NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Reserve Bank of New Zealand

on the

proposed changes to the *Capital Adequacy Framework* arising as a result of Basel III

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Submission by the New Zealand Bankers' Association to Reserve Bank of New Zealand on proposed changes to the Capital Adequacy Framework arising as a result of Basel III

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.

2. The following thirteen registered banks in New Zealand are members of NZBA:
   - ANZ National Bank Limited
   - ASB Bank Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - Citibank, N.A.
   - The Co-Operative Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited.

3. If you have any questions about this submission, or would like to discuss any aspect of it further, please contact either myself or Philip Leath, the Chair of the NZBA Tax Working Group:

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NZBA SUBMISSION ON BASEL III IMPLEMENTATION

1. INTRODUCTION AND OVERVIEW

1.1 The New Zealand Bankers' Association ("**NZBA**") is grateful for the opportunity to comment on the implementation of Basel III. This submission relates to issues associated with the Reserve Bank of New Zealand's ("**RBNZ**") proposed changes to the *Capital Adequacy Framework* arising as a result of Basel III. References to the *Capital Adequacy Framework* are to the draft *Capital Adequacy Framework (Internal Models Based Approach)*, although all submissions apply equally to the draft *Capital Adequacy Framework (Standardised Approach)*.

1.2 Broadly speaking the industry has two high level concerns. The first is that the proposed requirements do not align in key respects with the requirements adopted by the Australian Prudential Regulation Authority ("**APRA**"). Given that all the major New Zealand banks have Australian parents, these inconsistencies pose a serious practical difficulty. If the same instruments cannot satisfy the capital requirements under both regimes, it may mean that domestic banks simply do not offer to the market in New Zealand. The second high level concern relates to the tax haircut concept. NZBA has concerns both about the overarching concept, and some of the practical aspects of the proposal.

1.3 Details of these concerns are outlined in the five specific submissions below. These submissions, in summary, are:

(a) **First submission** (see section 2): The proposed definition of non-viability does not allow for the authority in the home jurisdiction to trigger a non-viability event, which is inconsistent with the finalised APRA standards. We submit that the RBNZ should adopt the same definition of non-viability as APRA.

(b) **Second submission** (see section 3): The proposal to prevent additional tier one and tier two capital instruments from converting into the ordinary shares of the listed parent bank is inconsistent with APRA's finalised standards. The RBNZ's *Capital Adequacy Framework* should be aligned with APRA's standards by permitting conversion of an additional tier one or tier two capital instrument into ordinary shares of the listed parent.

(c) **Third submission** (see section 4): We recommend that the *Capital Adequacy Framework* as finalised:

(i) should remove the tax haircut requirement entirely, on the basis that the prospect of any actual tax liability arising upon conversion or write-off is theoretical rather than a practical likelihood; or

(ii) in the alternative to 1.3(c)(i) above, should, considering that any bank, following a non-viability trigger event, would be highly likely to have tax losses sufficient to offset any debt forgiveness income (such that no tax liability from the conversion or write-off would in fact arise), refine the tax haircut requirement to take into account the effect of such tax losses.

(d) **Fourth submission** (see section 5): It is currently unclear from the *Capital Adequacy Framework* whether a tax haircut is required for instruments which provide for conversion, with a backstop mechanism of write-off as required. To clarify this point, we recommend that the *Capital Adequacy Framework* expressly stipulate that no tax haircut arises on account of a potential tax liability to the extent the liability would arise only if the backstop mechanism is used. This would align the New Zealand position with the position recently confirmed by APRA in its finalised standards.

(e) **Fifth submission** (see section 6): The *Capital Adequacy Framework* needs to consistently refer to the possibility of partial write-off and conversion, and should be amended to clarify that it is only the face value that is required to be written-off or converted on non-viability (and not the accrued interest also), to be consistent with the APRA standards.

2. FIRST SUBMISSION: INCONSISTENT DEFINITION OF NON-VIABILITY

The issue

2.1 The non-viability trigger is an essential part of the Basel III implementation. NZBA has major concerns regarding the inconsistencies between the proposed RBNZ definition of 'non-viability' and the definition that has been adopted by APRA. The APRA definition, which is aligned to the Basel Committee on Banking Supervision definition, is an extended definition which allows for authorities in both the home and host jurisdictions to trigger a non-viability event.

