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Legal Update
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Basel Committee Releases Final Text of Basel III Framework

On December 16, 2010, the Basel Committee on Banking Supervision (Committee) released the final text of the Basel III package of capital and liquidity reforms, which were originally proposed in December 2009, were modified and elaborated upon in subsequent releases in July and September 2010, and were endorsed by the G20 leaders in November 2010.[1] Because most of the key elements of the Basel III package had been agreed upon and announced prior to release of the final text (including the new minimum capital requirements and phase-in arrangements announced in September), the release is in many respects anti-climactic. Nevertheless, the final package does flesh out in more detail than prior releases several important elements, such as the revised net stable funding ratio component of the new liquidity standard. The final text – including translation into specific regulatory language of the broadly agreed-upon July 2010 "adjustments" to the original Basel III proposal – also provides important new details about the definition of capital, the treatment of counterparty credit risk, the leverage ratio, and operation of the regulatory capital buffers, among other topics.

Following on our earlier Basel III Updates,[2] this Legal Update focuses on several key new insights provided by the release of the final regulatory language, as well as challenges for the implementation process.[3]

Capital Requirements

The minimum regulatory capital requirements and "transition arrangements" set forth in the final Basel III text are unchanged from those announced in September 2010. These include a minimum 4.5 percent common equity risk-based capital requirement, a 6 percent tier 1 risk-based capital requirement, an 8 percent total risk-based capital requirement, an additional 2.5 percent common equity capital conservation buffer (discussed below), and a periodic countercyclical capital buffer (also discussed below), in addition to the new 3 percent non-risk-based leverage ratio.

The transition arrangements call for the new common equity and tier 1 minimum capital requirements to be phased in beginning in 2013, and for the capital conservation buffer to be phased in beginning in 2016. Instruments no longer qualifying as tier 1 or tier 2 capital under Basel III will be phased out beginning in 2013, but over a 10-year period. The chart attached as Appendix A summarizes these basic requirements and transition arrangements.[4]

DEFINITION OF CAPITAL

The final Basel III text includes several modifications to the definition of capital as compared to the original December 2009 proposal.

- **Minority Interests.** Building upon the Committee's July 2010 announcement that it would permit some "prudent recognition" of minority interests as common equity, the final

Basel III text permits, subject to various restrictions, the recognition of minority interests in a fully consolidated bank subsidiary as common equity of the parent bank.[5] In order for any minority interest to be recognized, the instrument giving rise to the minority interest must meet all of the criteria for recognition as capital (whether common equity tier 1 capital, additional tier 1 capital, or tier 2 capital) that would apply if the instrument had been issued by the parent bank. Minority interests are specifically excluded from the parent bank's common equity if the parent bank or an affiliate has directly or indirectly funded the minority investment. The final text provides that capital issued out of a special purpose vehicle (SPV) may be recognized as additional tier 1 capital or tier 2 capital (but not common equity) of the parent bank only if the sole asset of the SPV is an investment in capital of the parent bank in a form that meets the applicable criteria (i.e., additional tier 1 or tier 2).

- **Deferred Tax Assets.** As announced in July, the final text confirms that limited recognition as common equity will be permitted for deferred tax assets (DTAs) that "arise from temporary differences," while DTAs that "rely on future profitability of the bank to be realized" must be fully deducted from common equity.[6] The final text identifies the allowance for loan losses as an example of the type of DTA relating to temporary differences that need only be partially deducted, and it specifically mentions DTAs "relating to operating losses, such as the carry forward of unused tax losses, or unused tax credits" as examples of the types of fully deducted DTAs. The final language also specifies that DTAs may be netted with associated deferred tax liabilities (DTLs) only if they relate to taxes imposed by the same tax authority (i.e., in the United States, DTLs based on state taxes could not be netted against DTAs based on federal taxes) and the offsetting is specifically permitted by the relevant tax authority. Moreover, DTLs permitted to be netted against DTAs must exclude amounts that have been netted against the deduction of goodwill, intangibles, and defined benefit plans, and must be allocated on a *pro rata* basis between DTAs subject to the partial deduction and DTAs that are to be deducted in full.
- **Investments in the Capital of Unconsolidated Banking, Financial and Insurance Entities (covered entities).** The capital treatment of these investments is effectively divided into two categories: (i) investments in covered entities where the bank owns 10 percent or less of the common shares of a single entity, which must be aggregated and any amounts over 10 percent of the bank's common equity must be deducted from the same component of capital for which the capital would qualify if issued by the bank itself; and (ii) investments in covered entities where the bank owns more than 10 percent of the common share capital of a single entity, or where the entity is an affiliate of the bank, in which case all investments that are not common equity must likewise be deducted from the corresponding capital category, but investments in common shares would be eligible for limited recognition as common equity of the bank.[6]
- **Unrealized Gains and Losses.** The final text incorporates the Committee's earlier decision to tie the regulatory capital treatment of unrealized gains and losses (other than those related to changes in value of a bank's liabilities due to changes in its own credit risk) to the accounting treatment. However, it confirms that in jurisdictions that did not previously require the deduction of unrealized losses, any new deduction will be eligible for the five-year phase-in for other capital deductions. The final text also simply repeats the Committee's previous commitment that it will "continue to review" the appropriate regulatory capital treatment of unrealized gains, which are currently recognized to a

