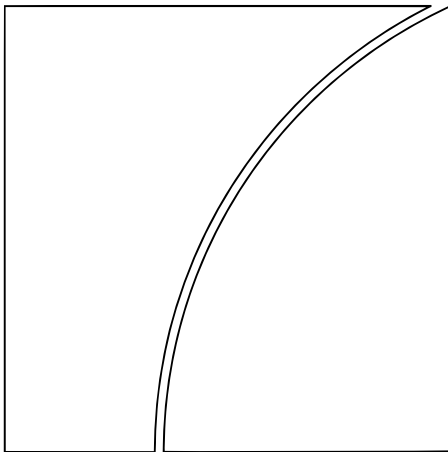


Basel Committee on Banking Supervision

CAP

Definition of capital

This standard describes the criteria that bank capital instruments must meet to be eligible to satisfy the Basel capital requirements, as well as necessary regulatory adjustments and transitional arrangements.



BANK FOR INTERNATIONAL SETTLEMENTS

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CAP10

Definition of eligible capital

This chapter sets out the eligibility criteria for regulatory capital. Three categories of instruments are permitted: Common Equity Tier 1, Additional Tier 1 and Tier 2.

Version effective as of 15 December 2019

Updated to include the following FAQs:
CAP10.11 FAQ24 and CAP10.16 FAQ10.

Components of capital

10.1

Regulatory capital consists of three categories, each governed by a single set of criteria that instruments are required to meet before inclusion in the relevant category.

1. Common Equity Tier 1 (going-concern capital)
2. Additional Tier 1 (going-concern capital)
3. Tier 2 Capital (gone-concern capital)

10.2

Total regulatory capital is the sum of Common Equity Tier 1, Additional Tier 1 and Tier 2 capital, net of regulatory adjustments described in [CAP30](#). Tier 1 capital is the sum of Common Equity Tier 1 and Additional Tier 1 capital, net of the regulatory adjustments in [CAP30](#) applied to those categories.

10.3

It is critical that banks' risk exposures are backed by a high-quality capital base. To this end, the predominant form of Tier 1 capital must be common shares and retained earnings.

10.4

Throughout [CAP10](#) the term "bank" is used to mean bank, banking group or other entity (eg holding company) whose capital is being measured.

10.5

A bank must seek prior supervisory approval if it intends to include in capital an instrument which has its dividends paid in anything other than cash or shares.

Common Equity Tier 1

10.6

Common Equity Tier 1 capital consists of the sum of the following elements:

1. Common shares issued by the bank that meet the criteria for classification as common shares for regulatory purposes (or the equivalent for non-joint stock companies);
2. Stock surplus (share premium) resulting from the issue of instruments included Common Equity Tier 1;
3. Retained earnings;
4. Accumulated other comprehensive income and other disclosed reserves;
5. Common shares issued by consolidated subsidiaries of the bank and held by third parties (ie minority interest) that meet the criteria for inclusion in Common Equity Tier 1 capital. See [CAP10.20](#) to [CAP10.26](#) for the relevant criteria; and
6. Regulatory adjustments applied in the calculation of Common Equity Tier 1.

10.7

Retained earnings and other comprehensive income include interim profit or loss. National

authorities may consider appropriate audit, verification or review procedures. Dividends are removed from Common Equity Tier 1 in accordance with applicable accounting standards. The treatment of minority interest and the regulatory adjustments applied in the calculation of Common Equity Tier 1 are addressed in separate sections.

Common shares issued by the bank

10.8

For an instrument to be included in Common Equity Tier 1 capital it must meet all of the criteria that follow. The vast majority of internationally active banks are structured as joint stock companies and for these banks the criteria must be met solely with common shares. In the rare cases where banks need to issue non-voting common shares as part of Common Equity Tier 1, they must be identical to voting common shares of the issuing bank in all respects except the absence of voting rights.

1. Represents the most subordinated claim in liquidation of the bank.
2. Entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation (ie has an unlimited and variable claim, not a fixed or capped claim).
3. Principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law).
4. The bank does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.
5. Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items).
6. There are no circumstances under which the distributions are obligatory. Non payment is therefore not an event of default. Among other things, this requirement prohibits features that require the bank to make payments in kind.
7. Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.
8. It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and pari passu with all the others.
9. The paid-in amount is recognised as equity capital (ie not recognised as a liability) for determining balance sheet insolvency.
10. The paid-in amount is classified as equity under the relevant accounting standards.
11. It is directly issued and paid-in and the bank cannot directly or indirectly have funded the instrument or the purchase of the instrument.
12. The paid-in amount is neither secured nor covered by a guarantee of the issuer or related entity or subject to any other arrangement that legally or economically enhances the seniority of the claim.
13. It is only issued with the approval of the owners of the issuing bank, either given directly

by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners.

14. It is clearly and separately disclosed on the bank's balance sheet.

Additional Tier 1 capital

10.9

Additional Tier 1 capital consists of the sum of the following elements:

1. instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital (and are not included in Common Equity Tier 1);
2. stock surplus (share premium) resulting from the issue of instruments included in Additional Tier 1 capital;
3. instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Additional Tier 1 capital and are not included in Common Equity Tier 1 capital. See [CAP10.20](#) to [CAP10.26](#) for the relevant criteria; and
4. regulatory adjustments applied in the calculation of Additional Tier 1 Capital.

10.10

The treatment of instruments issued out of consolidated subsidiaries of the bank and the regulatory adjustments applied in the calculation of Additional Tier 1 capital are addressed in separate sections.

10.11

The following criteria must be met or exceeded for an instrument issued by the bank to be included in Additional Tier 1 capital.

1. Issued and paid-in
2. Subordinated to depositors, general creditors and subordinated debt of the bank. In the case of an issue by a holding company, the instrument must be subordinated to all general creditors.
3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors
4. Is perpetual, ie there is no maturity date and there are no step-ups or other incentives to redeem
5. May be callable at the initiative of the issuer only after a minimum of five years:
 1. To exercise a call option a bank must receive prior supervisory approval; and
 2. A bank must not do anything which creates an expectation that the call will be exercised; and
 3. Banks must not exercise a call unless:
 - (i)

They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

(ii)

The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

4. The use of tax event and regulatory event calls are permitted within the first five years of a capital instrument, but supervisors will only permit the bank to exercise such a call if in their view the bank was not in a position to anticipate the event at issuance.
6. Any repayment of principal (eg through repurchase or redemption) must be with prior supervisory approval and banks should not assume or create market expectations that supervisory approval will be given.
7. Dividend/coupon discretion:
 1. the bank must have full discretion at all times to cancel distributions/payments
 2. cancellation of discretionary payments must not be an event of default
 3. banks must have full access to cancelled payments to meet obligations as they fall due
 4. cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stockholders.
8. Dividends/coupons must be paid out of distributable items.
9. The instrument cannot have a credit-sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.
10. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law.
11. Instruments classified as liabilities for accounting purposes must have a principal loss-absorption mechanism. This must generate Common Equity Tier 1 under the relevant accounting standards and the instrument will only receive recognition in Additional Tier 1 up to the minimum level of Common Equity Tier 1 generated by the loss-absorption mechanism. The mechanism must operate through either:
 1. conversion to common shares at an objective pre-specified trigger point of at least 5.125% Common Equity Tier 1; or
 2. a writedown mechanism which allocates losses to the instrument at a pre-specified trigger point of at least 5.125% Common Equity Tier 1. The writedown will have the following effects:
 - (i)

