BASEL COMMITTEE ON BANKING SUPERVISION

**Annexure B**

BANK FOR INTERNATIONAL SETTLEMENTS

# Press release

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## Group of Governors and Heads of Supervision announces higher global minimum capital standards

At its 12 September 2010 meeting, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced a substantial strengthening of existing capital requirements and fully endorsed the agreements it reached on 26 July 2010. These capital reforms, together with the introduction of a global liquidity standard, deliver on the core of the global financial reform agenda and will be presented to the Seoul G20 Leaders summit in November.

The Committee's package of reforms will increase the minimum common equity requirement from 2% to 4.5%. In addition, banks will be required to hold a capital conservation buffer of 2.5% to withstand future periods of stress bringing the total common equity requirements to 7%. This reinforces the stronger definition of capital agreed by Governors and Heads of Supervision in July and the higher capital requirements for trading, derivative and securitisation activities to be introduced at the end of 2011.

Mr Jean-Claude Trichet, President of the European Central Bank and Chairman of the Group of Governors and Heads of Supervision, said that "the agreements reached today are a fundamental strengthening of global capital standards." He added that "their contribution to long term financial stability and growth will be substantial. The transition arrangements will enable banks to meet the new standards while supporting the economic recovery." Mr Nout Wellink, Chairman of the Basel Committee on Banking Supervision and President of the Netherlands Bank, added that "the combination of a much stronger definition of capital, higher minimum requirements and the introduction of new capital buffers will ensure that banks are better able to withstand periods of economic and financial stress, therefore supporting economic growth."

*Increased capital requirements*

Under the agreements reached today, the minimum requirement for common equity, the highest form of loss absorbing capital, will be raised from the current

2% level, before the application of regulatory adjustments, to 4.5% after the application of stricter adjustments. This will be phased in by 1 January 2015. The Tier 1 capital requirement, which includes common equity and other qualifying financial instruments based on stricter criteria, will increase from 4% to 6% over the same period. (Annex 1 summarises the new capital requirements.)

The Group of Governors and Heads of Supervision also agreed that the capital conservation buffer above the regulatory minimum requirement be calibrated at 2.5% and be met with common equity, after the application of deductions. The purpose of the conservation buffer is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. While banks are allowed to draw on the buffer during such periods of stress, the closer their regulatory capital ratios approach the minimum requirement, the greater the constraints on earnings distributions. This framework will reinforce the objective of sound supervision and bank governance and address the collective action problem that has prevented some banks from curtailing distributions such as discretionary bonuses and high dividends, even in the face of deteriorating capital positions.

A countercyclical buffer within a range of 0% – 2.5% of common equity or other fully loss absorbing capital will be implemented according to national circumstances. The purpose of the countercyclical buffer is to achieve the broader macroprudential goal of protecting the banking sector from periods of excess aggregate credit growth. For any given country, this buffer will only be in effect when there is excess credit growth that is resulting in a system wide build up of risk. The countercyclical buffer, when in effect, would be introduced as an extension of the conservation buffer range.

These capital requirements are supplemented by a non-risk-based leverage ratio that will serve as a backstop to the risk-based measures described above. In July, Governors and Heads of Supervision agreed to test a minimum Tier 1 leverage ratio of 3% during the parallel run period. Based on the results of the parallel run period, any final adjustments would be carried out in the first half of 2017 with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

Systemically important banks should have loss absorbing capacity beyond the standards announced today and work continues on this issue in the Financial Stability Board and relevant Basel Committee work streams. The Basel Committee and the FSB are developing a well integrated approach to systemically important financial institutions which could include combinations of capital surcharges, contingent capital and bail-in debt. In addition, work is continuing to strengthen resolution regimes. The Basel Committee also recently issued a consultative document Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability. Governors and Heads of Supervision endorse the aim to strengthen the loss absorbency of non-common Tier 1 and Tier 2 capital instruments.

*Transition arrangements*

Since the onset of the crisis, banks have already undertaken substantial efforts to raise their capital levels. However, preliminary results of the Committee's comprehensive quantitative impact study show that as of the end of 2009, large banks will need, in the aggregate, a significant amount of additional capital to meet these new requirements. Smaller banks, which are particularly important for lending to the SME sector, for the most part already meet these higher standards.

The Governors and Heads of Supervision also agreed on transitional arrangements for implementing the new standards. These will help ensure that the banking sector can meet the higher capital standards through reasonable earnings retention and capital raising, while still supporting lending to the economy. The transitional arrangements, which are summarised in Annex 2, include:

- National implementation by member countries will begin on 1 January 2013. Member countries must translate the rules into national laws and regulations before this date. As of 1 January 2013, banks will be required to meet the following new minimum requirements in relation to risk-weighted assets (RWAs):
  - 3.5% common equity/RWAs;
  - 4.5% Tier 1 capital/RWAs, and
  - 8.0% total capital/RWAs.

