

## **ANNEX 2A: REQUIREMENTS FOR LOWER TIER 2 CAPITAL INSTRUMENTS**

### Requirements Relating to the Reporting Bank Issuing Lower Tier 2 Capital Instruments

1.1 A Reporting Bank intending to issue any Lower Tier 2 capital instrument ("LT2") for the purpose of inclusion as Tier 2 Capital shall:

- (a) consult the Authority well in advance if the instrument has additional features that are not explicitly addressed in paragraph 1.3; and
- (b) obtain the approval of the Authority for the instrument to qualify as Lower Tier 2 Capital.

1.2 In applying for such approval, a Reporting Bank shall:

- (a) submit an appropriate memorandum of compliance stating how the proposed issuance complies with the requirements set out in paragraph 1.3 and identifying the relevant portions of the agreement governing the issuance of the instrument which address the requirements; and
- (b) confirm to the Authority in writing that it has received a written external legal opinion stating that the requirements in paragraph 1.3 have been met.

[MAS Notice 637 (Amendment 2) 2007]

### Minimum Requirements for LT2

1.3 To qualify for inclusion as Tier 2 Capital, an LT2 shall satisfy the following requirements:

- (a) the LT2 is issued and fully paid-up in cash. Only the net proceeds received from the issuance of LT2 shall be included as capital;
- (b) the LT2 has a minimum original maturity of at least 5 years. Where the agreement governing the issuance of the LT2 provides for the loan to be drawn down in a series of tranches, the minimum original maturity for each tranche shall be 5 years from the date of its draw-down;

- (c) any redemption of the LT2 at the option of the Reporting Bank (whether through a call option, repurchase or otherwise) is subject to the prior approval of the Authority<sup>1</sup>. Without prejudice to any other matter that the Authority may consider relevant, the Authority shall, in determining whether to grant its approval, have regard to whether the Reporting Bank's capital is likely to remain adequate after redemption;
- (d) the agreement governing the issuance of the LT2 does not contain any provision that mandates or creates an incentive for the Reporting Bank to repay the outstanding principal of the instrument early<sup>2</sup>, other than a call option which may be exercised by the Reporting Bank no earlier than 5 years after the issuance of the LT2, accompanied by a provision whereby the dividend or coupon rate payable under the LT2 increases by no more than:
  - (i) in the case of an LT2 with a maturity of less than 10 years, 50 basis points over the initial rate, less the swap spread between the initial index basis and the stepped-up index basis; or
  - (ii) in the case of an LT2 with a maturity of 10 years or more, 100 basis points over the initial rate, less the swap spread between the initial index basis and the stepped-up index basis,if the Reporting Bank chooses not to exercise its option, such increase in dividend or coupon rate being the only one during the validity period of the LT2;
- (e) where the LT2 provides the holders with the option to demand repayment prior to maturity, the earliest possible repayment date will be regarded as the effective maturity date of the LT2 for the purposes of this paragraph;

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<sup>1</sup> Approval is likely to be granted where:

- (a) the LT2 is replaced by equal or higher quality capital (including an increase in retained earnings);
- (b) the Reporting Bank or any of its banking group companies is reducing its operations in Singapore or elsewhere;
- (c) the LT2 was issued for the purposes of a merger with, or acquisition by, the Reporting Bank and the merger or acquisition is aborted;
- (d) there is a change in tax status of the LT2 due to changes in the applicable tax laws of the country or territory in which the LT2 was issued;
- (e) in the case of a merger or acquisition, the LT2 is exchanged for shares or any instrument of the surviving or new Reporting Bank (as the case may be) with terms and conditions that qualify the shares or instrument as equal or higher quality capital; or
- (f) there is a change in this Notice relating to the recognition of the LT2 as capital for calculating CAR.

<sup>2</sup> Examples are a cross-default or negative pledge clause or a restrictive covenant for an LT2 issued as debt.

- (f) the dividend or coupon rate, or the formulae for calculating dividend or coupon payments is fixed at the time of issuance of the LT2 and is not linked to the credit standing of the Reporting Bank<sup>3</sup>;
- (g) the holder of the LT2 has a priority of claim in respect of the principal and dividend or coupon payments of the LT2, in the event of a winding up of the Reporting Bank, which is lower than that of depositors and other creditors of the Reporting Bank, except where such persons rank equally with, or behind holders of the LT2;
- (h) the LT2 is not secured or covered under any arrangement that legally or economically enhances the priority of the claim of any holder of the LT2 as against the persons set out in paragraph 1.3(g) above;
- (i) for any LT2 issued as debt by the Reporting Bank, the holder of the LT2 waives his right to set off any amounts he owes the Reporting Bank against any subordinated amount owed to him due to the LT2 and commits to return any set-off amounts or benefits received to the liquidator;
- (j) the subordination provisions of the LT2 are governed by the laws of Singapore. Where the LT2 is to be subject to the laws of a jurisdiction other than Singapore, the Reporting Bank shall satisfy itself and the Authority that all the relevant conditions specified in paragraph 1.3 are met under the laws of that jurisdiction;
- (k) the main features of the LT2, in particular paragraphs 1.3(f) to (i) above, are disclosed clearly and accurately;
- (l) the agreement governing the issuance of the LT2 cannot be changed without the prior approval of the Authority as the proposed changes may impact its eligibility as Tier 2 Capital subject to Limits;
- (m) the LT2 does not qualify in full for inclusion as Tier 2 Capital subject to Limits in its final 4 years to maturity. The eligible amount shall be amortised on a straight-line basis by 20% per annum. Where the LT2 is repayable in separate tranches, each tranche shall be amortised individually, as if it were a separate loan. The amortisation schedule is as follows:

<u>Years to maturity (x)</u>	<u>Amortised amount eligible to be included in Tier 2 Capital subject to Limits</u>
x > 4	100%
3 < x ≤ 4	80%
2 < x ≤ 3	60%
1 < x ≤ 2	40%
x ≤ 1	20% ; and

<sup>3</sup> For the avoidance of doubt, this does not preclude linking dividends or coupons to movements in general market indices.

- (n) where a Reporting Bank issues subordinated debt in a foreign currency, the debt is to be revalued periodically (at least monthly) in terms of Singapore dollars at the prevailing exchange rates. Where the Reporting Bank intends to use a swap to hedge the foreign exchange exposure arising from the foreign currency debt, it shall first consult the Authority on the capital treatment applicable to the hedge.

[MAS Notice 637 (Amendment) 2007]