

Regulatory Capital—Transitional Provisions

Introduction

1. To allow banking corporations to comply more easily with the new regulatory capital requirements upon the implementation of Basel III, a transitional period ahead of full implementation has been set forth. The transitional provisions pertain to regulatory adjustments and deductions from capital and to capital instruments that do not qualify for inclusion in regulatory capital under the new criteria set forth. This Directive specifies transitional periods for different items and explains how they are to be applied.

Regulatory adjustments and deductions from capital

2. Regulatory adjustments and deductions from capital, including sums exceeding the 15 percent limit on significant investments in financial corporations and deferred tax assets from timing differentials, shall be deducted from Common Equity Tier 1 as set forth below:

For year beginning on	Deduction from Common Equity Tier 1 capital
January 1, 2014	20 percent
January 1, 2015	40 percent
January 1, 2016	60 percent
January 1, 2017	80 percent
January 1, 2018, and thereafter	100 percent

3. During the transitional period, the balance not deducted from capital shall remain subject to existing treatment.
4. Insofar as equity in the financial statements includes accumulated other comprehensive income or loss balance due to adjustments of defined benefits to employees, the provisions in Section 2 above for the transitional period shall also apply to said accumulated other comprehensive income or loss balance. The

provisions in Section 2 above for the transitional period shall also apply to the amount attributed directly to retained earnings as of January 1, 2013, in respect of initial adoption of US accounting rules regarding employee benefits.

5. The provisions for the transitional period shall also apply to deductions from Tier 2 capital and the balance not deducted from capital shall remain subject to existing treatment. Compulsory deductions from Additional Tier 1 Capital shall be deducted from Common Equity Tier 1.

For example:

- * When the new provisions require the deduction of an item from capital in 2014, 20 percent of said deduction shall be made from Common Equity Tier 1 capital and 80 percent from the relevant capital tier in accordance with existing treatment up to December 31, 2013.
- * When the new provisions require the deduction of an item from capital in 2014 and the item was risk-weighted under the provisions that were in effect until December 31, 2013, 20 percent of said deduction shall be made from Common Equity Tier 1 and 80 percent shall be weighted in accordance with the risk weights were in effect up to December 31, 2013.

Items weighted at 1,250 percent

6. The treatment of excess investment in an individual real corporation shall be applied gradually during the period beginning on January 1, 2014, and ending on January 1, 2018, in a manner similar to the treatment of deductions, where each year the portion not weighted at 1,250 percent shall be weighted at the risk weight that was in effect until December 31, 2013.

Threshold deductions

7. Calculation of threshold deductions for the period beginning on January 1, 2014, and ending on January 1, 2018, shall be made as set forth in Section 13 of Proper Conduct of Banking Business Directive 202.

Capital issued out of subsidiaries and held by third parties (minority interest)

8. The treatment of capital issued out of subsidiaries and held by third parties (e.g., minority interest) that meets the conditions specified in Section 2 of Proper Conduct of Banking Business Directive 202 may be included in regulatory capital from January 1, 2014, onward. Where such capital is ineligible for inclusion in regulatory capital but is included under existing treatment, 20 percent of the sum shall be excluded from the relevant tier on January 1, 2014, 40 percent on January 1, 2015, 60 percent on January 1, 2016, 80 percent on January 1, 2017, and 100 percent on and after January 1, 2018.

Capital instruments that do not qualify as regulatory capital

9. Capital instruments that while not qualifying as regulatory capital do meet the conditions specified in Section 10 below shall be subject to transitional arrangements from January 1, 2014, onward. Fixing the base at the nominal amount of such instruments outstanding on January 1, 2013, their recognition shall be capped at 80 percent from January 1, 2014, with the cap reduced by 10 percentage points in each subsequent year. This cap, applied to Tier 1 and Tier 2 capital instruments separately, refers to the total amount of instruments outstanding that no longer meet the new criteria. Insofar as an instrument is redeemed or its recognition in capital is amortized after January 1, 2014, the nominal amount serving as the base shall not be reduced. The rates of reduction are shown in the table below:

For year beginning on	Recognition cap
January 1, 2014	80 percent
January 1, 2015	70 percent
January 1, 2016	60 percent
January 1, 2017	50 percent
January 1, 2018	40 percent
January 1, 2019	30 percent
January 1, 2020	20 percent
January 1, 2021	10 percent
January 1, 2022, and thereafter	0 percent

10. a. Additional Tier 1 and Tier 2 capital instruments issued by a banking corporation or by a subsidiary thereof may qualify for inclusion as regulatory capital during the transitional period provided the following conditions are met:

- Those issued before September 12, 2010, shall be subject to the transitional arrangements specified in this Directive.
- Those issued between September 12, 2010, and December 31, 2013:
 - Instruments that meet all criteria in Appendices C and D of Proper Conduct of Banking Business Directive 202, with the exception of Criterion 11 in Appendix C, Criterion 9 in Appendix D, and Appendix E (Loss Absorbency Requirements at the Point of Non-Viability) shall be subject to the transitional arrangements specified in this Directive.
 - Instruments that fail to satisfy the foregoing provisions shall not be eligible for inclusion in the transitional directives.

b. In addition, instruments that have an incentive to be redeemed and were issued by September 12, 2010, shall be treated as follows:

- * For an instrument that had a call and a step-up before January 1, 2014 (or another incentive to be redeemed): if the instrument is not called on its effective maturity date and on a forward-looking basis will meet the new criteria for inclusion in Tier 1 or Tier 2 capital, it shall continue to be recognized in that tier of capital.
- * For an instrument that has a call and a step-up on or after January 1, 2014 (or another incentive to be redeemed), if the instrument is not called on its effective maturity date and on a forward looking basis will meet the new criteria for inclusion in Tier 1 or Tier 2 capital, it shall continue to be recognized in that tier of capital. Prior to the effective maturity date, the instrument shall be considered an “instrument that no longer qualifies as Additional Tier 1 or Tier 2” and shall be subject to the transitional arrangements set forth in this Directive from January 1, 2014, onward.
- * For an instrument that has a call and a step-up between September 12, 2010, and January 1, 2014 (or another incentive to be redeemed), if the instrument is not called on its effective maturity date and on a forward looking basis will not meet the new criteria for inclusion in Tier 1 or Tier 2 capital, it shall be fully derecognized in that tier of regulatory capital from January 1, 2014, onward.
- * For an instrument that has a call and a step-up on or after January 1, 2014 (or another incentive to be redeemed), if the instrument is not called on its effective maturity date and on a forward looking basis will not meet the new criteria for inclusion in Tier 1 or Tier 2 capital, it shall be derecognized in that tier of regulatory capital from the effective maturity date. Prior to the effective maturity date, the instrument shall be considered an “instrument that no longer qualifies as Additional Tier 1 or Tier 2 capital” and shall be subject to the transitional arrangements set forth in this Directive from January 1, 2014, onward.

- * For an instrument that had a call and a step-up on or before September 12, 2010 (or another incentive to be redeemed), if the instrument was not called on its effective maturity date and on a forward looking basis will not meet the new criteria for inclusion in Tier 1 or Tier 2 capital, it shall be considered an “instrument that no longer qualifies as Additional Tier 1 or Tier 2 capital” and shall be subject to the transitional arrangements set forth in this Directive from January 1, 2014, onward.

Appendix 1 includes a flowchart that demonstrates the implementation of the transitional provisions for capital instruments that do not qualify as regulatory capital.

Updates

Circular 06 no.	Version	Details	Date
2386	1	Original	May 30, 2013
2451	2	Revision	January 7, 2015