  The minimum common equity and Tier 1 requirements will be phased in between 1 January 2013 and 1 January 2015. On 1 January 2013, the minimum common equity requirement will rise from the current 2% level to 3.5%. The Tier 1 capital requirement will rise from 4% to 4.5%. On 1 January 2014, banks will have to meet a 4% minimum common equity requirement and a Tier 1 requirement of 5.5%. On 1 January 2015, banks will have to meet the 4.5% common equity and the 6% Tier 1 requirements. The total capital requirement remains at the existing level of 8.0% and so does not need to be phased in. The difference between the total capital requirement of 8.0% and the Tier 1 requirement can be met with Tier 2 and higher forms of capital.
- The regulatory adjustments (ie deductions and prudential filters), including amounts above the aggregate 15% limit for investments in financial institutions, mortgage servicing rights, and deferred tax assets from timing differences, would be fully deducted from common equity by 1 January 2018.
- In particular, the regulatory adjustments will begin at 20% of the required deductions from common equity on 1 January 2014, 40% on 1 January 2015, 60% on 1 January 2016, 80% on 1 January 2017, and reach 100% on 1 January 2018. During this transition period, the remainder not deducted from common equity will continue to be subject to existing national treatments.
- The capital conservation buffer will be phased in between 1 January 2016 and year end 2018 becoming fully effective on 1 January 2019. It will begin at 0.625% of RWAs on 1 January 2016 and increase each subsequent year by an additional 0.625 percentage points, to reach its final level of 2.5% of RWAs on 1 January 2019. Countries that experience excessive credit growth should consider accelerating the build up of the capital conservation buffer and the countercyclical buffer. National authorities have the discretion to impose shorter transition periods and should do so where appropriate.
- Banks that already meet the minimum ratio requirement during the transition period but remain below the 7% common equity target

(minimum plus conservation buffer) should maintain prudent earnings retention policies with a view to meeting the conservation buffer as soon as reasonably possible.

- Existing public sector capital injections will be grandfathered until 1 January 2018. Capital instruments that no longer qualify as non-common equity Tier 1 capital or Tier 2 capital will be phased out over a 10 year horizon beginning 1 January 2013. Fixing the base at the nominal amount of such instruments outstanding on 1 January 2013, their recognition will be capped at 90% from 1 January 2013, with the cap reducing by 10 percentage points in each subsequent year. In addition, instruments with an incentive to be redeemed will be phased out at their effective maturity date.
- Capital instruments that do not meet the criteria for inclusion in common equity Tier 1 will be excluded from common equity Tier 1 as of 1 January 2013. However, instruments meeting the following three conditions will be phased out over the same horizon described in the previous bullet point: (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.
- Only those instruments issued before the date of this press release should qualify for the above transition arrangements.

Phase-in arrangements for the leverage ratio were announced in the 26 July 2010 press release of the Group of Governors and Heads of Supervision. That is, the supervisory monitoring period will commence 1 January 2011; the parallel run period will commence 1 January 2013 and run until 1 January 2017; and disclosure of the leverage ratio and its components will start 1 January 2015. Based on the results of the parallel run period, any final adjustments will be carried out in the first half of 2017 with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

After an observation period beginning in 2011, the liquidity coverage ratio (LCR) will be introduced on 1 January 2015. The revised net stable funding ratio (NSFR) will move to a minimum standard by 1 January 2018. The Committee will put in place rigorous reporting processes to monitor the ratios during the transition period and will continue to review the implications of these standards for financial markets, credit extension and economic growth, addressing unintended consequences as necessary.

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.

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

The **Group of Central Bank Governors and Heads of Supervision** is the governing body of the Basel Committee and is comprised of central bank governors and (non-central bank) heads of supervision from member countries. The Committee's Secretariat is based at the Bank for International Settlements in Basel, Switzerland.

# Annex 1

| Calibration of the Capital Framework<br>Capital requirements and buffers (all numbers in percent) | | | |
|---|---|---|---|
| | **Common Equity (after deductions)** | **Tier 1 Capital** | **Total Capital** |
| Minimum | 4.5 | 6.0 | 8.0 |
| Conservation buffer | 2.5 | | |
| Minimum plus conservation buffer | 7.0 | 8.5 | 10.5 |
| Countercyclical buffer range* | 0 – 2.5 | | |

* Common equity or other fully loss absorbing capital

## Annex 2: Phase-in arrangements (shading indicates transition periods)

## (all dates are as of 1 January)

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | As of 1 January 2019 |
|---|---|---|---|---|---|---|---|---|---|
| Leverage Ratio | Supervisory monitoring | | Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015 | | | | | Migration to Pillar 1 | |
| Minimum Common Equity Capital Ratio | | | 3.5% | 4.0% | 4.5% | 4.5% | 4.5% | 4.5% | 4.5% |
| Capital Conservation Buffer | | | | | | 0.625% | 1.25% | 1.875% | 2.50% |
| Minimum common equity plus capital conservation buffer | | | 3.5% | 4.0% | 4.5% | 5.125% | 5.75% | 6.375% | 7.0% |
| Phase-in of deductions from CET1 (including amounts exceeding the limit for DTAs, MSRs and financials ) | | | | 20% | 40% | 60% | 80% | 100% | 100% |
| Minimum Tier 1 Capital | | | 4.5% | 5.5% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Minimum Total Capital | | | 8.0% | 8.0% | 8.0% | 8.0% | 8.0% | 8.0% | 8.0% |
| Minimum Total Capital plus conservation buffer | | | 8.0% | 8.0% | 8.0% | 8.625% | 9.25% | 9.875% | 10.5% |
| Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital | | | Phased out over 10 year horizon beginning 2013 | | | | | | |

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | As of 1 January 2019 |
|---|---|---|---|---|---|---|---|---|---|
| Liquidity coverage ratio | Observation period begins | | | | Introduce minimum standard | | | | |
| Net stable funding ratio | | Observation period begins | | | | | | Introduce minimum standard | |