2.2 The more specific definition of a non-viability trigger event now proposed by the RBNZ would make it impossible to include a definition of non-viability in offers that would meet the requirements of both regulators. The practical effect will be that it would inhibit the

raising of capital in New Zealand by banks with Australian parents, due to the duplication that would be required to satisfy both regimes.

Recommendation: that RBNZ adopt the APRA definition of non-viability

2.3 We submit that aligning the two regimes will not only align New Zealand with the definition used by the Basel Committee and APRA, but will also allow for an instrument to satisfy both regulators.

2.4 Once the definitions are aligned the RBNZ could publish guidance on the circumstances in which it would expect to make a non-viability determination and this guidance could reflect the non-viability definition contained in the current draft standards.

3. SECOND SUBMISSION: LOSS ABSORBENCY REQUIREMENTS

The issue

3.1 In the *Letter to Chief Executives of locally incorporated (internal models) New Zealand banks* (September 2012), RBNZ poses the following as one of its consultation questions (Appendix 2, Question 1):

> Do you consider that instruments that comply with our proposed loss absorbency at the point of non-viability requirements (in BS2B) will also comply with the loss absorbency at the point of non-viability requirements of ... (APRA)?

3.2 NZBA considers that RBNZ's proposal and APRA's finalised standards are inconsistent.

3.3 In respect of conversion, APRA states in *Prudential Standard APS 111: Capital Adequacy: Measurement of Capital* (September 2012) that (at Attachment J, Paragraph 1):

> An Additional Tier 1 Capital or Tier 2 Capital instrument must include a provision under which, on the occurrence of a non-viability trigger event (as defined in paragraphs 3, 4 and 5 of this Attachment), it will be immediately and irrevocably:
>
> (a) converted into **the ordinary shares of the ADI or its parent entity, which must be listed at the time the instrument is issued**; ...
>
> [Emphasis added, footnotes omitted]

3.4 In contrast, the *Capital Adequacy Framework* provides at paragraphs 2.48 and 2.57 that the instrument must be "...converted into the ordinary shares of the registered bank". Considering that RBNZ's proposals require conversion into shares of the New Zealand registered bank, and APRA's finalised standards require conversion into shares in an entity which is listed at the time the instrument is issued (and the ordinary shares of no New Zealand registered bank are currently listed), it is not possible to structure an

instrument that meets both the conversion requirements of APRA and the conversion requirements of RBNZ.

3.5 While it is possible to meet the APRA and RBNZ requirements by issuing an instrument that provides for write-off, write-off without consideration will most likely lead to the tax haircut issue and the detrimental consequences arising from the tax haircut, outlined in section 4. NZBA acknowledges that RBNZ's proposals allow for compensation to be provided as part of a write-off. However, as explained in paragraph 4.5(b) below, it is not clear that instruments which provide for write-off and compensation will be able to meet APRA's requirements. Therefore (and as explained further below), unless the tax haircut issue is addressed, or RBNZ allows for conversion into ordinary shares in the Australian listed parent, NZBA considers that the most likely outcome of these series of conflicts between APRA's standards and RBNZ's proposals is that the Australian parent bank will issue additional tier one and tier two capital instruments that provide for conversion into its ordinary shares in the case of a non-viability event, and will inject intra-group regulatory capital into the New Zealand registered bank.

3.6 To overcome this inconsistency between APRA's finalised standards and RBNZ's requirements as currently proposed, NZBA submits that RBNZ should allow an instrument to convert into equity in a parent company, even if the parent company is Australian-based.

3.7 We understand RBNZ is concerned about allowing conversion into ordinary shares in parent companies in the light of the possible risk that the obligation on the parent to issue the shares to effect conversion may not be enforceable (due to, for example, steps taken by APRA, or some other legal impediment) and that this in turn may prevent the debt instrument from being discharged. While we acknowledge this concern, NZBA considers this risk can be addressed by:

(a) requiring the relevant Australian parent to be a contractual party to the terms of the instrument (making it contractually bound by its terms): and

(b) (as a further fallback to paragraph 3.7(a) above), requiring the instrument to provide for the debt to be written-off (without recourse to the New Zealand bank) if conversion is not possible (as is currently already provided for in paragraphs 2.49 and 2.58 of the *Capital Adequacy Framework*).

