NEW ZEALAND BANKERS ASSOCIATION

#014

Submission

to the

Inland Revenue Department

on

Addressing Hybrid Mismatch Arrangements: A Government Discussion Document

11 November 2016

NEW ZEALAND BANKERS ASSOCIATION
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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 that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following fifteen registered banks in New Zealand are members of NZBA:

    - ANZ Bank New Zealand Limited
    - ASB Bank Limited
    - Bank of China (NZ) Limited
    - Bank of New Zealand
    - Bank of Tokyo-Mitsubishi, UFJ
    - Citibank, N.A.
    - The Co-operative Bank Limited
    - Heartland 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.

Background

3. NZBA welcomes the opportunity to provide feedback to the Inland Revenue Department (**IRD**) on "Addressing Hybrid Mismatch Arrangements: A Government Discussion Document" (**Discussion Document**).

4. NZBA welcomes the opportunity to discuss any of our feedback directly with IRD officials and, as outlined in our feedback, we recommend ongoing discussions with IRD Officials on this topic as the proposals develop. In this regard, please contact:

    Philip Leath
    Chair of NZBA Tax Working Group
    GM, Tax – ANZ
    04 436 6493 / 021 280 4717

General Comments

5. As a general comment, NZBA supports the ongoing work of the OECD to address valid concerns over base erosion and profit shifting (**BEPS**). As is highlighted by the OECD, implementation of the OECD's BEPS recommendations should be co-ordinated on a multilateral approach. In the case of the anti-hybrid mismatch proposals, it will be important that New Zealand and Australia are aligned. In addition, given the complexity of the anti-hybrid mismatch proposals, it will be critical that any rules are clear and certain, particularly from a bank regulatory capital perspective to ensure certainty for investors, banks and the New Zealand banking system (including prudential regulators).

Submissions

6. NZBA outlines below key submission points in respect of the potential outcomes from the anti-hybrid mismatch proposal on bank regulatory capital. Our submissions focus on some of the specific questions raised in the Discussion Document and also provides general comments.

    a. NZBA submits that there should be exclusion of bank regulatory capital from the anti-hybrid mismatch proposals (submission point 5H in the Discussion Document). RBNZ and APRA require Additional Tier 1 and Tier 2 capital to contain loss absorbency measures on the occurrence of certain stress events by either a conversion trigger into ordinary shares of the registered (or parent) bank or for the capital to be written off[1]. The purpose of the loss absorbency measures is to absorb or protect against the impact of bank stresses and protect depositors. It is these, and other, regulatory conversion requirements that create an equity, and therefore hybrid element for such bank regulatory capital. In the case of the so called "frankable/deductible" bank regulatory capital, it is the combination of this regulatory conversion requirement and the Australian tax debt/ equity classification that results in the distributions being considered equity in Australia, upon which franking credits must be attached due to the streaming requirements of the Australian tax rules. The fact that the franking credits are not generated from the investments of the funds raised by the issue should not be relevant. If it were relevant, the natural concomitant would be to allow streaming of franking credits or, in New Zealand's case, imputation credits – however, this is contrary to long standing New Zealand tax policy.

    b. If our submission that there should be an exclusion for bank regulatory capital is not accepted, NZBA submits that existing bank regulatory capital issuances should be grand-parented (submission point 11E in the Discussion Document). We consider such grand-parenting should apply for all bank regulatory capital issued prior to the date of enactment of the enabling legislation or, at the earliest, from the date of release of the Discussion Document. We note that significant global uncertainty remains over whether bank regulatory capital should be excluded from anti-hybrid proposals. The OECD final report, "Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report", drew no firm conclusion on bank regulatory capital and recommended each country adopt its own approach on this topic. Australia has not yet concluded how it will approach bank regulatory capital as part of their proposed anti-hybrid mismatch proposals, despite considering this topic for considerable time (and, as we submit below, New Zealand should harmonise its approach on bank regulatory capital to any approach Australia adopts). In further support of this submission, we note that:

        i. Any potentially impacted bank regulatory capital will require multiple regulators' approvals to restructure (where any request for such approval would, most likely, not be possible until legislation is enacted or, at least, substantively certain). It will also be important to ensure market liquidity exists for possible restructures, particularly as the potentially impacted bank regulatory capital issuances are held by the public and not related parties (contrary to what appears to be the inference from paragraph 11.20 of the Discussion Document). As such, it is preferable that bank regulatory capital

[1] As a write-off of bank regulatory capital results in a reduction to the regulatory value of an instrument (due to the tax liability that arises upon a write-off), the write-off option is economically undesirable (refer paragraphs 2.47 and 2.60 of RNBZ's Capital Adequacy Framework (Internal Models based Approach) – BS2B).

is grand-parented or, at least, a significant lead-in time is provided for any restructure of bank regulatory capital.

ii. It is not possible to restructure bank regulatory capital with a different instrument to "avoid any adverse consequences" from the anti-hybrid mismatch proposals (as paragraph 11.20 of the Discussion Document suggests). This is because banks are required to hold regulatory capital and it is the regulatory requirements that create the hybrid element.

iii. Further, given the limited liquidity of available investors for bank regulatory capital, it would be highly risky to seek to restructure the existing issuances to be held by, say, different investors (i.e. other than Australian investors). This would particularly be the case if all banks were required to restructure at similar times. Any such restructure may undermine the very purpose of the regulatory capital regime – to safeguard the New Zealand banking system.

c. If our submission on grand-parenting is not accepted, NZBA submits that any proposals to apply the anti-hybrid mismatch proposals to bank regulatory capital should align, in both design and implementation dates, to the final position Australia adopts on bank regulatory capital in respect of their anti-hybrid approach. Harmonising the New Zealand approach to that of Australia would align to the OECD's recommendation of taking a co-ordinated multi-lateral approach and minimise any additional market and regulatory disruptions that could arise if a different approach or timeframe were implemented. Harmonisation would be particularly important if Australia excludes bank regulatory capital from their anti-hybrid mismatch proposals (for example if they amend their rules to treat distributions on Additional Tier 1 capital as deductible) to ensure consistency across the trans-Tasman banking industry and regulators.

d. NZBA recommends extensive consultation occurs on any further development of the anti-hybrid mismatch proposals, importantly before legislation is drafted, and that any draft legislation/ exposure draft is made available to interested parties for comment prior to introduction to Parliament as a Bill. This is particularly relevant for bank regulatory capital issued to the public which contains terms and conditions that are dependent upon the precise wording of tax legislation. We would be very happy to set up working group meetings with appropriate representatives from members of the NZBA in this regard.