BANK FOR INTERNATIONAL SETTLEMENTS

Press release

Press enquiries: +41 61 280 8188
press@bis.org
www.bis.org

Ref no: 03/2011

13 January 2011

Basel Committee issues final elements of the reforms to raise the quality of regulatory capital

The Basel Committee today issued minimum requirements to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss.

These requirements were endorsed by the Committee's oversight body, the Group of Governors and Heads of Supervision, at its 10 January meeting. Members agreed that under certain conditions, including a peer review process and disclosure, the proposal's objective could be met through a statutory resolution regime if it produces equivalent outcomes to the contractual approach.

During the financial crisis a number of distressed banks were rescued by the public sector injecting funds in the form of common equity and other forms of Tier 1 capital. While this had the effect of supporting depositors it also meant that Tier 2 capital instruments (mainly subordinated debt), and in some cases Tier 1 instruments, did not absorb losses incurred by certain large internationally-active banks that would have failed had the public sector not provided support.

In order for an instrument issued by a bank to be included in Additional (ie non-common) Tier 1 or in Tier 2 capital, it must meet or exceed minimum requirements set out in the attached annex. These requirements are in addition to the criteria detailed in the Basel III capital rules that were published in December 2010.

About the Basel Committee

The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. It seeks to promote and strengthen supervisory and risk management practices globally. The Committee comprises representatives from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. Observers on the Basel Committee are: the Committee of European Banking

Supervisors, the European Central Bank, the European Commission, the Financial Stability Institute and the International Monetary Fund.

Centralbahnplatz 2 · CH-4002 Basel · Switzerland · Tel: +41 61 280 8080 · Fax: +41 61 280 9100 · email@bis.org

Annex

Minimum requirements to ensure loss absorbency at the point of non-viability

Scope and post trigger instrument

1. The terms and conditions of all non-common Tier 1 and Tier 2 instruments issued by an internationally active bank must have a provision that requires such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of the trigger event unless:

   (a) the governing jurisdiction of the bank has in place laws that (i) require such Tier 1 and Tier 2 instruments to be written off upon such event, or (ii) otherwise require such instruments to fully absorb losses before tax payers are exposed to loss;

   (b) a peer group review confirms that the jurisdiction conforms with clause (a); and

   (c) it is disclosed by the relevant regulator and by the issuing bank, in issuance documents going forward, that such instruments are subject to loss under clause (a) in this paragraph.

2. Any compensation paid to the instrument holders as a result of the write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies).

3. 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.

Trigger event

4. The trigger event is the earlier of: (1) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; and (2) 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.

5. The issuance of any new shares as a result of the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.

Group treatment

6. The relevant jurisdiction in determining the trigger event is 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 if 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 trigger event is the earlier of: (1) 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 (2) 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.

7. Any common stock paid as compensation to the holders of the instrument must be common stock of either the issuing bank or of the parent company of the consolidated group (including any successor in resolution).

Transitional arrangements

Instruments issued on or after 1 January 2013 must meet the criteria set out above to be included in regulatory capital. Instruments issued prior to 1 January 2013 that do not meet the criteria set out above, but that meet all of the entry criteria for Additional Tier 1 or Tier 2 capital set out in *Basel III: A global regulatory framework for more resilient banks and banking systems*, will be considered as an "instrument that no longer qualifies as Additional Tier 1 or Tier 2" and will be phased out from 1 January 2013 according to paragraph 94(g).