3.8 If both these requirements apply in respect of an instrument, the instrument will ordinarily convert (with the parent being contractually required to honour such an agreement) and, failing that, will be written off. This should be sufficient for the requirements of RBNZ because, even in the seemingly unlikely event that there was a

legal impediment to conversion into ordinary shares of the listed parent entity, the fallback mechanism (being the write-off) ensures the debt instrument is discharged nonetheless.

3.9 In support of this submission we refer to the preference RBNZ previously expressed for conversion over write-off, and the difficulty of meeting the current conversion requirements. In RBNZ's *Consultation Paper: Further elements of Basel III capital adequacy requirements in New Zealand* (March 2012), RBNZ stated at paragraph 21:

> The Reserve Bank proposes that the terms and conditions of all non-common equity instruments require that the instrument be converted to equity - rather than be written-off - under certain circumstances (discussed below). We do not favour a write-off approach, as write-off with no compensation could rank debt holders below equity holders.

3.10 Although RBNZ later indicated that it would also allow for write-off (in the *Letter to the Chief Executives of locally incorporated New Zealand banks: Basel III implementation in New Zealand - update* (May 2012)), the general point, regarding the undesirability of debt holders in effect ranking below equity holders, remains. That being so, the *Capital Adequacy Framework* should provide for a meaningful conversion mechanism. For the mechanism to be meaningful, conversion into ordinary shares in the listed parent should be permitted. There are two reasons for this:

(a) first, conversion into shares in the subsidiary (ie, the New Zealand registered bank) would leave holders with illiquid shares; and

(b) second (and more fundamentally), the effect of the APRA standards (which require conversion into ordinary shares in the listed parent) is that conversion into shares in the New Zealand registered bank is not an available option for the largest New Zealand banks.

3.11 It is unclear to NZBA why RBNZ is willing to recognise for regulatory capital purposes an instrument that provides for write-off and compensation in the form of ordinary shares in the listed parent, but is unwilling to accept an instrument that provides for straight conversion into ordinary shares in the listed parent, with the backstop of write-off should conversion not be possible. The latter instrument achieves the same outcome (in terms of RBNZ's objectives) as the former.

3.12 Furthermore, we refer to the Bank for International Settlements' *Consultative Document: Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability* (August 2010), which states on pages 7 and 8:

> As already highlighted, it is the write-off of the capital instruments (required under paragraph 1 of the proposal) that increases the common equity of the

> bank and removes the possibility of the capital instrument holders remaining senior to any common equity injected by the public sector. The issuance of new shares simply affects the ownership structure of the bank after the trigger event.
>
> Banking groups, or jurisdictions implementing the proposal described in this consultative document, may wish to avoid the possibility that the conversion of subordinated debt capital in a subsidiary of a group removes full ownership of the subsidiary through creating new shareholders of that subsidiary. **Paragraph 7 therefore allows the trigger event to lead to conversion into shares of the parent company of the group as an alternative to shares in the subsidiary bank**. Under this alternative the same amount of common equity is created by the trigger event, the only difference is that the instrument holders now receive shares in the parent company as compensation for the write-off of the capital instrument.
>
> [Emphasis added]

3.13 The emboldened passage supports the very point being made by NZBA, which is that conversion into shares in the subsidiary bank is impractical, such that conversion into ordinary shares in the listed parent bank should be permitted. A further relevant point is that the passage from the *Consultative Document* does not describe conversion and write-off as mutually exclusive propositions. Instead, the passage cited above recognises that what is critical is to "...remov[e] the possibility of the capital instrument holders remaining senior to any common equity injected by the public sector". So long as that objective is accomplished, the label used to describe how that occurs (ie, conversion or write-off), and whether it is the parent or the subsidiary bank that issues the shares into which the tier two instrument is converted, should not be determinative.

Summary of submission

3.14 It is undesirable for the regulatory capital definitions of Australia and New Zealand to be inconsistent given the degree of integration between the two countries, in the absence of very good reason. For the reasons set out at paragraphs 3.7 to 3.13 above, there is no good reason in this case.