Reduce the claim of the instrument in liquidation;
 - (ii)

Reduce the amount repaid when a call is exercised; and
 - (iii)

Partially or fully reduce coupon/dividend payments on the instrument.
12. The aggregate amount to be written down/converted for all instruments classified as liabilities for accounting purposes on breaching the trigger level must be at least the amount needed to immediately return the bank's Common Equity Tier 1 ratio to the trigger level or, if this is not possible, the full principal value of the instruments.
13. Neither the bank nor a related party over which the bank exercises control or significant

influence can have purchased the instrument, nor can the bank directly or indirectly fund the instrument or the purchase of the instrument.

14. The instrument cannot have any features that hinder recapitalisation, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.
15. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (eg a special purpose vehicle - "SPV"), proceeds must be immediately available without limitation to a single operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 capital.
16. The terms and conditions must have a provision that requires, at the option of the relevant authority, the instrument to either be written off or converted into common equity upon the occurrence of a trigger event, unless the criteria in [CAP10.12](#) are met. Any compensation paid to instrument holders as a result of a write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies) of either the issuing bank or the parent company of the consolidated group (including any successor in resolution) and must be paid prior to any public sector injection of capital (so that the capital provided by the public sector is not diluted). The issuing bank must maintain at all times all prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur. The trigger event:
 1. is the earlier of:
 - (i)

a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; and
 - (ii)

the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority; and
 2. is determined by the jurisdiction in which the capital is being given recognition for regulatory purposes. Therefore, where an issuing bank is part of a wider banking group and the issuing bank wishes the instrument to be included in the consolidated group's capital in addition to its solo capital, the terms and conditions must specify an additional trigger event. This additional trigger event is the earlier of:
 - (i)

a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority in the home jurisdiction; and
 - (ii)

the decision to make a public sector injection of capital, or equivalent support, in the jurisdiction of the consolidated supervisor, without which the firm receiving the support would have become non-viable, as determined by the relevant authority in that jurisdiction.

10.12

The terms and conditions of Additional Tier 1 instruments must include a write-off or conversion provision activated at the option of the relevant authority upon the occurrence of the trigger event (as described in [CAP10.11](#)(16)) unless the following criteria are met. The same criteria apply in the case of the requirement for a write-off or conversion provision in Tier 2 instruments (as described in [CAP10.16](#)(10)):

1. the governing jurisdiction of the bank has in place laws that:
 1. require such instruments to be written off upon such event, or
 2. otherwise require such instruments to fully absorb losses before tax payers are exposed to loss; and
2. it is disclosed by the relevant regulator and by the issuing bank, in issuance documents issued on or after 1 January 2013, that such instruments are subject to loss under [CAP10.12](#)(1).

10.13

Stock surplus (ie share premium) that is not eligible for inclusion in Common Equity Tier 1, will only be permitted to be included in Additional Tier 1 capital if the shares giving rise to the stock surplus are permitted to be included in Additional Tier 1 capital.

Tier 2 capital

10.14

Tier 2 capital consists of the sum of the following elements:

1. instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital);
2. stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;
3. instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital. See [CAP10.20](#) to [CAP10.26](#) for the relevant criteria;
4. certain loan-loss provisions as specified in [CAP10.18](#) and [CAP10.19](#); and
5. regulatory adjustments applied in the calculation of Tier 2 capital.

10.15

The treatment of instruments issued out of consolidated subsidiaries of the bank and the regulatory adjustments applied in the calculation of Tier 2 capital are addressed in separate sections.

10.16

The objective of Tier 2 is to provide loss absorption on a gone-concern basis. Based on this objective, the following criteria must be met or exceeded for an instrument to be included in Tier 2 capital.

1. Issued and paid-in
2. Subordinated to depositors and general creditors of the bank. In the case of an issue by a holding company, the instrument must be subordinated to all general creditors.

3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general bank creditors
4. Maturity:
 1. Minimum original maturity of at least five years
 2. Recognition in regulatory capital in the remaining five years before maturity will be amortised on a straight line basis.
 3. There are no step-ups or other incentives to redeem.
5. May be callable at the initiative of the issuer only after a minimum of five years:
 1. To exercise a call option a bank must receive prior supervisory approval;
 2. A bank must not do anything that creates an expectation that the call will be exercised; and
 3. Banks must not exercise a call unless:
 - (i)

they replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or
 - (ii)

the bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.
 4. The use of tax event and regulatory event calls are permitted within the first five years of a capital instrument, but supervisors will only permit the bank to exercise such a call if in their view the bank was not in a position to anticipate the event at issuance.
6. The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation.
7. The instrument cannot have a credit-sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.
8. Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the instrument or the purchase of the instrument.
9. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (eg an SPV), proceeds must be immediately available without limitation to a single operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 capital.
10. The terms and conditions must have a provision that requires, at the option of the relevant authority, the instrument to either be written off or converted into common equity upon the occurrence of a trigger event, unless the laws of the governing jurisdiction meet the criteria in [CAP10.12](#). Any compensation paid to instrument holders as a result of a write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies) of either the issuing bank or the parent company of the consolidated group (including any successor in resolution) and must be paid prior to any public sector injection of capital (so that the capital provided by the public sector is not diluted). The issuing bank must maintain at all times all prior authorisation necessary to immediately issue the relevant number of shares specified in

the instrument's terms and conditions should the trigger event occur. The trigger event:

1. is the earlier of:

(i)

a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; and

(ii)

the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority; and

2. is determined by the jurisdiction in which the capital is being given recognition for regulatory purposes. Therefore, where an issuing bank is part of a wider banking group and the issuing bank wishes the instrument to be included in the consolidated group's capital in addition to its solo capital, the terms and conditions must specify an additional trigger event. This additional trigger event is the earlier of:

(i)

a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority in the home jurisdiction; and

(ii)

the decision to make a public sector injection of capital, or equivalent support, in the jurisdiction of the consolidated supervisor, without which the firm receiving the support would have become non-viable, as determined by the relevant authority in that jurisdiction.

10.17

Stock surplus (ie share premium) that is not eligible for inclusion in Tier 1 will only be permitted to be included in Tier 2 capital if the shares giving rise to the stock surplus are permitted to be included in Tier 2 capital.

