South African Reserve Bank
From the Office of
the Registrar of Banks

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

Guidance Note 3/2013 issued in terms of section 6(5) of the Banks Act, 1990

Loss absorbency requirements for Additional Tier 1 and Tier 2 capital instruments

Executive summary

Among other things, the amended Regulations relating to Banks (the Regulations) that were implemented with effect from 1 January 2013 set out the prescribed minimum requirements for capital instruments to qualify as either Additional Tier 1 or Tier 2 capital.

This guidance note serves to inform all relevant persons of matters related to the loss absorbency requirements and the relevant trigger events for capital instruments.

1. Introduction

1.1 In view of the implementation of the Basel III framework on 1 January 2013, the amended minimum requirements for Additional Tier 1 and Tier 2 capital instruments are set out in the Regulations that were implemented with effect from 1 January 2013.

1.2 This Office provided initial guidance to banks in terms of loss absorption at the point of non-viability in Guidance Note 2 of 2012, section 2.2, issued on 8 February 2012.

1.3 Banks are advised that this Office will continue to monitor international developments around the loss absorption requirements and, should it become necessary, issue further guidance.

2. Trigger event specified

2.1 Regulations 38(13)(b)(i), 38(13)(b)(iv)(H) and 38(14)(a)(i) of the Regulations prescribe that the terms and conditions of the capital instrument shall contain a provision that requires the instruments to be either converted to the most subordinated form of equity, or be written off at the discretion of the Registrar at the occurrence of a specified trigger event.

2.2 The trigger event for both Additional Tier 1 and Tier 2 capital instruments shall likely be the earlier of the decision by the Registrar as envisaged in regulations 38(13)(b)(i) and 38(14)(a)(i) of the Regulations or when a bank or controlling company's Common Equity Tier 1 (CET 1) ratio is equal to or below 5.875 per cent.

2.3 A bank or controlling company must notify the Registrar immediately, in writing, when its CET1 ratio falls below 6.50 per cent of risk-weighted exposures.

2.4 Banks should clearly indicate in the terms and conditions of Additional Tier 1 and Tier 2 capital instruments issued whether such instruments would either be written off or converted into the most subordinated form of equity at the occurrence of a trigger event, at the discretion of the Registrar, as envisaged in regulations 38(13)(b)(i) and 38(14)(a)(i) of the Regulations.

2.5 Conversion or write-off need only occur to the extent where the bank is deemed to be viable again as specified in writing by the Registrar. In terms of ranking, Additional Tier 1 instruments are likely to be converted or written off prior to any conversion or write-off of Tier 2 instruments.

2.6 The instruments to be converted or written off will be determined by the Registrar and shall be based on the book value of the instruments as reflected in the bank's financial statements at the same time.

2.7 In the event where a bank has more than one type of capital instrument qualifying as Tier 2 capital, containing either a conversion or write-off provision, such instruments will be treated *pari passu*, meaning that partial conversion or write-off could occur at the occurrence of the trigger event, up to the point where the bank is deemed viable again.

3. Conversion to most subordinated form of equity

3.1 Banks shall include in the issue documentation for Additional Tier 1 and Tier 2 instruments, which provide for conversion into the most subordinated form of equity, the following information:

3.1.1 number of shares or a formula to determine the number of shares in the most subordinated form of equity to be received by Additional Tier 1 and Tier 2 instrument holders at conversion; and

3.1.2 the number of shares to be received per formula to be a fixed amount.

3.2 In instances when, following a trigger event, the conversion of a capital instrument:

3.2.1 cannot be undertaken;

3.2.2 is not irrevocable; or

3.2.3 will not result in an immediate increase in CET1;

then such an instrument shall, instead of being converted into the most subordinated form of equity, be written off and result in an increase in the bank's CET1.

4. Instruments written off

4.1 Instruments issued with a provision for write-off shall be written off permanently with no provision for a write-up once the bank becomes viable again.

4.2 The value of the capital instruments to be repaid in the event of an early call or redemption shall be irrevocably reduced to the written-off amount of the instrument.

5. Group treatment

5.1 Capital instruments issued out of a fully consolidated subsidiary included in the consolidated amount of qualifying capital shall, in accordance with regulations 38(13)(b)(i) and 38(14)(a)(i), be converted or written off at the occurrence of a trigger event that is the earlier of either the circumstances envisaged in paragraph 2.2 above, or a decision by the relevant host regulator that a write-off without which the subsidiary would become non-viable is necessary.

6. Statutory legislation

6.1 The South African Reserve Bank and the National Treasury are in the process of drafting legislation for the South African recovery and resolution regime that will also make provision for statutory bail-in. This legislation will also cover trigger events at the point of non-viability for purpose of that legislation and it is foreseen that the capital ratio related triggers will be similar.

6.2 It is foreseen that once this legislation becomes enforceable, the contractual terms and conditions regarding conversion or write-off of instruments already issued and qualifying as capital as per regulations 38(13) and 38(14) of the Regulations are likely to take preference over the relevant statutory legislation requirements, once the specified trigger event is breached.

7. Invitation for comment

7.1 Banks and interested persons are hereby invited to submit their comments in respect of this guidance note to: SARB-banksup@resbank.co.za, for the attention of Mr Neil Maree by no later than 4 July 2013.

René van Wyk
Registrar of Banks

The previous guidance note issued was Guidance Note 2/2013, dated 18 January 2013.