I. Basel Committee regulations regarding Basel III

The Basel Committee on Banking Supervision (BCBS) has finalised the Basel III framework. Its main goal is to enhance bank and banking sector resilience to unexpected shocks and promote financial stability. The higher levels of capital, combined with a global liquidity framework, will significantly reduce the probability and severity of banking crises in the future.

12.10.2010 - the BCBS announced the calibration and timeline for the package of reforms on the minimum capital requirements and liquidity for banks.

16.12.2010 - the BCBS issued the Basel III rules text, which presents the details of global regulatory standards on bank capital adequacy and liquidity. The rules text presents the details of the Basel III Framework, which covers both microprudential and macroprudential elements.

13.01.2011 - the BCBS issued minimum requirements to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss\(^1\). These requirements are in addition to the criteria detailed in the Basel III capital rules mentioned above.

The Basel III requirements begin to take effect from the beginning of 2013 and will be progressively phased in by 2019. Transitional arrangements ensure that Basel III can be implemented in all countries without impeding the economic recovery. All countries should adopt the Basel III agreements in their national laws and regulations in time for an effective implementation in 2013.

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\(^1\) An instrument issued by a bank to be included in Additional (i.e. non-common) Tier 1 or in Tier 2 capital must meet or exceed minimum requirements set out in the document.
The Basel III framework sets out:

1. Higher and better-quality capital:
   a. increase in the minimum common equity requirement from 2% to 4.5% and a capital
      conservation buffer of 2.5%, bringing the total common equity requirement to 7%;
   b. longstanding 8.0% Basel minimum ratio increases to 10.5%, including 2.5% “capital
      conservation buffer”;
   c. tighter definition of capital (phasing out of non-standard Tier 1 over 10 years beginning
      2013; tighter treatment of deductions including minority interests, investments in other
      financial institutions, deferred tax assets; Tier 3 abolished).

2. Better risk coverage, especially related to capital markets activities:
   a. trading book exposures will be subject to a stressed value at risk requirement;
   b. higher risk weights for securitisations and re-securitisations in both the banking and the
      trading book.

3. The introduction of a leverage ratio as a backstop to the risk-based requirement:
   a. measures to promote the build up of capital that can be drawn down in periods of
      stress;
   b. a 3% minimum leverage ratio of Tier 1 capital to total assets will be tested and
      monitored from 2011, to be formally introduced from 2013.

4. The introduction of two global liquidity standards:
   a. Liquidity Coverage Ratio (LCR) - will be subject to an observation period from 2011
      and formally introduced from 2015;
   b. Net Stable Funding Ratio (NSFR) - will be subject to an observation period from 2013
      and formally introduced from 2018.

Generally much future BCBS activity will be focused on implementation of the Basel III
framework and will cover the following areas:

1. the observation of certain elements of Basel III (especially liquidity measures),
2. further development of supervisory standards (including the market risk rules, systemically important banks, the reliance on external ratings, large exposures, revision of the trading book),
3. efforts to improve supervisory practices and cross-border bank resolution practices
   (e.g. revisions of the Core Principles in 2011).

Current work of the BCBS regarding Basel III includes:

1. Pillar 3 disclosure requirements on remuneration - add greater specificity to the
   disclosure guidance on this topic that was included in the supplemental Pillar 2
   guidance. A consultation paper ‘Pillar 3 disclosure requirements for remuneration’ was
   issued 27 December 2010.

2. Capitalisation of bank exposures to central counterparties – on 20 December the
   BCBS issued a consultative paper including proposals relating to the capitalisation of
   bank exposures to a central counterparty - CCP - and, in particular, those related to
   the capital treatment of default fund exposures.

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2 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. The capital conservation buffer will be phased in
between 1 January 2016 and year end 2018 becoming fully effective on 1 January 2019.

