South African Reserve Bank

From the Office of
the Registrar of Banks

G2/2012

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To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Guidance note 2/2012 issued in terms of section 6(5) of the Banks Act, 1990

Matters related to the implementation of Basel III

Executive summary

The Basel III framework will be implemented in South Africa from 1 January 2013. This guidance note provides guidance on certain elements contained in the new definition of capital, including the additional loss absorbency requirements at the point of non-viability, as well as on elements pertaining to the phasing out arrangements of existing capital instruments that no longer qualify as regulatory capital in terms of the Basel III framework and the treatment of disclosed reserves.

1. Introduction

1.1 In June 2011, the Basel Committee on Banking Supervision (BCBS) released its final reform package to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector, commonly referred to as the Basel III framework[1]. Basel III will be implemented in South Africa with effect from 1 January 2013.

1.2 This guidance note provides clarity on certain elements pertaining to the implementation of the new definition of capital under Basel III in South Africa. However, this guidance note is not exhaustive and further guidance will be provided in due course. Guidance is provided on two main areas, namely (1) the phasing out arrangements for non-common equity Tier 1 capital instruments that no longer qualify as regulatory capital in terms of the new definition of capital under Basel III, including the requirements pertaining to the loss absorbency provisions at the point of non-viability, and (2) the treatment of disclosed reserves under Basel III.

2. Capital instruments

2.1 Phasing out of existing capital instruments

2.1.1 The Basel III framework specifies a number of specific criteria for instruments to qualify as either common equity Tier 1 (CET1), additional Tier 1 or Tier 2 capital instruments. These criteria are listed under paragraphs 49 to 65 of the Basel III framework and are also referred to as the "Basel III entry criteria".

2.1.2 The BCBS has, in paragraphs 94 to 96, set out the transitional arrangements for the implementation of the new definition of capital.

2.1.3 It should be noted under paragraphs 94(g), 95 and 96 that any existing capital instruments that no longer qualify as regulatory capital in terms of Basel III as CET1, additional Tier 1 or Tier 2 capital instruments will be phased out as from 1 January 2013 over a ten-year period.

2.1.4 Only capital instruments issued before 12 September 2010 will qualify for the above-mentioned phasing out of existing capital instruments. Any capital instruments issued between 12 September 2010 and 1 January 2013 which do not meet all the Basel III entry criteria mentioned above in paragraph 2.1.1, will no longer qualify as regulatory capital in terms of Basel III as from 1 January 2013.

2.2 Loss absorbency at the point of non-viability

2.2.1 On 13 January 2011, the BCBS issued a press release setting out the new additional requirements for all additional Tier 1 and Tier 2 capital instruments to ensure full loss absorbency at the point of non-viability.

2.2.2 In terms of the above-mentioned press release by the BCBS, the following clause or provision is required for inclusion in the terms and conditions of all non-common Tier 1 and Tier 2 capital instruments issued on or after 1 January 2013 in order to qualify as eligible capital under the new Basel III definition of capital:

a) These instruments will, at the discretion of the relevant authority, be either written off or converted into common equity upon the occurrence of the trigger event.
b) A trigger event is the earlier of:
   i. a decision that a write-off of the instrument, without which the bank would become non-viable, is necessary, as determined by the relevant authority; and
   ii. a decision to make a public sector injection of capital, or equivalent support, without which the bank would become non-viable, as determined by the relevant authority.

[1] Documents released by the BCBS in respect of the Basel III framework include *Basel III: A global regulatory framework for more resilient banks and banking systems* (June 2011) and *Basel III: International framework for liquidity risk measurement, standards and monitoring* (December 2010).

c) "Relevant authority" is likely to be the South African Reserve Bank or the relevant governmental authority in South Africa with the responsibility of making decisions relating to the declaration of a bank as being non-viable, with the effect of triggering loss absorption within the relevant capital instruments.

2.2.3 Banks have the option to include the requirements set out in paragraph 2.2.2 above for all issuances of additional Tier 1 and Tier 2 capital instruments during 2012 that would result in such instruments fully qualifying as eligible capital instruments under the Basel III framework as from 1 January 2013, subject to such instruments also meeting all the Basel III entry criteria as mentioned in paragraph 2.1.1 above.

2.2.4 Any additional Tier 1 and Tier 2 capital instruments issued between 12 September 2010 and 1 January 2013 that do not meet the additional loss absorbency requirements as mentioned in paragraph 2.2.2 above, but which meet the Basel III entry criteria as mentioned in paragraph 2.1.1 above, will be phased out from 1 January 2013 over a ten-year period in line with the requirements set out in paragraph 94(g) of the Basel III framework.

3. Treatment of disclosed reserves under the new definition of capital

3.1 In accordance with paragraph 52 of the Basel III framework, any accumulated other comprehensive income and other disclosed reserves, such as the foreign currency translation reserve, available for sale reserve and share-based payment reserve (SBPR), shall be included in the determination of capital under Basel III as from 1 January 2013.

3.2 Notice should be taken that this Office, as well as other BCBS members, will continue to monitor developments in the international accounting framework for accounting reserves potentially qualifying as capital.

3.3 From 1 January 2013 only equity-settled SBPR, and not cash-settled SBPR, as classified in terms of International Financial Reporting Standards shall be eligible for inclusion under the new definition of capital.

3.4 These reserves will be catered for under the proposed amended form BA 700, which will be modified to cater for the implementation of Basel III and which will form part of the proposed amended Regulations relating to Banks that are to be released for comment later in 2012.

4. Acknowledgement of receipt

4.1 Two additional copies of this guidance note are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.

René van Wyk
Registrar of Banks

The previous guidance note issued was Guidance Note 1/2012, dated 23 January 2012.