3.15 Further, if the proposed tax haircut were to remain in its current form (see section 4 below), the write-off mechanism would lead to such additional complexity and (potentially) additional cost as compared to the conversion mechanism that instruments that would need to rely on that write-off mechanism would not be issued in the New Zealand market. That in turn would have detrimental consequences as described in paragraphs 4.5 and 4.5(c).

3.16 We therefore submit that the requirements of the conversion mechanism should be amended to remove the inconsistency with the APRA standards. Conversion should be permitted into ordinary shares of the New Zealand registered bank, or (if the New Zealand registered bank is directly or indirectly owned by a listed entity) ordinary shares of that listed entity. If an instrument issued by a New Zealand registered bank were

convertible into ordinary shares of the listed parent entity, there would need to be a consideration flow from the New Zealand registered bank to the listed parent entity. But that consideration flow would be satisfied solely by the issue of ordinary shares in the New Zealand registered bank; there would be no residual claim on the New Zealand bank.

4. THIRD SUBMISSION: THE TAX HAIRCUT REQUIREMENT SHOULD NOT PROCEED

Issue

4.1 The income tax consequences of a conversion or write-off of a debt instrument may affect the amount of capital that can be recognised in respect of that instrument under the *Capital Adequacy Framework*. Specifically, the *Capital Adequacy Framework* at paragraphs 2.51 and 2.60 provides, in respect of additional tier one and tier two capital, that:

> In determining the value of an instrument for the purposes of regulatory capital recognition, the nominal value of an instrument must be reduced by potential tax and other offsets that occur at the time of conversion or write-off. In particular, the amount of an instrument that may be recognised in the bank's Tier 1 and total capital ratios is the minimum level of Common Equity Tier 1 capital that would be generated by a full conversion or write-off of the instrument, **and must account for potential taxation liabilities or other potential offsets at the time of conversion or write-off**. Adjustments must be updated over time to reflect the best estimate of the offset value. The Reserve Bank may require a tax opinion on potential tax liabilities.
>
> [Emphasis added]

Tax liability highly unlikely to arise in practice

4.2 If an instrument were to give rise to taxable income upon non-viability, it is highly unlikely that an actual tax liability will arise in respect of such income. If a non-viability event (leading to either conversion or write-off) occurred, the relevant banking group would be highly likely to have deductible tax losses which would offset any taxable income. No actual tax liability (having economic consequences) would arise.

4.3 That being so, the tax haircut requirement as currently proposed is directed at a tax liability that is theoretical, rather than one that has any realistic prospect of arising in practice. And yet the tax haircut would have significantly detrimental consequences, as discussed in paragraphs 4.5 and 4.5(c) below.

4.4 Those paragraphs need to be understood in the context of whether a potential tax liability (ie, before taking into account tax losses) arises. If loss absorption occurs via write-off, a potential tax liability will most likely arise. If conversion into the registered

bank's ordinary shares occurs, while not certain, it is likely that a tax liability will not arise. Of course, whether a potential tax liability would arise will depend on the terms of the particular instrument. And while we acknowledge the ability to compensate the holder via the issue of shares in the listed parent in the case of write-off, to implement such an arrangement in a way that does not give rise to a tax liability appears to be difficult, and could require complexity of such a degree that it would not be viable to issue the instrument to third party investors. Further, it is unlikely that such an arrangement will comply with APRA's standards,[1] in which case, for the Australian-owned banks, write-off combined with compensation via the issue of ordinary shares in the listed parent would not be an option.

The tax haircut would increase the cost of capital for New Zealand banks

4.5 The tax haircut would increase the cost of capital into New Zealand as a result of the following:

(a) If a New Zealand bank were required to recognise a potential tax liability, it would need to issue a greater nominal (or actual) amount of capital to attain the necessary amount of regulatory capital. As tier one capital and tier two capital are more expensive than other forms of funding, New Zealand banks would suffer an increase in their cost of capital from the tax haircut. For economic and governance reasons, the New Zealand banks are unlikely to issue instruments providing for a conversion into ordinary shares of the New Zealand bank. Consequently, the write-off mechanism would be the only available loss absorption mechanism for New Zealand banks under RBNZ's proposals.

