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Guidance Note

Subject: **Capital Instruments**
Guideline A, Minimum Continuing Capital and Surplus Requirements (MCCSR)

Date: **June 2000**

OSFI's *Guideline A, Minimum Continuing Capital and Surplus Requirements* (MCCSR) sets out the primary considerations for defining the capital of a company for purposes of measuring capital adequacy. This guidance note modifies and clarifies OSFI's position regarding the acceptability of certain features pertaining to Tier 1 preferred shares and Tier 2a hybrid instruments.

Early Redemption

OSFI's MCCSR Guideline does not permit redemption of a Tier 1 preferred share or a Tier 2a hybrid instrument within the first five years of issuance. Although OSFI continues to believe in the need to restrict redemption during the initial five years, there are certain circumstances under which we would consider redemption during this period. These circumstances are limited to:

(i) tax laws change, adversely affecting the tax advantage of the preferred shares/hybrid instrument; or
(ii) OSFI's capital adequacy rules change, such that the preferred shares/hybrid instrument could no longer be included in calculating the risk-based capital of the company on a consolidated basis.

OSFI continues to require the Superintendent's consent for redemption at any time.

Dividend Reset

The MCCSR Guideline requires Tier 1 capital to be permanent. It is OSFI's position that permanence is impaired by a preferred share in which the dividend is reset periodically based, in whole or in part, on the issuer's credit rating or financial condition. In keeping with this policy, a dividend-reset mechanism that does not specify a cap, consistent with the company's credit quality at the original date of issue, is not acceptable because it raises the possibility that the dividend would be reset based on the future credit quality of the company. Any existing preferred shares containing such a feature and previously approved for inclusion in Tier 1 are grandfathered.

It is OSFI's position that a dividend reset feature appearing in a Tier 1 instrument must not give rise to any level of step-up. A step-up is a pre-set increase at a future date in the dividend rate to be paid on an instrument. OSFI expects companies wishing to include a dividend reset feature in a Tier 1 instrument to demonstrate that the reset rate does not constitute a step-up, given the company's credit quality at the original date of issue.

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