limited degree as tier 2 capital in jurisdictions such as the United States.

- **Contingent Convertible Capital.** The final Basel III text indicates that it is not, in fact, final in all respects and that additional revisions and guidance will be forthcoming in several areas, including the definition of capital. Specifically, the Committee is in the process of finalizing additional criteria for tier 1 and tier 2 capital that would include a potentially far-reaching requirement for non-common stock capital instruments to be treated as capital. Under these criteria, the terms of all non-common stock regulatory capital instruments would have to permit the instrument to be written off or converted to common stock (i) in the event of a public sector capital infusion without which the bank would, in the judgment of the relevant regulatory authority, become insolvent, or (ii) in the event that the regulatory authority determines that a write-down is necessary in order for the bank to avoid insolvency. The final Basel III text does not provide a specific time frame for release of final rules regarding these requirements, but it does note that the requirements will be added to the new Basel III capital definitions upon completion. Prior Committee releases indicate that these contingent convertible capital instruments could play a significant role in the heightened capital requirements for systemically important financial institutions that are currently under consideration by the Committee and the Financial Stability Board.[7]

CAPITAL BUFFERS

The Basel III package includes two new capital buffers that exist apart from, and in addition to, the new minimum capital requirements; namely, a capital conservation buffer and a countercyclical capital buffer.

- **Capital Conservation Buffer.** The capital conservation buffer was largely fleshed out in the original December 2009 proposal and has been adopted in final form without any significant modification, other than specifying the specific common equity ratio triggers and earnings conservation ratios. The buffer, a cushion of common equity above the Basel III minimum capital requirements, is set at 2.5 percent of risk-weighted assets, effectively increasing the minimum common equity and total capital requirements under Basel III to 7 percent and 10.5 percent, respectively.[8] Banks with capital levels that fall within the buffer will be forced to conserve (rather than distribute) earnings, which will limit a bank's ability to pay dividends, engage in share buybacks, or make "discretionary bonus payments." The chart below summarizes how the buffer will operate, with an increasing percentage of earnings subject to the conservation requirement as a bank's common equity approaches the Basel III minimum (i.e., 4.5).

Minimum Capital Conservation Standards

COMMON EQUITY RATIO	MINIMUM CAPITAL CONSERVATION RATIO (as a percentage of earnings)
4.5% to 5.125%	100%
5.125% to 5.75%	80%
5.75% to 6.375%	60%
6.375% to 7.0%	40%
> 7.0%	0%

- **Countercyclical Capital Buffer.** The countercyclical capital buffer, proposed conceptually in December 2009 and the subject of a more detailed proposal in July 2010,[9] is generally consistent with the prior proposals. This additional capital buffer, structured as an "add-on" to the capital conservation buffer, is intended to encourage the increase of bank capital during "bubble" periods when excess credit growth is determined to be associated with a buildup of systemic risk. The final Basel III text requires that banks meet countercyclical capital buffer requirements with common equity, but indicates that the Committee is still reviewing whether to permit "other fully loss absorbing capital" beyond common equity to be used and, if permitted, what form it might take.