(b) Further, for the Australian-owned banks a disparity arises between RBNZ's loss absorption mechanism and APRA's loss absorption mechanism (as was discussed above in section 3). This is because RBNZ's proposals would not allow for a straight conversion into listed parent ordinary shares. While RBNZ's proposals do allow for compensation to the holder in the form of ordinary shares in the listed parent, this is only in the case of a write-off, and so is unlikely to be achievable consistently with the APRA standards (see paragraph 4.4 above). Further, even if the write-off mechanism could be implemented (consistently with APRA's standards) so as not to trigger a potential New Zealand tax liability, complex arrangements would be required. Even then it would be highly uncertain whether such complex arrangements would mitigate

[1] One of APRA's requirements which could be difficult to adhere to when providing for compensation in the write-off scenario is paragraph 17 of Attachment J in *Prudential Standard APS 111: Capital Adequacy: Measurement of Capital*, which provides: "The contractual terms and conditions of the issue of an instrument must not provide for any residual claims on the issuer that are senior to ordinary shares of the ADI, or the parent entity, in the event that a trigger point is reached and a conversion or write-off is undertaken."

the potential tax liability. Faced with that uncertainty and complexity, it is most likely that the Australian parent bank would issue (for example) tier two regulatory capital itself and then inject capital into New Zealand. The tax haircut feature of the *Capital Adequacy Framework* as proposed could therefore have the consequence that, due to inefficiency (if the tax haircut applies), or complexity (due to the steps that would need to be taken to ensure that the tax haircut does not apply), it is no longer feasible for New Zealand banks to look to the New Zealand capital markets to meet their tier two capital requirements.

(c) APRA's *Prudential Standard APS 222: Associations with Related Entities* places constraints on the ability of Australian-owned banks to raise capital from the Australian bank. Consequently, the tax haircut would not only be likely to lead Australian-owned banks to seek to meet their capital requirements via the Australian parent (paragraph (b) above), but it could also in turn lead to less capital being available to the New Zealand bank (given APS 222 constraints).

4.6 To make the New Zealand banking system generally more dependent on capital provided by foreign parent banks would seem to be an unintended and highly undesirable consequence of the current proposals. It would be detrimental to the New Zealand economy (given the cost of capital implications). In addition, it would not seem to advance RBNZ's financial stability objectives. These implications would be all the more unfortunate given that they would arise from a requirement to recognise a tax haircut for a theoretical tax liability that in all practical likelihood will never arise, given the likely tax loss position described at paragraph 4.2 above.

Recommendation: proposed tax haircut should not proceed, or should be modified to reflect relevance of tax losses

4.7 As indicated above, any tax liability that may arise from conversion or write-off at the point of non-viability is theoretical only. That being so, and given the detrimental consequences to which the tax haircut could give rise, NZBA submits that there is a sound case for RBNZ not to include the tax haircut requirement in the *Capital Adequacy Framework*.

4.8 Alternatively, if the tax haircut requirement is retained, then the requirement should be based on the tax liability after taking into account tax losses and any other relevant tax attributes that can be expected to be available at the time of conversion or write-off.

5. FOURTH SUBMISSION: IF THE TAX HAIRCUT REMAINS, CLARIFY THAT THERE IS NO TAX HAIRCUT IF AN INSTRUMENT PROVIDES PRIMARILY FOR CONVERSION AND THE WRITE-OFF IS A BACKSTOP ONLY

5.1 Where an instrument provides for conversion into shares upon non-viability, no tax liability should ordinarily arise. This is the case because the conversion into shares is treated for tax purposes as having repaid the debt, and as the debt is repaid, there is no debt forgiveness income, and hence no potential tax liability.

5.2 However, paragraphs 2.49 and 2.58 of the *Capital Adequacy Framework* each provide:

> Where the instrument provides a right of conversion, the terms of the instrument must provide that where, following the occurrence of a non-viability trigger event, conversion of a capital instrument:
>
> (a) is not capable of being immediately undertaken; or
>
> (b) is revocable
>
> the registered bank has the right to write-off the principal amount and any accrued interest owing under the instrument.

5.3 This raises the question of whether, where an instrument provides for conversion, the tax haircut may nonetheless be necessary because there is a possibility that (if there is an impediment to conversion) write-off would be required. (This assumes the write-off scenario would give rise to debt forgiveness income, which it may or may not, depending on the precise terms of the instrument.)

