Basel Committee on Banking Supervision

CAP
Definition of capital
CAP90
Transitional arrangements

Version effective as of 15 Dec 2019

First version in the format of the consolidated framework.
Transitional arrangements for certain capital instruments

90.1 Capital instruments that no longer qualify as non-common equity Tier 1 or Tier 2 capital are phased out beginning 1 January 2013. Fixing the base at the nominal amount of such instruments outstanding on 1 January 2013, their recognition is capped at 90% from 1 January 2013, with the cap reducing by 10 percentage points in each subsequent year.

90.2 This cap is applied to Additional Tier 1 and Tier 2 separately and refers to the total amount of instruments outstanding that no longer meet the relevant entry criteria. To the extent an instrument is redeemed, or its recognition in capital is amortised, after 1 January 2013, the nominal amount serving as the base is not reduced.

90.3 In addition, instruments with an incentive to be redeemed are treated as follows:

(1) For an instrument that has a call and a step-up prior to 1 January 2013 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward-looking basis meets the new criteria for inclusion in Tier 1 or Tier 2, it continues to be recognised in that tier of capital.

(2) For an instrument that has a call and a step-up on or after 1 January 2013 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward-looking basis meets the new criteria for inclusion in Tier 1 or Tier 2, it continues to be recognised in that tier of capital. After the call date, the full amount of a Tier 1 instrument, or the applicable amortised amount of a Tier 2 instrument, is recognised. Prior to the effective maturity date, the instrument would be considered an “instrument that no longer qualifies as Additional Tier 1 or Tier 2” and therefore is phased out from 1 January 2013.

(3) For an instrument that has a call and a step-up between 12 September 2010 and 1 January 2013 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward-looking basis does not meet the new criteria for inclusion in Tier 1 or Tier 2, it is fully derecognised in that tier of regulatory capital from 1 January 2013 and not included in the base for the transitional arrangements.
(4) For an instrument that has a call and a step-up on or after 1 January 2013 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in Tier 1 or Tier 2, it is derecognised in that tier of regulatory capital from the effective maturity date. Prior to the effective maturity date, the instrument would be considered an “instrument that no longer qualifies as Additional Tier 1 or Tier 2” and therefore is phased out from 1 January 2013.

(5) For an instrument that had a call and a step-up on or prior to 12 September 2010 (or another incentive to be redeemed), if the instrument was not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in Tier 1 or Tier 2, it is considered an “instrument that no longer qualifies as Additional Tier 1 or Tier 2” and therefore is phased out from 1 January 2013.

90.4 Capital instruments that do not meet the criteria for inclusion in Common Equity Tier 1 are excluded from Common Equity Tier 1 as of 1 January 2013. However, instruments meeting the following three conditions are phased out over the same horizon described in CAP90.1:

(1) they are issued by a non-joint stock company;¹

(2) they are treated as equity under the prevailing accounting standards; and

(3) they receive unlimited recognition as part of Tier 1 capital under current national banking law.

Footnotes
¹ Non-joint stock companies were not addressed in the Basel Committee’s 1998 agreement on instruments eligible for inclusion as they do not issue voting common shares.

90.5 The following instruments qualify for the above transition arrangements:

(1) instruments issued before 12 September 2010; and
(2) instruments issued prior to 1 January 2013 that meet all of the entry criteria for Additional Tier 1 or Tier 2 apart from the non-viability criteria in \textit{CAP10.11} (16) and \textit{CAP10.16}(10).

90.6 Public sector capital injections made before 16 December 2010 and that do not comply with the eligibility criteria in \textit{CAP10} receive no recognition in regulatory capital after 1 January 2018. The transitional arrangements in \textit{CAP90.1} to \textit{CAP90.4} do not apply to these instruments.

**Transitional arrangements for expected credit loss accounting**

90.7 The Committee has determined that it may be appropriate for a jurisdiction to introduce a transitional arrangement for the impact on regulatory capital from the application of expected credit loss (ECL) accounting. Jurisdictions applying a transitional arrangement must implement such an arrangement as follows.