10.18

Under the standardised approach to credit risk, provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within Tier 2. Provisions ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded. Furthermore, general provisions/general loan-loss reserves eligible for inclusion in Tier 2, measured gross of tax effects, will be limited to a maximum of 1.25 percentage points of credit risk-weighted assets (RWA) calculated under the standardised approach.

10.19

Under the internal ratings based approach, where the total expected loss amount is less than total eligible provisions (measured gross of tax effects), as explained in [CRE35](#), banks may recognise the difference in Tier 2 capital up to a maximum of 0.6% of credit risk-weighted assets calculated under the internal ratings-based approach. At national discretion, a limit lower than 0.6% may be applied.

Minority interest (ie non-controlling interest) and other capital issued out of consolidated subsidiaries that is held by third parties

10.20

Minority interest arising from the issue of common shares by a fully consolidated subsidiary of the bank may receive recognition in Common Equity Tier 1 only if:

1. the instrument giving rise to the minority interest would, if issued by the bank, meet all of the criteria for classification as common shares for regulatory capital purposes; and
2. the subsidiary that issued the instrument is itself a bank.

10.21

The amount of minority interest meeting the criteria above that will be recognised in consolidated Common Equity Tier 1 will be calculated as follows:

1. Total minority interest meeting the two criteria above minus the amount of the surplus Common Equity Tier 1 of the subsidiary attributable to the minority shareholders.
2. Surplus Common Equity Tier 1 of the subsidiary is calculated as the Common Equity Tier 1 of the subsidiary minus the lower of:
 1. the minimum Common Equity Tier 1 requirement of the subsidiary plus the capital conservation buffer (ie 7.0% of consolidated RWA); and
 2. the portion of the consolidated minimum Common Equity Tier 1 requirement plus the capital conservation buffer (ie 7.0% of consolidated RWA) that relates to the subsidiary.
3. The amount of the surplus Common Equity Tier 1 that is attributable to the minority shareholders is calculated by multiplying the surplus Common Equity Tier 1 by the percentage of Common Equity Tier 1 that is held by minority shareholders.

10.22

Tier 1 capital instruments issued by a fully consolidated subsidiary of the bank, whether wholly or partly owned, to third-party investors (including amounts under [CAP10.21](#)) may receive recognition in Tier 1 capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 capital.

10.23

The amount of this capital that will be recognised in Tier 1 will be calculated as follows:

1. Total Tier 1 of the subsidiary issued to third parties minus the amount of the surplus Tier 1 of the subsidiary attributable to the third-party investors.
2. Surplus Tier 1 of the subsidiary is calculated as the Tier 1 of the subsidiary minus the lower of:
 1. the minimum Tier 1 requirement of the subsidiary plus the capital conservation buffer (ie 8.5% of RWA); and
 2. the portion of the consolidated minimum Tier 1 requirement plus the capital conservation buffer (ie 8.5% of consolidated RWA) that relates to the subsidiary.
3. The amount of the surplus Tier 1 that is attributable to the third party investors is calculated by multiplying the surplus Tier 1 by the percentage of Tier 1 that is held by third-party investors.

4. The amount of this Tier 1 capital that will be recognised in Additional Tier 1 will exclude amounts recognised in Common Equity Tier 1 under [CAP10.21](#).

10.24

Total capital instruments (ie Tier 1 and Tier 2 capital instruments) issued by a fully consolidated subsidiary of the bank, whether wholly or partly owned, to third-party investors (including amounts under [CAP10.21](#) to [CAP10.23](#)) may receive recognition in Total Capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 or Tier 2 capital.

10.25

The amount of this capital that will be recognised in consolidated Total Capital will be calculated as follows:

1. Total capital instruments of the subsidiary issued to third parties minus the amount of the surplus Total Capital of the subsidiary attributable to the third-party investors.
2. Surplus Total Capital of the subsidiary is calculated as the Total Capital of the subsidiary minus the lower of:
 1. the minimum Total Capital requirement of the subsidiary plus the capital conservation buffer (ie 10.5% of RWA); and
 2. the portion of the consolidated minimum Total Capital requirement plus the capital conservation buffer (ie 10.5% of consolidated RWA) that relates to the subsidiary.
3. The amount of the surplus Total Capital that is attributable to the third-party investors is calculated by multiplying the surplus Total Capital by the percentage of Total Capital that is held by third-party investors.
4. The amount of this Total Capital that will be recognised in Tier 2 will exclude amounts recognised in Common Equity Tier 1 under [CAP10.21](#) and amounts recognised in Additional Tier 1 under [CAP10.23](#).

10.26

Where capital has been issued to third parties out of an SPV, none of this capital can be included in Common Equity Tier 1. However, such capital can be included in consolidated Additional Tier 1 or Tier 2 and treated as if the bank itself had issued the capital directly to the third parties only if it meets all the relevant entry criteria and the only asset of the SPV is its investment in the capital of the bank in a form that meets or exceeds all the relevant entry criteria (as required by [CAP10.11](#)(15) for Additional Tier 1 and [CAP10.16](#)(9) for Tier 2). In cases where the capital has been issued to third parties through an SPV via a fully consolidated subsidiary of the bank, such capital may, subject to the requirements of this paragraph, be treated as if the subsidiary itself had issued it directly to the third parties and may be included in the bank's consolidated Additional Tier 1 or Tier 2 in accordance with the treatment outlined in [CAP10.23](#) to [CAP10.26](#).

CAP30

Regulatory adjustments

This chapter describes adjustments that must be made to the components of regulatory capital in order to calculate the amount of a bank's capital resources that may be used to meet prudential requirements.

Version effective as of 15 December 2019

First version in the format of the consolidated framework.

Introduction

30.1

This section sets out the regulatory adjustments to be applied to regulatory capital. In most cases these adjustments are applied in the calculation of Common Equity Tier 1.

30.2

Global systemically important banks (G-SIBs) are required to meet a minimum total loss-absorbing capacity (TLAC) requirement set in accordance with the Financial Stability Board's (FSB) TLAC principles and term sheet. The criteria for an instrument to be recognised as TLAC by the issuing G-SIB are set out in the FSB's TLAC Term Sheet. Banks that invest in TLAC or similar instruments may be required to deduct them in the calculation of their own regulatory capital.

30.3

For the purposes of this section, holdings of TLAC include the following, hereafter collectively referred to as "other TLAC liabilities":

1. All direct, indirect and synthetic investments in the instruments of a G-SIB resolution entity that are eligible to be recognised as external TLAC but that do not otherwise qualify as regulatory capital for the issuing G-SIB, with the exception of instruments excluded by [CAP30.4](#); and
2. All holdings of instruments issued by a G-SIB resolution entity that rank pari passu to any instruments included in [CAP30.3\(1\)](#), with the exceptions of:
 1. instruments listed as liabilities excluded from TLAC in Section 10 of the FSB TLAC Term Sheet ("Excluded Liabilities"); and
 2. instruments ranking pari passu with instruments eligible to be recognised as TLAC by virtue of the exemptions to the subordination requirements in Section 11 of the FSB TLAC Term Sheet.