The countercyclical capital buffer would be imposed periodically, on a jurisdictional basis, at the discretion of national or other jurisdictional banking authorities. Unlike the original July 2010 proposal, which would have required countercyclical buffer add-ons to be announced 12 months in advance of their effective date, the final text calls for increases in the buffer to be preannounced "by up to 12 months," apparently providing regulators with the discretion to implement the buffer with notice of less than 12 months.

The final Basel III package includes a separate document containing detailed guidance for national authorities, including principles for operating the buffer, communicating buffer decisions, and exercising jurisdictional reciprocity. Reciprocity issues will be particularly important with respect to internationally active banks, which will be required to identify the geographic location of their private-sector credit exposures and calculate a bank-specific countercyclical capital buffer as a weighted average of the buffers in place in all jurisdictions where the bank has exposures. Home country authorities would then be responsible for ensuring that their supervised institutions are properly calculating and adhering to international buffer requirements. The effect of this regime on large, internationally active institutions is that they likely will be subject to a smaller buffer, on a more frequent basis, than more localized institutions.

COUNTERPARTY CREDIT RISK

The Basel III package also includes significant reforms to the pre-existing Basel II counterparty credit risk (CCR) framework, including substantially increased capital requirements for CCR exposures arising from OTC derivatives, repos, and securities financing activities.[10] Thus, consistent with prior Basel III releases, the final text includes a new capital charge to cover the risk of mark-to-market losses associated with deterioration (short of default) in the creditworthiness of a derivative counterparty[11] – referred to under the Basel III framework as credit valuation adjustment (CVA) risk. Banks with the appropriate regulatory approvals will be permitted to calculate the CVA capital charge using a models-based advanced approach, while all other banks will apply a standardized approach.[12]

The final text includes several significant revisions to the CVA framework as originally proposed in December 2009, which should ameliorate to some extent the "excessive calibration" of the original proposal. These revisions, announced "conceptually" in July 2010, include elimination of the "5x multiplier" included in the December 2009 draft, elimination of the double counting of losses when the CVA capital charge is aggregated with the default risk capital charge, and recognition of a broader range of hedges in calculating the CVA capital charge – including in particular certain index CDS that would not have been recognized under the original proposal.

The final Basel III CCR framework also continues to include a 25 percent asset value correlation (AVC) adjustment – a multiplier applied when risk-weighting exposures to large financial institutions. As announced in July 2010, however, the Committee confirmed in the final text that this adjustment should apply to exposures to regulated financial institutions with assets greater than $100 billion (rather than $25 billion, as under the December 2009 proposal), as well as unregulated financial institutions regardless of size.

The final Basel III text also includes measures intended to reduce over-reliance on external credit ratings in assessing CCR, such as limiting the extent to which an issue-specific rating can be used for unrated issues of the same issuer, and requiring banks to perform their own credit risk assessments of exposures to individual borrowers or counterparties regardless of whether the exposures are rated or unrated. The final text incorporates into the regulatory capital framework the International Organization of Securities Commissions (IOSCO) code of conduct for credit rating agencies, which requires rating agencies to meet various transparency and disclosure requirements, such as publishing the general nature of compensation arrangements with assessed parties. Under these criteria, external credit ratings of securitization exposures would not be eligible for recognition if the ratings are provided only to the parties to a transaction.

LEVERAGE RATIO

The final Basel III text follows through on the Committee's previously announced plans to adopt a non-risk-based leverage ratio as a "backstop" measure to reinforce the risk-based capital requirements. As expected, the Committee will test a minimum tier 1 leverage ratio of 3 percent during the so-called "parallel run" period from January 2013 to January 2017. However, the final text reiterates that the Committee also intends to collect data during the transition period to track the impact of using alternative measures – i.e., common equity or total capital.

Consistent with the Committee's July 2010 announcement, the final Basel III text provides that for leverage ratio purposes, banks should calculate exposures for securities financing transactions (repos, reverse repos, securities lending and borrowing, and margin lending transactions) and derivatives by applying the accounting measure (plus, in the case of derivatives, an "add-on" for potential future exposure) and the regulatory netting rules based on the Basel II framework. This represents a shift from the original December 2009 proposal, which would not have permitted netting for these items.

The final text also confirms that certain off-balance sheet items should be included in the calculation of exposure by applying a uniform 100 percent credit conversion factor (CCF). As agreed in July 2010, a 10 percent CCF will apply for unconditionally cancelable commitments, although the Committee will continue its review of this issue to ensure that the 10 percent CCF is "appropriately conservative."

