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POSITIVE COMPONENTS OF CAPITAL

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21st February 2011

OVERVIEW

Total regulatory capital will consist of the sum of the following elements:

1. **Tier 1 Capital (going-concern capital)**
   a. **Common Equity Tier 1**
   b. **Additional Tier 1**

2. **Tier 2 Capital (gone-concern capital)**

Regulatory Capital vs Accounting Equity

Balance Sheet (Solo)		Regulatory Capital	
Assets	**200**		
Liabilities	**100**		
(o/w) Subordinated liabilities	**(50)**	**50**	**T2/AT1**
"Surplus" provisions	**(5)** ------	**5**	**T2**
Net assets	100	**100** ______ **155**	**CET1**
Net assets =	**Common Shares**		**CET1**
	Reserves - **P&L** - **Other**		**CET1**
	Other equity instruments		**NCT1**

CAPITAL INSTRUMENTS - OVERVIEW

	Common Shares	Additional Tier 1		Tier 2
Characteristics		Equity	Liabilities	
Maturity	Undated	Undated		Dated
Dividends/ Coupons	Full discretion, non-cumulative	Full discretion, Non-cumulative		Mandatory
Loss absorbency	Absorbs first loss	Absorbs losses after common shares	Absorbs losses at pre-defined trigger and at point of non-viability	Absorbs losses at point of non-viability
Subordination	Most deeply subordinated (pari passu)	Subordinated to T2 and senior creditors (pari passu)		Subordinated to senior creditors

COMMON EQUITY TIER 1 (CET1)

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Common Equity Tier 1 (CET1) capital consists of the following elements:

- Common shares issued by the bank that meet the criteria for classification as common shares for regulatory purposes (or the equivalent for non-joint stock companies);
- Stock surplus (share premium) resulting from the issue of instruments included in CET1;
- Retained earnings;
- Other comprehensive income and other disclosed reserves
- Minority interests that meet the criteria for inclusion in CET1; and
- Regulatory adjustments applied in the calculation of CET1

COMMON SHARES

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- For joint stock companies the criteria must be met solely with common shares. In the rare cases where banks need to issue non-voting common shares as part of Common Equity Tier 1, they must be identical to voting common shares of the issuing bank in all respects except the absence of voting rights.

Criteria for classification as common shares in CET1*

1. Represents the most subordinated claim in liquidation of the bank.

2. Entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation (ie has an unlimited and variable claim, not a fixed or capped claim).

**NB. The criteria also apply to non joint stock companies, such as mutuals, cooperatives or savings institutions, taking into account their specific constitution and legal structure. The application of the criteria should preserve the quality of the instruments by requiring that they are deemed fully equivalent to common shares in terms of their capital quality.*

COMMON SHARES CRITERIA cont'd

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3. Principal is perpetual and never repaid outside of liquidation.
4. The bank does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.
5. Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items).
6. There are no circumstances under which the distributions are obligatory. Non payment is therefore not an event of default.
7. Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.

COMMON SHARES CRITERIA cont'd

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8. It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and pari passu with all the others.

9. The paid in amount is recognised as equity capital (ie not recognised as a liability) for determining balance sheet insolvency.

10. The paid in amount is classified as equity under the relevant accounting standards.

11. It is directly issued and paid-in and the bank can not directly or indirectly have funded the purchase of the instrument.

COMMON SHARES CRITERIA cont'd

12. The paid in amount is neither secured nor covered by a guarantee of the issuer or related entity or subject to any other arrangement that legally or economically enhances the seniority of the claim.

13. It is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners.

14. It is clearly and separately disclosed on the bank's balance sheet.

ADDITIONAL TIER 1 CAPITAL

Additional Tier 1 (AT1) capital consists of the sum of the following elements:

- Instruments issued by the bank that meet the criteria for inclusion in AT1 capital;
- Stock surplus (share premium) resulting from the issue of instruments included in AT1 capital;
- Minority interests; and
- Regulatory adjustments applied in the calculation of AT1 capital

ADDITIONAL TIER 1 CAPITAL

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Criteria for inclusion in AT1 capital

1. Issued and paid-in
2. Subordinated to depositors, general creditors and subordinated debt of the bank
3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors
4. Is perpetual, ie there is no maturity date and there are no step-ups or other incentives to redeem

Criteria for inclusion in AT1 capital *cont'd*

5. May be callable at the initiative of the issuer only after a minimum of five years:
    a. To exercise a call option a bank must receive prior supervisory approval; and

    b. A bank must not do anything which creates an expectation that the call will be exercised; and

    c. Banks must not exercise a call unless:

        i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or

        ii. The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised

6. Any repayment of principal (eg through repurchase or redemption) must be with prior supervisory approval and banks should not assume or create market expectations that supervisory approval will be given

Criteria for Inclusion in AT1 capital *cont'd*

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7. Dividend/coupon discretion:

   a. the bank must have full discretion at all times to cancel distributions/payments

   b. cancellation of discretionary payments must not be an event of default

   c. banks must have full access to cancelled payments to meet obligations as they fall due

   d. cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stockholders.

8. Dividends/coupons must be paid out of distributable items

9. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.

10. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law.

Criteria for inclusion in AT1 capital *cont'd*

11. Instruments classified as liabilities for accounting purposes must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

    a. Reduce the claim of the instrument in liquidation;
    b. Reduce the amount re-paid when a call is exercised; and
    c. Partially or fully reduce coupon/dividend payments on the instrument.

12. Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument

13. The instrument cannot have any features that hinder recapitalisation, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame

14. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (eg a special purpose vehicle – "SPV"), proceeds must be immediately available without limitation to an operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in AT1 capital

TIER 2 CAPITAL

OVERVIEW

Tier 2 capital consists of the sum of the following elements:

- Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital;
- Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;
- Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital;
- Certain loan loss provisions; and
- Regulatory adjustments applied in the calculation of Tier 2 Capital.

Loss absorbency at the point of non-viability (PON)

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.

Loss absorbency at the point of non-viability (PON) cont

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.

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Questions?