30.4

In certain jurisdictions, G-SIBs may be able to recognise instruments ranking pari passu to Excluded Liabilities as external TLAC up to a limit, in accordance with the exemptions to the subordination requirements set out in the penultimate paragraph of Section 11 of the FSB TLAC Term Sheet. A bank's holdings of such instruments will be subject to a proportionate deduction approach. Under this approach, only a proportion of holdings of instruments that are eligible to be recognised as external TLAC by virtue of the subordination exemptions will be considered a holding of TLAC by the investing bank. The proportion is calculated as:

1. the funding issued by the G-SIB resolution entity that ranks pari passu with Excluded Liabilities and that is recognised as external TLAC by the G-SIB resolution entity; divided by
2. the funding issued by the G-SIB resolution entity that ranks pari passu with Excluded Liabilities and that would be recognised as external TLAC if the subordination requirement was not applied.

30.5

Under the proportionate deduction approach, banks must calculate their holdings of other TLAC liabilities of the respective issuing G-SIB resolution entities based on the latest available public

information provided by the issuing G-SIBs on the proportion to be used.

30.6

The regulatory adjustments relating to TLAC in [CAP30.18](#) to [CAP30.31](#) apply to holdings of TLAC issued by G-SIBs from the date at which the issuing G-SIB becomes subject to a minimum TLAC requirement.

Goodwill and other intangibles (except mortgage servicing rights)

30.7

Goodwill and all other intangibles must be deducted in the calculation of Common Equity Tier 1, including any goodwill included in the valuation of significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation. With the exception of mortgage servicing rights, the full amount is to be deducted net of any associated deferred tax liability (DTL) which would be extinguished if the intangible assets become impaired or derecognised under the relevant accounting standards. The amount to be deducted in respect of mortgage servicing rights is set out in the threshold deductions section below.

30.8

Subject to prior supervisory approval, banks that report under local GAAP may use the IFRS definition of intangible assets to determine which assets are classified as intangible and are thus required to be deducted.

Deferred tax assets

30.9

Deferred tax assets (DTAs) that rely on future profitability of the bank to be realised are to be deducted in the calculation of Common Equity Tier 1. DTAs may be netted with associated DTLs only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority. Where these DTAs relate to temporary differences (eg allowance for credit losses) the amount to be deducted is set out in [CAP30.32](#) to [CAP30.34](#). All other such assets, eg those relating to operating losses, such as the carry forward of unused tax losses, or unused tax credits, are to be deducted in full net of deferred tax liabilities as described above. The DTLs permitted to be netted against DTAs must exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets, and must be allocated on a pro rata basis between DTAs subject to the threshold deduction treatment and DTAs that are to be deducted in full.

30.10

An overinstallment of tax or, in some jurisdictions, current year tax losses carried back to prior years may give rise to a claim or receivable from the government or local tax authority. Such amounts are typically classified as current tax assets for accounting purposes. The recovery of such a claim or receivable would not rely on the future profitability of the bank and would be assigned the relevant sovereign risk weighting.

Cash flow hedge reserve

30.11

The amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) should be derecognised in the calculation of Common Equity Tier 1. This means that positive amounts should be deducted and negative amounts should be added back.

30.12

This treatment specifically identifies the element of the cash flow hedge reserve that is to be derecognised for prudential purposes. It removes the element that gives rise to artificial volatility in common equity, as in this case the reserve only reflects one half of the picture (the fair value of the derivative, but not the changes in fair value of the hedged future cash flow).

Shortfall of the stock of provisions to expected losses

30.13

Banks using the internal ratings-based (IRB) approach for other asset classes must compare the amount of total eligible provisions, as defined in [CRE35.4](#), with the total expected loss amount as calculated within the IRB approach and defined in [CRE35.2](#). Where the total expected loss amount exceeds total eligible provisions, banks must deduct the difference from Common Equity Tier 1. The full amount is to be deducted and should not be reduced by any tax effects that could be expected to occur if provisions were to rise to the level of expected losses. Securitisation exposures will be subject to [CRE40.36](#) and will contribute to neither the total expected loss amount nor the total eligible provisions.

Gain on sale related to securitisation transactions

30.14

Banks must deduct from Common Equity Tier 1 any increase in equity capital resulting from a securitisation transaction, such as that associated with expected future margin income resulting in a gain on sale that is recognised in regulatory capital.

Cumulative gains and losses due to changes in own credit risk on fair valued liabilities

30.15

Derecognise in the calculation of Common Equity Tier 1, all unrealised gains and losses that have resulted from changes in the fair value of liabilities that are due to changes in the bank's own credit risk. In addition, with regard to derivative liabilities, derecognise all accounting valuation adjustments arising from the bank's own credit risk. The offsetting between valuation adjustments arising from the bank's own credit risk and those arising from its counterparties' credit risk is not allowed.

Defined benefit pension fund assets and liabilities

30.16

Defined benefit pension fund liabilities, as included on the balance sheet, must be fully recognised in the calculation of Common Equity Tier 1 (ie Common Equity Tier 1 cannot be increased through derecognising these liabilities). For each defined benefit pension fund that is an asset on the balance sheet, the net asset on the balance sheet in respect of the plan or fund should be deducted in the calculation of Common Equity Tier 1 net of any associated deferred tax liability which would be extinguished if the asset should become impaired or derecognised under the relevant accounting standards. Assets in the fund to which the bank has unrestricted and unfettered access can, with supervisory approval, offset the deduction. Such offsetting assets should be given the risk weight they would receive if they were owned directly by the bank.

30.17

This treatment addresses the concern that assets arising from pension funds may not be capable of being withdrawn and used for the protection of depositors and other creditors of a bank. The concern is that their only value stems from a reduction in future payments into the fund. The treatment allows for banks to reduce the deduction of the asset if they can address these concerns and show that the assets can be easily and promptly withdrawn from the fund.

Investments in own shares (treasury stock), own other capital instruments or own other TLAC liabilities

30.18

All of a bank's investments in its own common shares, whether held directly or indirectly, will be deducted in the calculation of Common Equity Tier 1 (unless already derecognised under the relevant accounting standards). In addition, any own stock which the bank could be contractually obliged to purchase should be deducted in the calculation of Common Equity Tier 1. The treatment described will apply irrespective of the location of the exposure in the banking book or the trading book. In addition:

1. Gross long positions may be deducted net of short positions in the same underlying exposure only if the short positions involve no counterparty risk.
2. Banks should look through holdings of index securities to deduct exposures to own shares. However, gross long positions in own shares resulting from holdings of index securities may be netted against short position in own shares resulting from short positions in the same underlying index. In such cases the short positions may involve counterparty risk (which will be subject to the relevant counterparty credit risk charge).
3. Subject to supervisory approval, a bank may use a conservative estimate of investments in its own shares where the exposure results from holdings of index securities and the bank finds it operationally burdensome to look through and monitor its exact exposure.