3 LCR requires the bank to carry a stock of high quality liquid assets to enable it to survive a 30 day stress scenario.
II. EU regulations (implementation process of Basel II and Basel III)

Across the EU the Basel II agreement is given legal “life” by the Capital Requirements Directive, which is comprised of two directives which came into force on 1 November 2007:

1. Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions; and


These two directives introduced a supervisory framework in the EU, the main aim of which is to ensure the financial soundness of credit institutions (banks, building societies and certain investment firms) and reflect the Basel II rules on capital measurement and capital standards.

As a result of the regular updating process of the legal framework, the European Commission has already adopted two CRD amendments:

1. The Capital Requirements Directive amendment II ("CRD II")\(^4\) - came into force in 31 December 2010, with transitional provisions for some of the requirements. The revisions can be broadly split into four categories:
   a. revisions of rules that were brought forward from previous directives, such as the large exposures regime and derogations for bank networks from prudential requirements;
   b. establishing principles and rules that had not been formalised at the EU level such as the treatment of hybrid capital instruments within original own funds;
   c. clarifying the supervisory framework for crisis management and establishing colleges for enhancing both the efficiency and effectiveness of supervision;
   d. revisions prompted by the financial crisis, most notably the rules related to capital requirements and risk management for securitisation positions.

2. The Capital Requirements Directive amendment III ("CRD III")\(^5\) - amendments address capital requirements for the trading book and re-securitisations, disclosure of securitisation exposures, and remuneration policies. Rules on remuneration came into effect from 1 January 2011; other rules will come into effect from 31 December 2011.

The Capital Requirements Directive amendment IV ("CRD IV") will consist of a set of more fundamental changes and is still under development by the EU Commission. Issues being considered include:

1. simplification and reduction of national discretionary powers,
2. tightening of the definition of capital,
3. introduction of capital requirements for systemically important financial institutions,
4. introduction of a dynamic capital buffering requirement, to counter procyclicality,
5. introduction of specific requirements for liquidity buffers,
6. introduction of supplementary measures (e.g. possible leverage ratio),


7. specific capital requirements for mortgages granted in foreign currency,
8. simplification of the Bank Branch Accounts Directive.

The European Commission and the BCBS have been working together on developing the respective amendments to the Basel II framework and the new global liquidity standards. Consequently, the possible changes to the CRD set out in the Commission's consultation document will be closely aligned with the amendments to the Basel II framework and the introduction of a global liquidity standard.

Current work of the European Commission also covers consultation on countercyclical buffers. A public consultation was launched on 19 September 2010 to seek stakeholders' views on possible measures to mitigate fluctuations in the financial system by introducing countercyclical capital buffers for banks.

III. UK regulations (implementation process of Basel II and Basel III)

In the UK transposition of CRD has been split between HM Treasury and the Financial Services Authority (FSA).

The new CRD II-related rules and guidance came into force on 31 December 2010. The FSA has implemented the majority of the CRD II amendments, through changes to their Handbook\(^6\), which directly affect the obligations on firms. HM Treasury has implemented the remaining areas of CRD II, which mainly place new duties on the FSA.

The CRD III-related provisions regarding remuneration came into force on 1 January 2011. The other CRD III rules will become material from 31 December 2011, with transitional provisions until 31 December 2013.

Current work of the FSA and HM Treasury:

1. On 24 September 2010 the FSA published a policy statement regarding capital planning buffers\(^7\). However the UK’s regulatory approach to capital buffers may require review in the context of international developments (implementing the Basel III package).

2. On 17 December 2010 the FSA published a revised Remuneration Code\(^8\) to take into account changes required by the Capital Requirements Directive (CRD III) - the revised Code will encompass a much larger group of firms including all banks and building societies and CAD investment firms.


\(^6\) Policy Statement 10/19 ‘Strengthening Capital Standards 3’ issued by the FSA on 17 December 2010.
\(^7\) Policy Statement 10/14 ‘Capital planning buffers’ issued by the FSA on 24 September 2010.
\(^8\) Policy Statement 10/21 ‘Implementing CRD3 requirements on the disclosure of remuneration’ issued by the FSA on 17 December 2010
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