Liquidity Requirements

In addition to revised regulatory capital requirements, the Basel III package includes new global liquidity standards consisting of two elements: the Liquidity Coverage Ratio (LCR), which is intended to ensure that banks have sufficient high-quality liquid assets to sustain a significant 30-day stress scenario, and the Net Stable Funding Ratio (NSFR), which has a one-year time horizon and is intended to promote the use of more stable sources of funding on an ongoing basis.

LIQUIDITY COVERAGE RATIO

The LCR requires banks to maintain enough unencumbered high-quality liquid assets, convertible into cash, to meet their total expected net cash outflows for the next 30 calendar days under stressed conditions. As was expected following the Committee's July 2010 announcement of broad agreement on the Basel III package, the final text divides "high-quality liquid assets" into Level 1 assets (generally, cash, central bank reserves, and government securities that receive a 0 percent risk-weight under the Basel II standardized approach), and Level 2 assets (government securities that receive a 20 percent risk-weight under Basel II, and certain highly-rated nonfinancial corporate bonds and covered bonds not issued by the bank or its affiliates). Level 1 assets may comprise an unlimited proportion of the required assets and are not subject to any haircut, while Level 2 assets may comprise no more than 40 percent of the total amount of high-quality liquid assets and are subject to a minimum 15 percent haircut.

The final text includes detailed guidance on calculating total net cash outflows – i.e., total expected cash outflows minus total expected cash inflows, under a specified stress scenario (including, among other things, run-off of a portion of retail deposits, partial loss of wholesale funding capacity, contractual outflows and collateral posting requirements resulting from a credit downgrade, and unscheduled draws on credit and liquidity facilities), over the next 30 days. In order to prevent banks from relying solely on expected cash inflows to meet the LCR requirement, the amount of expected inflows that is permitted to offset expected outflows is capped at 75 percent. Thus, the minimum required amount of high-quality liquid assets is equal to 25 percent of expected outflows.

An observation period for the LCR will begin in 2011, with the standard set to be introduced as a minimum requirement in 2015.

NET STABLE FUNDING RATIO

The NSFR is intended to promote reliance on more medium- and long-term funding based on the liquidity characteristics of an institution's assets over a one-year time horizon. The Committee expects the NSFR to limit over-reliance on short-term wholesale funding when markets are highly liquid, to encourage better assessment of liquidity risk across all on- and off-balance sheet items, and to offset incentives for institutions to fund their highly liquid assets with short-term funds that mature just outside of the 30-day time horizon of the LCR standard.

Under this requirement, a bank's available stable funding (ASF) must be equal to or greater than its required stable funding (RSF). Components of ASF include the bank's capital, preferred stock with maturity greater than one year, liabilities with effective maturities of greater than one year, and the portion of demand or term deposits expected to remain with the bank over a one-year stress scenario time horizon. Each component is assigned an ASF factor that discounts its face value according to the perceived level of stability: capital, for example, receives an ASF factor of 100 percent (full recognition), while unsecured wholesale funding receives an ASF factor of 50 percent. Similarly, each of the bank's assets is assigned an RSF factor based on its liquidity risk profile, with highly liquid assets such as readily available and unencumbered cash and securities requiring no long-term funding (i.e., an RSF factor of 0 percent) and less liquid assets receiving increasing RSF factors up to a maximum of 100 percent.

As was expected following the Committee's July 2010 announcement that the controversial original NSFR in the December 2009 proposal would be withdrawn and issued in revised form, the final Basel III text reflects a number of revisions to the December 2009 draft – particularly with respect to calibration of the ASF and RSF factors. For example, "stable" and "less stable" deposits each will receive a higher ASF factor under the final proposal (90 percent and 80 percent, respectively) than they received under the December 2009 draft (85 percent and 70 percent, respectively). The RSF factor for residential mortgages and other loans that would qualify for a 35 percent or better risk-weight under the Basel II standardized approach has been reduced from 100 percent under the December 2009 proposal to 65 percent under the final text. In addition, the extent to which off-balance sheet credit and liquidity facilities would need to be pre-funded has been limited by reducing the applicable RSF factor from 10 percent to 5 percent.