30.19

This deduction is necessary to avoid the double-counting of a bank's own capital. Certain accounting regimes do not permit the recognition of treasury stock and so this deduction is only relevant where recognition on the balance sheet is permitted. The treatment seeks to remove the double-counting that arises from direct holdings, indirect holdings via index funds and potential future holdings as a result of contractual obligations to purchase own shares.

30.20

Following the same approach outlined above, banks must deduct investments in their own

Additional Tier 1 in the calculation of their Additional Tier 1 capital and must deduct investments in their own Tier 2 in the calculation of their Tier 2 capital. G-SIB resolution entities must deduct holdings of their own other TLAC liabilities in the calculation of their TLAC resources. If a bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, then the shortfall will be deducted from the next higher tier of capital. In the case of insufficient TLAC resources, then the holdings will be deducted from Tier 2.

Reciprocal cross-holdings in the capital or other TLAC liabilities of banking, financial and insurance entities

30.21

Reciprocal cross-holdings of capital that are designed to artificially inflate the capital position of banks will be deducted in full. Banks must apply a “corresponding deduction approach” to such investments in the capital of other banks, other financial institutions and insurance entities. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself. Reciprocal cross-holdings of other TLAC liabilities that are designed to artificially inflate the TLAC position of G-SIBs must be deducted in full from Tier 2 capital.

Investments in the capital or other TLAC liabilities of banking, financial and insurance entities that are outside the scope of regulatory consolidation and where the bank does not own more than 10% of the issued common share capital of the entity

30.22

The regulatory adjustment described in this section applies to investments in the capital or other TLAC liabilities of banking, financial and insurance entities that are outside the scope of regulatory consolidation and where the bank does not own more than 10% of the issued common share capital of the entity. These investments are deducted from regulatory capital, subject to a threshold. For the purpose of this regulatory adjustment:

1. Investments include direct, indirect and synthetic holdings of capital instruments or other TLAC liabilities. For example, banks should look through holdings of index securities to determine their underlying holdings of capital or other TLAC liabilities.
2. Holdings in both the banking book and trading book are to be included. Capital includes common stock and all other types of cash and synthetic capital instruments (eg subordinated debt). Other TLAC liabilities are defined in [CAP30.3](#) and [CAP30.4](#).
3. For capital instruments, it is the net long position that is to be included (ie the gross long position net of short positions in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year). Banks are also permitted to net gross long positions arising through holdings of index securities against short positions in the same underlying index, as long as the maturity of the short position matches the maturity of the long position or has residual maturity of at least a year. For other TLAC liabilities, it is the gross long position in [CAP30.23](#), [CAP30.24](#) and [CAP30.25](#) and the net long position that is to be included in [CAP30.26](#).
4. Underwriting positions in capital instruments or other TLAC liabilities held for five working days or less can be excluded. Underwriting positions held for longer than five working

days must be included.

5. If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment.
6. National discretion applies to allow banks, with prior supervisory approval, to exclude temporarily certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

30.23

A G-SIB's holdings of other TLAC liabilities must be deducted from Tier 2 capital resources, unless either the following conditions are met, or the holding falls within the 10% threshold provided in [CAP30.26](#).

1. The holding has been designated by the bank to be treated in accordance with this paragraph;
2. The holding is in the bank's trading book;
3. The holding is sold within 30 business days of the date of acquisition; and
4. Such holdings are, in aggregate and on a gross long basis, less than 5% of the G-SIB's common equity (after apply all other regulatory adjustments in full listed prior to [CAP30.22](#)).

30.24

If a holding designated under [CAP30.23](#) no longer meets any of the conditions set out in that paragraph, it must be deducted in full from Tier 2 capital. Once a holding has been designated under [CAP30.23](#), it may not subsequently be included within the 10% threshold referred to in [CAP30.26](#). This approach is designed to limit the use of the 5% threshold in [CAP30.23](#) to holdings of TLAC instruments needed to be held within the banking system to ensure deep and liquid markets.

30.25

If a bank is not a G-SIB, its holdings of other TLAC liabilities must be deducted from Tier 2 capital resources, unless:

1. such holdings are, in aggregate and on a gross long basis, less than 5% of the bank's common equity (after applying all other regulatory adjustments listed in full prior to [CAP30.22](#)); or
2. the holdings fall within the 10% threshold provided in [CAP30.26](#).

30.26

If the total of all holdings of capital instruments and other TLAC liabilities, as listed in [CAP30.22](#) and not covered by the 5% threshold described in [CAP30.23](#) and [CAP30.24](#) (for G-SIBs) or [CAP30.25](#) (for non-G-SIBs), in aggregate and on a net long basis exceed 10% of the bank's common equity (after applying all other regulatory adjustments in full listed prior to [CAP30.22](#)) then the amount above 10% is required to be deducted. In the case of capital instruments, deduction should be made applying a corresponding deduction approach. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself. In the case of holdings of other TLAC liabilities, the deduction should be applied to Tier 2 capital. Accordingly, the amount to be deducted from

common equity should be calculated as the total of all holdings of capital instruments and those holdings of other TLAC liabilities not covered by [CAP30.23](#) and [CAP30.24](#) or [CAP30.25](#) which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by the common equity holdings as a percentage of the total holdings of capital instruments and other TLAC liabilities not covered by [CAP30.23](#) and [CAP30.24](#) or [CAP30.25](#). This would result in a common equity deduction which corresponds to the proportion of the holdings held in common equity. Similarly, the amount to be deducted from Additional Tier 1 capital should be calculated as the total of all holdings of capital instruments and other TLAC liabilities not covered by [CAP30.23](#) and [CAP30.24](#) or [CAP30.25](#) which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by the Additional Tier 1 capital holdings as a percentage of the total. The amount to be deducted from Tier 2 capital should be calculated as the total of all holdings of capital instruments and other TLAC liabilities not covered by [CAP30.23](#) and [CAP30.24](#) or [CAP30.25](#) which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by holdings of the Tier 2 capital and other TLAC liabilities as a percentage of the total.

30.27

If a bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (eg if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1).

30.28

Amounts that are not deducted will continue to be risk weighted. Thus, instruments in the trading book will be treated as per the market risk rules and instruments in the banking book should be treated as per the IRB approach or the standardised approach (as applicable). For the application of risk weighting the amount of the holdings must be allocated on a pro rata basis between those below and those above the threshold.

Significant investments in the capital or other TLAC liabilities of banking, financial and insurance entities that are outside the scope of regulatory consolidation

30.29

The regulatory adjustment described in this section applies to investments in the capital or other TLAC liabilities of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate of the bank. In addition:

1. Investments include direct, indirect and synthetic holdings of capital instruments or other TLAC liabilities. For example, banks should look through holdings of index securities to determine their underlying holdings of capital or other TLAC liabilities.
2. Holdings in both the banking book and trading book are to be included. Capital includes common stock and all other types of cash and synthetic capital instruments (eg subordinated debt). Other TLAC liabilities are defined in [CAP30.3](#) to [CAP30.4](#). It is the net long position that is to be included (ie the gross long position net of short positions in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year). Banks are also permitted to net gross long positions arising through holdings of index securities against short positions in the same underlying index, as long as the maturity of the short position matches the maturity of the long position or has residual maturity of at least a

year.

