomposed into constituent instruments before carrying out the calculations.

Subpart 5 provides for the calculation of the capital charge for equity risk in the banking book.

Subpart 6 requires a deposit taker to designate financial instruments, foreign exchange, and commodities as either banking book or trading book instruments. In general terms, instruments held for trading-related purposes must be included in the trading book.

A deposit taker must designate all instruments that are not trading book instruments as banking book instruments. It must also designate certain other instruments as banking book instruments (whether or not they also meet the requirements to be trading book instruments). Examples of these instruments are equity securities that are not listed on a share market and retail credit instruments. A deposit taker may also get approval from the Bank to designate certain instruments as banking book instruments.

A deposit taker must have a policy and procedures regarding its trading book designations and must restrict movement between the books. Particular provisions apply with respect to transfers within and between the books.

Part 8

Part 8 provides for the calculation of the capital requirement for operational risk, which is a component of total credit risk RWA.

The approach is similar to the approach in *Calculation of RWA for operational risk OPE 25: Standardised approach, prepared by the Basel Committee on Banking Supervision, effective 1 January 2023.* It is based on a deposit taker's business indicator, which reflects operational risk in various areas of the deposit taker's business.

The Bank may, by licence condition, impose an operational risk overlay on a deposit taker, which may be an increase to either the total requirement for operational risk or a component of the calculations used to determine the business indicator needed to determine that amount.

Part 9

Part 9 covers matters relating to funds management, securitisations, and insurance. It also sets out detail relating to whether a loan transfer is a clean transfer.

Subpart 1 requires a deposit taker, in certain circumstances, to consolidate an SPV that is used for funds management or securitisation in its capital group for the purposes of calculating capital requirements. The subpart also sets out how the deposit taker must treat any credit enhancement (for example, a guarantee) provided to the SPV if the SPV is not required to be consolidated in its capital group.

Subpart 2 requires a deposit taker, in certain circumstances, to deduct from its tier 1 capital a credit enhancement or funding exposure provided by the deposit taker or a subsidiary to an insurance entity that is affiliated with the deposit taker.

Subpart 3 provides that any funding exposure in relation to an SPV that is not consolidated, or in respect of an affiliated insurance entity, that exceeds 10% of the deposit taker's tier 1 capital, must be deducted from tier 1 capital.

Subpart 4 sets out the methods, and related requirements, for lending originated by the deposit taker or a member of the capital group to be classified as a clean transfer under the standard. A deposit taker may exclude a clean transfer from the calculation of credit risk RWAs.

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Replacement empowering Act and provisions	Not applicable
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