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To all mutually owned authorised deposit-taking institutions (ADIs)

Mutual equity interests

On 18 October 2013, APRA wrote to mutually owned ADIs providing a draft *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital* for comment. The draft APS 111 contained provisions to allow mutually owned ADIs to issue Additional Tier 1 (AT1) Capital or Tier 2 (T2) Capital instruments that could, if the relevant conversion provisions in APS 111 relating to loss absorption or non-viability were triggered, convert to 'mutual equity interests' in the issuing ADI. On conversion, mutual equity interests would be included as Common Equity Tier 1 (CET1) Capital for APS 111 purposes.

APRA received two submissions on the draft APS 111, from the Customer Owned Banking Association (COBA) and from the Australian Centre for Financial Studies. Copies of these submissions are available on the APRA web-site. In addition to these submissions, APRA has had further discussions with COBA and the Australian Securities and Investments Commission (ASIC).

The feedback received was supportive of APRA's proposals. However, some minor redrafting was suggested to improve clarity without altering the original intent. APRA has amended the draft APS 111 in light of this feedback.

As mutual equity interests could potentially raise issues relating to the demutualisation provisions in Part 5 of Schedule 4 to the *Corporations Act 2001* (Corporations Act) and *Regulatory Guide 147 Mutuality – Financial Institutions* (RG 147) issued by ASIC, APRA has liaised closely with COBA and ASIC to ensure that the requirements for the issue of mutual equity interests are practical to implement whilst consistent with the intent of the Basel III reforms and the application of ASIC's guidance under RG 147.

Mutual equity interests are contingent in nature, in that they are only created from conversions of AT1 and T2 Capital instruments in extreme circumstances. The direct issue by mutually owned ADIs of CET1 capital instruments other than ordinary shares raises more complex concerns, associated with the interaction of Basel III requirements, demutualisation provisions in the Corporations Act and the needs of potential investors *vis-à-vis* existing members of mutually owned ADIs. Addressing these concerns necessarily requires careful consideration and a broad consultation process. Against this background and given the desire of mutually owned ADIs that APRA address sooner the issue of AT1 and T2 Capital instruments with conversion features, development of mutual equity interest proposals was necessarily narrowly focused.

APRA is now releasing APS 111 in its final form. Mutually owned ADIs will be able to issue AT1 and T2 Capital instruments that provide for conversion into mutual equity interests in the event that the loss absorption or non-viability provisions in these instruments are triggered. Mutual equity interests that result from such a conversion will qualify to be included in CET1 Capital provided they comply with the relevant provisions of APS 111.

APRA reminds mutually owned ADIs that they should satisfy themselves as to how relevant provisions in the Corporations Act may apply, in their specific circumstances, to the issue of AT1 and T2 Capital instruments and any subsequent conversion of these instruments to mutual equity interests.

Yours sincerely,

Charles Littrell
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Policy, Statistics and International Division