3. Underwriting positions in capital instruments or other TLAC liabilities held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included.
4. If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment.
5. National discretion applies to allow banks, with prior supervisory approval, to exclude temporarily certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

30.30

All investments in capital instruments included above that are not common shares must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the bank itself. All holdings of other TLAC liabilities included above (and as defined in [CAP30.3](#) to [CAP30.5](#) ie applying the proportionate deduction approach for holdings of instruments eligible for TLAC by virtue of the penultimate paragraph of Section 11 of the FSB TLAC Term Sheet) must be fully deducted from Tier 2 capital. If the bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (eg if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1).

30.31

Investments included above that are common shares will be subject to the threshold treatment described in the next section.

Threshold deductions

30.32

Instead of a full deduction, the following items may each receive limited recognition when calculating Common Equity Tier 1, with recognition capped at 10% of the bank's common equity (after the application of all regulatory adjustments set out in [CAP30.7](#) to [CAP30.30](#)):

1. significant investments in the common shares of unconsolidated financial institutions (banks, insurance and other financial entities) as referred to in [CAP30.29](#);
2. mortgage servicing rights; and
3. DTAs that arise from temporary differences.

30.33

The amount of the three items that remains recognised after the application of all regulatory adjustments must not exceed 15% of the Common Equity Tier 1 capital, calculated after all regulatory adjustments.

30.34

The amount of the three items that are not deducted in the calculation of Common Equity Tier

1 will be risk weighted at 250%.

CAP50

Prudent valuation guidance

This chapter provides banks with guidance on prudent valuation for positions that are accounted for at fair value, whether they are in the trading book or in the banking book.

Version effective as of 15 December 2019

First version in the format of the consolidated framework.

Introduction

50.1

This section provides banks with guidance on prudent valuation for positions that are accounted for at fair value, whether they are in the trading book or in the banking book. This guidance is especially important for positions without actual market prices or observable inputs to valuation, as well as less liquid positions which raise supervisory concerns about prudent valuation. The valuation guidance set forth below is not intended to require banks to change valuation procedures for financial reporting purposes. Supervisors should assess a bank's valuation procedures for consistency with this guidance. One fact in a supervisor's assessment of whether a bank must take a valuation adjustment for regulatory purposes under [CAP50.11](#) to [CAP50.14](#) should be the degree of consistency between the bank's valuation procedures and these guidelines.

50.2

A framework for prudent valuation practices should at a minimum include the following.

Systems and controls

50.3

Banks must establish and maintain adequate systems and controls sufficient to give management and supervisors the confidence that their valuation estimates are prudent and reliable. These systems must be integrated with other risk management systems within the organisation (such as credit analysis). Such systems must include:

1. Documented policies and procedures for the process of valuation. This includes clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the bank's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, end of the month and ad-hoc verification procedures; and
2. Clear and independent (ie independent of front office) reporting lines for the department accountable for the valuation process. The reporting line should ultimately be to a main board executive director.

Valuation methodologies

Marking to market

50.4

Marking-to-market is at least the daily valuation of positions at readily available close out prices that are sourced independently. Examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.

50.5

Banks must mark-to-market as much as possible. The more prudent side of bid/offer should be used unless the institution is a significant market-maker in a particular position type and it can

close out at mid-market. Banks should maximise the use of relevant observable inputs and minimise the use of unobservable inputs when estimating fair value using a valuation technique. However, observable inputs or transactions may not be relevant, such as in a forced liquidation or distressed sale, or transactions may not be observable, such as when markets are inactive. In such cases, the observable data should be considered, but may not be determinative.

Marking to model

50.6

Only where marking-to-market is not possible should banks mark-to-model, but this must be demonstrated to be prudent. Marking-to-model is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. When marking to model, an extra degree of conservatism is appropriate. Supervisory authorities will consider the following in assessing whether a mark-to-model valuation is prudent:

1. Senior management should be aware of the elements of the trading book or other fair-valued positions which are subject to mark to model and should understand the materiality of the uncertainty this creates in the reporting of the risk/performance of the business.
2. Market inputs should be sourced, to the extent possible, in line with market prices (as discussed above). The appropriateness of the market inputs for the particular position being valued should be reviewed regularly.
3. Where available, generally accepted valuation methodologies for particular products should be used as far as possible.
4. Where the model is developed by the institution itself, it should be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model should be developed or approved independently of the front office. It should be independently tested. This includes validating the mathematics, the assumptions and the software implementation.
5. There should be formal change control procedures in place and a secure copy of the model should be held and periodically used to check valuations.
6. Risk management should be aware of the weaknesses of the models used and how best to reflect those in the valuation output.
7. The model should be subject to periodic review to determine the accuracy of its performance (eg assessing continued appropriateness of the assumptions, analysis of profit and loss versus risk factors, comparison of actual close out values to model outputs).
8. Valuation adjustments should be made as appropriate, for example, to cover the uncertainty of the model valuation (see also valuation adjustments in [CAP50.9](#) to [CAP50.14](#)).

Independent price verification

50.7

Independent price verification is distinct from daily mark-to-market. It is the process by which market prices or model inputs are regularly verified for accuracy. While daily marking-to-market may be performed by dealers, verification of market prices or model inputs should be

performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently). It need not be performed as frequently as daily mark-to-market, since the objective, ie independent, marking of positions, should reveal any error or bias in pricing, which should result in the elimination of inaccurate daily marks.

50.8

Independent price verification entails a higher standard of accuracy in that the market prices or model inputs are used to determine profit and loss figures, whereas daily marks are used primarily for management reporting in between reporting dates. For independent price verification, where pricing sources are more subjective, eg only one available broker quote, prudent measures such as valuation adjustments may be appropriate.

Valuation adjustments

50.9

As part of their procedures for marking to market, banks must establish and maintain procedures for considering valuation adjustments. Supervisory authorities expect banks using third-party valuations to consider whether valuation adjustments are necessary. Such considerations are also necessary when marking to model.

50.10

Supervisory authorities expect the following valuation adjustments/reserves to be formally considered at a minimum: unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, and future administrative costs and, where appropriate, model risk.

Adjustment to the current valuation of less liquid positions for regulatory capital purposes

50.11

Banks must establish and maintain procedures for judging the necessity of and calculating an adjustment to the current valuation of less liquid positions for regulatory capital purposes. This adjustment may be in addition to any changes to the value of the position required for financial reporting purposes and should be designed to reflect the illiquidity of the position. Supervisory authorities expect banks to consider the need for an adjustment to a position's valuation to reflect current illiquidity whether the position is marked to market using market prices or observable inputs, third-party valuations or marked to model.