90.8 The transitional arrangement must apply only to provisions that are “new” under an ECL accounting model. “New” provisions are provisions which do not exist under accounting approaches applied prior to the adoption of an ECL accounting model.

90.9 The transitional arrangement must adjust Common Equity Tier 1 capital. Where there is a reduction in Common Equity Tier 1 capital due to new provisions, net of tax effect, upon adoption of an ECL accounting model, the decline in Common Equity Tier 1 capital (the “transitional adjustment amount”) must be partially included (ie added back) to Common Equity Tier 1 capital over a number of years (the “transition period”) commencing on the effective date of the transition to ECL accounting.

90.10 Jurisdictions must choose whether banks under their supervision determine the transitional adjustment amount throughout the transition period by either:

1. calculating it just once, at the effective date of the transition to ECL accounting (ie static approach); or

2. recalculating it periodically to reflect the evolution of a bank’s ECL provisions within the transition period (ie dynamic approach).

90.11 The transitional adjustment amount may be calculated based on the impact on Common Equity Tier 1 capital upon adoption of an ECL accounting model or from accounting provisions disclosed before and after the adoption of an ECL accounting model.
For internal ratings-based (IRB) portfolios, the calculation of transitional adjustment amounts must take account of the shortfall of the stock of provisions to expected losses, as set out in CAP30.13. In some circumstances, an increase in provisions will not be fully reflected in IRB Common Equity Tier 1 capital.

The transition period commences from the date upon which a bank adopts ECL accounting in a jurisdiction that requires or permits the implementation of an ECL accounting framework. The transition period must be no more than five years.

During the transition period, the transitional adjustment amount will be partially included in (ie added back to) Common Equity Tier 1 capital. A fraction of the transitional adjustment amount (based on the number of years in the transition period) will be included in Common Equity Tier 1 capital during the first year of the transition period, with the proportion included in Common Equity Tier 1 capital phased out each year thereafter during the course of the transition period on a straight line basis. The impact of ECL provisions on Common Equity Tier 1 capital must not be fully neutralised during the transition period.

The transitional adjustment amount included in Common Equity Tier 1 capital each year during the transition period must be taken through to other measures of capital as appropriate (eg Tier 1 capital and total capital), and hence to the calculation of the leverage ratio and of large exposures limits.

Jurisdictions must choose between applying the consequential adjustments listed below or a simpler approach to ensure that banks do not receive inappropriate capital relief. (An example of a simpler approach that would not provide inappropriate capital relief would be amortising the transitional arrangement more rapidly than otherwise.)

1. Account should be taken of tax effects in calculating the impact of ECL accounting on Common Equity Tier 1 capital.

2. Any deferred tax asset (DTA) arising from a temporary difference associated with a non-deducted provision amount must be disregarded for regulatory purposes during the transitional period. This means that such DTA amount must not be considered for Common Equity Tier 1 capital, and in return must not be subject to deduction from Common Equity Tier 1 capital and must not be subject to risk weighting, as applicable.
(3) An accounting provision amount not deducted from Common Equity Tier 1 capital should not:

(a) be included in Tier 2 capital, even if the provision meets the definition of “general” or “excess” provisions;

(b) reduce exposure amounts in the standardised approach even if it meets the definition of a “specific” provision; or

(c) reduce the total exposure measure in the leverage ratio.

90.17 Jurisdictions must publish details of any transitional arrangement applied, the rationale for it, and its implications for supervision of banks (eg whether supervisory decisions will be based solely on regulatory metrics which incorporate the effect of the transitional arrangement). Jurisdictions that choose to implement a transitional arrangement must require their banks to disclose, as set out in DIS20:\(^2\):

(1) whether a transitional arrangement is applied; and

(2) the impact on the bank’s regulatory capital and leverage ratios compared to the bank’s “fully loaded” capital and leverage ratios had the transitional arrangements not been applied.

Footnotes

\(^2\) In addition to the required disclosures under Pillar 3, banks may also provide this information prominently on their website.