

BASEL III UPDATE

July 7, 2011

The details regarding the proposed new Basel III framework are beginning to take shape. We have prepared a number of detailed alerts regarding Basel, which may be found at <http://www.mofo.com/resources/regulatory-reform/#basel>.

Here are the highlights:

- **Minimum common equity** requirement will be set at 4.5% of risk-weighted assets.
- **Minimum Tier 1 capital** requirement will be set at 6%.
- **Minimum total capital requirement** will be set at 8%.
- For each category, there will be a 2.5% **capital conservation buffer**. The capital conservation buffer must be met with equity. As an institution starts to “use up” the conservation buffer, it will become subject to progressively more stringent constraints on dividends and on discretionary executive compensation leading to these payments being completely prohibited when the common equity levels reach the minimum requirement.
- Minimums will be phased in between January 2013 and January 2015, and the conservation buffer will be phased in from January 2016 to December 2018.
- A **countercyclical buffer** also could be imposed by countries in order to address economies that are building excessive risks as a result of experiencing rapid economic growth.
- In addition to raising the capital requirements, the Basel III framework imposes more stringent criteria in order for instruments to classify as common equity and to count as Tier 1 capital. Instruments that no longer will qualify as common equity will be progressively excluded beginning in January 2013.
- In relation to all Tier 1 and Tier 2 instruments that are not common stock, such instruments need to contain a contractual provision providing for write-off or conversion into equity upon a trigger based on a decision to make a public sector injection of capital without which the bank would become non-viable or a decision that such write-off or conversion is necessary for the viability of the bank.
- In addition to these more stringent criteria, the Basel III framework also requires that banks take certain deductions from common equity. Deductions from capital will be required for (among other things) minority interests in non-bank subsidiaries, unrealized losses, goodwill and other intangibles, gains and losses due to the bank’s own credit risk, any provision shortfall. The required deductions will be phased in beginning in January 2014.
- There will be higher capital requirements for certain trading, derivatives and securitization activities. These will be introduced at the end of 2011.
- There will be a leverage ratio. The current proposal is for a non-risk based Tier 1 leverage limit of 3%.
- A **liquidity coverage ratio** will be introduced in 2015 and the **net stable funding ratio** will be applied starting in 2018.
- In connection with its ongoing work on global systemically important financial institutions (“sifis”), the Basel Committee has indicated it is considering additional common equity tier one capital requirements for global sifis ranging between 1% and 2.5% depending on a bank’s systematic importance. An additional 1% surcharge may be imposed on such banks that materially increase their systemic importance in the future.

There are a number of elements of the Basel III framework that are still being discussed and considered.

Basel III Minimum Capital Requirements