50.12

Bearing in mind that the assumptions made about liquidity in the market risk capital requirement may not be consistent with the bank's ability to sell or hedge out less liquid positions, where appropriate, banks must take an adjustment to the current valuation of these positions, and review their continued appropriateness on an on-going basis. Reduced liquidity may have arisen from market events. Additionally, close-out prices for concentrated positions and/or stale positions should be considered in establishing the adjustment. Banks must consider all relevant factors when determining the appropriateness of the adjustment for less liquid positions. These factors may include, but are not limited to, the amount of time it would

take to hedge out the position/risks within the position, the average volatility of bid/offer spreads, the availability of independent market quotes (number and identity of market-makers), the average and volatility of trading volumes (including trading volumes during periods of market stress), market concentrations, the ageing of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks not included in [CAP50.11](#).

50.13

For complex products including, but not limited to, securitisation exposures and n-th-to-default credit derivatives, banks must explicitly assess the need for valuation adjustments to reflect two forms of model risk: the model risk associated with using a possibly incorrect valuation methodology; and the risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

50.14

The adjustment to the current valuation of less liquid positions made under [CAP50.12](#) must impact Tier 1 regulatory capital and may exceed those valuation adjustments made under financial reporting standards and [CAP50.9](#) and [CAP50.10](#).

CAP90

Transitional arrangements

This chapter describes transitional arrangements applying to certain capital instruments, as well as transitional arrangements that may be used by jurisdictions applying expected credit loss accounting.

Version effective as of 03 April 2020

Amended transitional arrangements for the regulatory capital treatment of ECL accounting as set out in the 3 April 2020 publication.

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;
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.

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 [CAP10.11](#)(16) and [CAP10.16](#)(10).

90.6

Public sector capital injections made before 16 December 2010 and that do not comply with the eligibility criteria in [CAP10](#) receive no recognition in regulatory capital after 1 January 2018. The transitional arrangements in [CAP90.1](#) to [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.

90.12

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.

90.13

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.

90.14

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.

90.15

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.

90.16

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:

1. be included in Tier 2 capital, even if the provision meets the definition of “general” or “excess” provisions;
2. reduce exposure amounts in the standardised approach even if it meets the definition of a “specific” provision; or
3. 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](#):

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.

90.18

In light of the Covid-19 pandemic, the Committee agreed on the following amendments to the transitional arrangements for the regulatory capital treatment of ECLs set out in [CAP90.7](#) to [CAP90.17](#):

1. Jurisdictions may apply the existing transitional arrangements, even if they were not initially implemented when banks first adopted the ECL model. They may also choose to apply the alternative transition set out in point (4) below.
2. Jurisdictions may permit banks to switch from the static approach to the dynamic approach to determine the transitional adjustment amount (even if they have previously switched the approach that they use).
3. In addition to the two existing approaches to calculate the transitional adjustment amount (the static and dynamic approach), jurisdictions may use alternative methodologies that aim to approximate the cumulative difference between provisions under the ECL accounting model and provisions under the prior incurred loss accounting model.
4. Irrespective of when a jurisdiction initially started to apply transitional arrangements, for the 2 year period comprising the years 2020 and 2021, jurisdictions may allow banks to add-back up to 100% of the transitional adjustment amount to CET1. The “add-back” amount must then be phased-out on a straight line basis over the subsequent 3 years.

90.19

The disclosure requirements of [CAP90.17](#) also apply when the modified transitional arrangements set out in [CAP90.18](#) are used.

CAP99

Application guidance

This chapter contains supporting information on the definition of indirect and synthetic holdings, the calculation of minority interests and the application of transitional arrangements.

Version effective as of 15 December 2019

First version in the format of the consolidated framework.

Minority interest illustrative example

99.1

Minority interest receives limited recognition in regulatory capital, as described in [CAP10.20](#) to [CAP10.26](#). The following paragraphs provide an illustrative example of how to calculate the amount eligible for inclusion.

99.2

A banking group consists of two legal entities that are both banks. Bank P is the parent and Bank S is the subsidiary and their unconsolidated balance sheets are set out below.

Bank P balance sheet		Bank S balance sheet	
Assets		Assets	
Loans to customers	100	Loans to customers	150
Investment in Common Equity Tier 1 of Bank S	7		
Investment in the Additional Tier 1 of Bank S	4		
Investment in the Tier 2 of Bank S	2		
Liabilities and equity		Liabilities and equity	
Depositors	70	Depositors	127
Tier 2	10	Tier 2	8
Additional Tier 1	7	Additional Tier 1	5
Common equity	26	Common equity	10

99.3

The balance sheet of Bank P shows that in addition to its loans to customers, it owns 70% of the common shares of Bank S, 80% of the Additional Tier 1 of Bank S and 25% of the Tier 2 capital of Bank S. The ownership of the capital of Bank S is therefore as follows:

Capital issued by Bank S			
	Amount issued to parent (Bank P)	Amount issued to third parties	Total

Common Equity Tier 1	7	3	10
Additional Tier 1	4	1	5
Tier 1	11	4	15
Tier 2	2	6	8
Total capital	13	10	23

99.4

The consolidated balance sheet of the banking group is set out below:

Consolidated balance sheet	
Assets	
Loans to customers	250
Liabilities and equity	
Depositors	197
Tier 2 issued by subsidiary to third parties	6
Tier 2 issued by parent	10
Additional Tier 1 issued by subsidiary to third parties	1
Additional Tier 1 issued by parent	7
Common equity issued by subsidiary to third parties (ie minority interest)	3
Common equity issued by parent	26

99.5

For illustrative purposes Bank S is assumed to have risk-weighted assets of 100. In this example, the minimum capital requirements of Bank S and the subsidiary's contribution to the consolidated requirements are the same since Bank S does not have any loans to Bank P. This means that it is subject to the following minimum plus capital conservation buffer requirements and has the following surplus capital:

Minimum and surplus capital of Bank S

	Minimum plus capital conservation buffer	Surplus
Common Equity Tier 1	7.0 (= 7.0% of 100)	3.0 (=10 - 7.0)
Tier 1	8.5 (= 8.5% of 100)	6.5 (=10 + 5 - 8.5)
Total capital	10.5 (= 10.5% of 100)	12.5 (=10 + 5 + 8 - 10.5)

99.6

The following table illustrates how to calculate the amount of capital issued by Bank S to include in consolidated capital, following the calculation procedure set out in [CAP10.20](#) to [CAP10.26](#):

Bank S: amount of capital issued to third parties included in consolidated capital					
	Total amount issued (a)	Amount issued to third parties (b)	Surplus (c)	Surplus attributable to third parties (ie amount excluded from consolidated capital) (d) =(c) * (b)/(a)	Amount included in consolidated capital (e) = (b) - (d)
Common Equity Tier 1	10	3	3.0	0.90	2.10
Tier 1	15	4	6.5	1.73	2.27
Total capital	23	10	12.5	5.43	4.57

99.7

The following table summarises the components of capital for the consolidated group based on the amounts calculated in the table above. Additional Tier 1 is calculated as the difference between Common Equity Tier 1 and Tier 1 and Tier 2 is the difference between Total Capital and Tier 1.