5.4 As a result of a discussion at a meeting held on 20 September 2012, NZBA understands that it does not follow that a tax haircut must always be recognised as a result of the required backstop capacity to write-off the instrument (as reflected in paragraphs 2.49 and 2.58 of the *Capital Adequacy Framework*). Instead, NZBA understands that so long as it is possible to conclude that there would be no income tax liability arising from the (primary) conversion mechanism, it is not necessary to also conclude that the backstop write-off mechanism would not give rise to an income tax liability. It would be helpful if this point could be confirmed in the final form of the *Capital Adequacy Framework*. For example, paragraphs 2.49 and 2.58 could go on to state: "For the purposes of paragraphs 2.51 and 2.60 [the paragraphs describing the tax haircut requirement], potential tax liabilities need not be assessed on the basis the conversion cannot be effected, or is revocable, unless circumstances at the date of issue indicate that either of those contingencies will arise".

5.5 This is consistent with APRA's approach in respect of recognising tax liabilities which would arise only if the backstop write-off mechanism were used. As stated on page 17

of APRA's *Response to Submissions II: Implementing Basel III capital reforms in Australia* (September 2012):

> Several submissions were concerned by APRA's proposal that ADI's should account for taxation liabilities in determining the amount of Common Equity Tier 1 Capital that would arise if loss absorption or non-viability requirements were triggered. A particular concern was that this obligation will also apply to the 'fail-safe' write-off provision mandated by APRA to come into effect should conversion not take place as anticipated.
>
> ...
>
> APRA accepts the argument that triggering the fail-safe write-off provisions is highly unlikely. Therefore, ADIs do not need to account for the potential tax liabilities that may be involved.

5.6 APRA achieved this result by inserting the emboldened words below in *Prudential Standard APS 111: Capital Adequacy: Measurement of Capital* (September 2012) at Attachment J, paragraph 2:

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

6. FIFTH SUBMISSION: PARTIAL WRITE-OFF OR CONVERSION

6.1 The *Capital Adequacy Framework* does not currently consistently provide for partial write-off or conversion. Paragraph 2.57 of the *Capital Adequacy Framework* provides:

> Subject to section 2.58, an Additional Tier 1 or Tier 2 capital instrument must include as a term of the instrument a right held by the registered bank, exercisable upon the occurrence of a non-viability trigger event (as defined in section 2.61), to:
>
> (a) convert, in part or full, the principal amount and any accrued interest owing under the instrument into the ordinary shares of the registered bank; or
>
> (b) write-off, in part or full, the principal amount and any accrued interest owing under the instrument in a manner that meets the requirements of section 2.66.

6.2 It is important that the principal amount of the instrument can convert or be written-off in full. However, in circumstances where no full conversion or write-off is necessary to ensure the bank satisfies RBNZ as to its situation, the *Capital Adequacy Framework* should more consistently refer to the possibility of partial conversion or write-off of the principal amount of the instrument. For example, paragraph 2.65 provides:

> For the purposes of conversion or write-off, the amount to be converted or written-off will be the principal amount outstanding plus any accrued interest attributable to the instrument in the most recent accounting records of the bank.

6.3 The above anomaly could be rectified by referring to the amount to be written-off or converted in accordance with the direction issued by RBNZ or the decision of the statutory manager. This is referred to in paragraph 2.62, which provides:

> The direction issued by the Reserve Bank or a decision of the statutory manager to exercise the right to convert or write-off the instrument may be for either full conversion or write-off, or for partial conversion or write-off.

6.4 Furthermore, there appears to be an inconsistency between RBNZ's proposals and APRA's finalised standards. RBNZ requires conversion or write-off of the principal amount of the instrument, as well as "...any accrued interest owing under the instrument...". In contrast, APRA requires that "...the amount to be converted or written off will be the face value of the instrument recorded in the books...". Rather than requiring accrued interest to convert or be written-off, NZBA submits that accrued interest should be dealt with consistently with APRA's finalised standards, which provide (at Attachment J, Paragraph 17):

> The contractual terms and conditions of the issue of an instrument must not provide for any residual claims on the issuer that are senior to ordinary shares of the ADI, or the listed parent entity, in the event that a trigger point is reached and a conversion or write off is undertaken