	Total amount issued by parent (all of which is to be included in consolidated capital)	Amount issued by subsidiaries to third parties to be included in consolidated capital	Total amount issued by parent and subsidiary to be included in consolidated capital
Common Equity Tier 1	26	2.10	28.10
<i>Additional Tier 1</i>	<i>7</i>	<i>0.17</i>	<i>7.17</i>
Tier 1	33	2.27	35.27
<i>Tier 2</i>	<i>10</i>	<i>2.30</i>	<i>12.30</i>
Total capital	43	4.57	47.57

Indirect and synthetic holdings

99.8

[CAP30.18](#) to [CAP30.31](#) describes the regulatory adjustments applied to a bank's investments in its own capital or other total loss-absorbing capacity (TLAC) instruments or those of other financial entities, even if they do not have direct holdings. More specifically, these paragraphs require banks to capture the loss that a bank would suffer if the capital or TLAC instrument is permanently written off, and subject this potential loss to the same treatment as a direct exposure. This section defines indirect and synthetic holdings and provides examples.

99.9

An indirect holding arises when a bank invests in an unconsolidated intermediate entity that has an exposure to the capital of an unconsolidated bank, financial or insurance entity and thus gains an exposure to the capital of that financial institution.

99.10

A synthetic holding arises when a bank invests in an instrument where the value of the instrument is directly linked to the value of the capital of an unconsolidated bank, financial or insurance entity.

99.11

Set out below are some examples of indirect and synthetic holdings to help illustrate this treatment:

1. The bank has an investment in the capital of an entity that is not consolidated for regulatory purposes and is aware that this entity has an investment in the capital of a financial institution.

2. The bank enters into a total return swap on capital instruments of another financial institution.
3. The bank provides a guarantee or credit protection to a third party in respect of the third party's investments in the capital of another financial institution.
4. The bank owns a call option or has written a put option on the capital instruments of another financial institution.
5. The bank has entered into a forward purchase agreement on the capital of another financial institution.

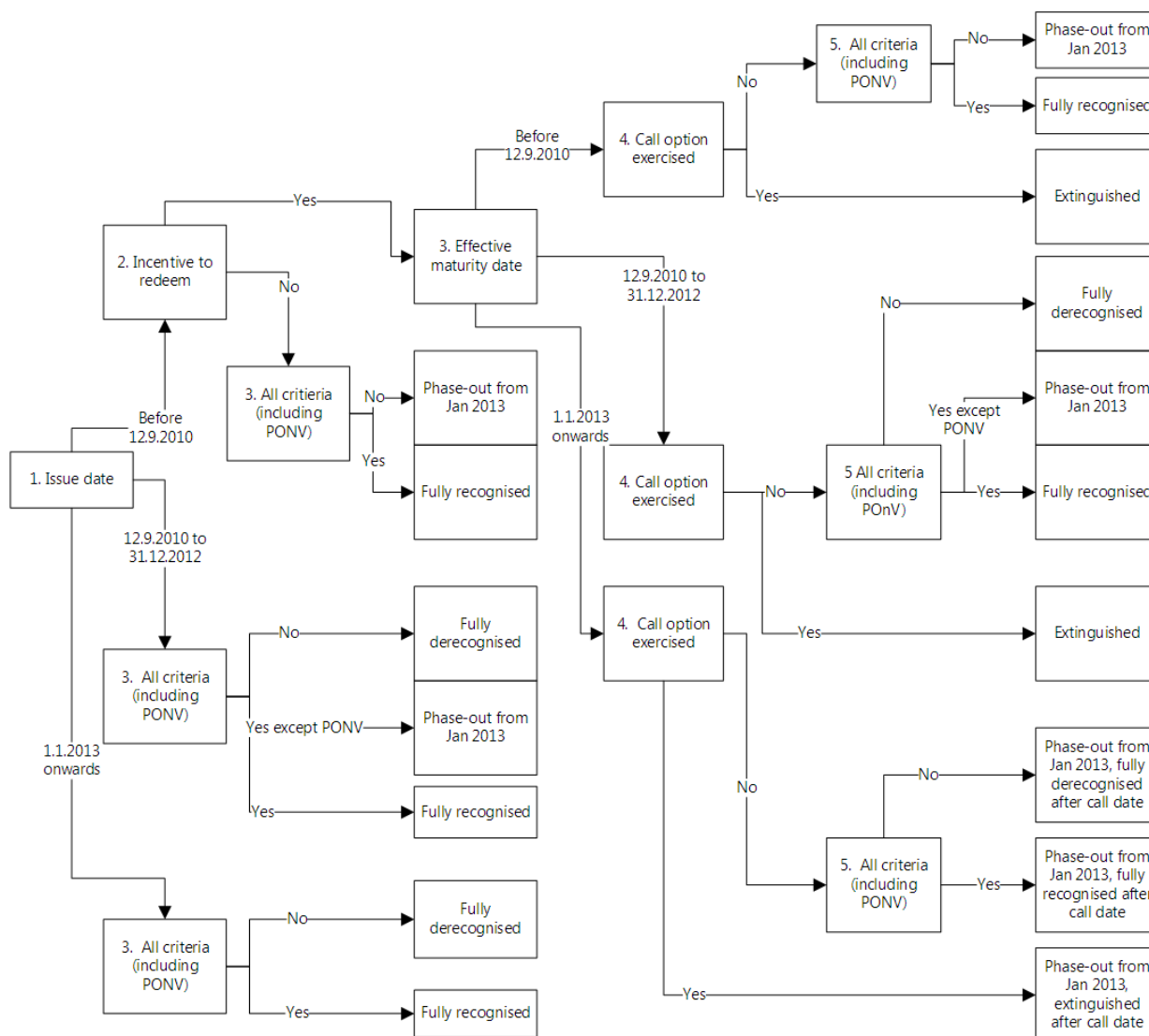
99.12

In all cases, the loss that the bank would suffer on the exposures if the capital of the financial institution is permanently written-off is to be treated as a direct exposure (ie subject to a deduction treatment).

Flowcharts illustrating transitional arrangements

99.13

The flowchart below illustrates the application of transitional arrangements in [CAP90.1](#) to [CAP90.3](#) and [CAP90.5](#). "Phase-out" refers to those transitional arrangements. "PONV" refers to the non-viability requirements in [CAP10.11](#)(16) and [CAP10.16](#)(10).



99.14

The flowchart below illustrates the application of transitional arrangements in [CAP90.4](#), which also sets out the "three conditions" and "phase-out" arrangements.