Notwithstanding these efforts to recalibrate the NSFR in response to dissatisfaction with the original proposal, the Committee will continue to study and refine the NSFR standard over the course of an observation period to begin in 2011, and the NSFR will not be introduced as a minimum requirement until 2018.

Conclusion

Although the December 2010 release is styled as the "final" text, there are a number of unresolved issues that ultimately will fall within the Basel III regime. For example, the NSFR remains under review, and the role to be played by contingent and convertible capital instruments under the Basel III regime has yet to be fully determined. In addition, the Committee also has yet to address the critical issue of the additional capital requirements that are expected to apply to systemically important financial institutions, with an announcement on that issue not likely until mid-2011.

The Committee also will continue to work on and refine other discrete areas of the Basel III package, such as the newly proposed capital requirements for exposures to CCPs; ambiguities in the final text (e.g., with respect to treatment of minority interests) may also warrant further clarification and elaboration. And the framework's restrictive treatment of certain trade-related exposures continues to draw criticism.[13] Accordingly, while the Basel III text is now largely complete, several significant issues remain and await further guidance from the Committee.

In addition, modifications to the Basel III regime that go beyond these open issues are not out of the question, as the Committee continues to assess the impact of higher capital and liquidity requirements on the banking industry and the broader economy during the relatively lengthy transition periods.[14] In particular, the adoption of new and relatively robust minimum liquidity requirements is likely to receive special scrutiny from international supervisors that do not have an historic frame of reference against which to measure and evaluate these new requirements, which are subject to a separate observation period.

Perhaps more significantly, Basel III must still be adopted by individual jurisdictions, and the implementation process will undoubtedly provide additional opportunities to revisit certain controversial elements of the international framework. For example, in the United States, the banking industry is likely to seek modification of several elements, including the relatively stringent treatment of DTAs, mortgage servicing rights, and certain trade-related exposures. More broadly, implementation of Basel III in the United States will be complicated by the capital and liquidity-related mandates of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), including the Collins Amendment[15] and the general restriction on the regulatory use of credit ratings,[16] as well as by the enormous burdens already placed on the US regulators to issue the hundreds of regulations and studies required by the Dodd-Frank Act. Moreover, US regulators must decide (perhaps as part of the long-pending proposal to adopt a standardized version of Basel II in the United States) whether, and to what extent, Basel III should be applied to the vast majority of US banks that are not now subject to Basel II. Finally, implementation in the United States requires the consensus of three different regulatory agencies and, particularly after the results of the recent election, will likely be subject to some degree of Congressional scrutiny.

In the EU, the translation of the Basel III text into legislation, first by a directive of the European Parliament and Council and then by legislation or rule-making in each member state, may require that certain aspects of the new capital and liquidity standards be modified or discarded. The Basel III leverage ratio, for example, has been the subject of substantial criticism in Europe, with several countries urging that a binding leverage ratio not be included in EU legislation. The EU has already adopted bank liquidity management standards based on earlier

Basel proposals, and EU member states have implemented these in different ways.[17] It is not yet clear how the various existing standards will be conformed with or superseded by the Basel III standards. While the EU, unlike the United States, has not yet decided to ban use of credit ratings in financial regulations, proposals have been offered to limit or condition their use, which could further complicate Basel III implementation.[18] In addition, the difficult economic climate in some Eurozone countries could make it more difficult for European legislators to agree on implementation of some Basel III measures. Finally, if the United States delays or limits implementation of Basel III (as it has already done for Basel II), that will tend to dampen enthusiasm for implementing the changes in Europe.

Thus, while release of the final Basel III text clearly is a significant development, the prospects for timely and faithful implementation of Basel III remain uncertain in many, if not all, affected jurisdictions.

Endnotes

1 Developed by the Committee in response to the global financial crisis, the Basel III package consists of two documents. The first, *A global regulatory framework for more resilient banks and banking systems*, focuses on increasing the quantity and quality of bank capital, as well as other capital-related reforms. The second, *International framework for liquidity risk measurement, standards and monitoring*, imposes a new global liquidity standard. The final Basel III documents, including results of the Committee's "quantitative impact study" of the financial effects of the new capital and liquidity standards, are available at: http://www.bis.org/list/basel3/index.htm.

2 For detailed information about the original December 2009 capital reform proposal, please see "Basel Committee Proposes Significant Reforms to Regulatory Capital Framework," available at http://www.mayerbrown.com/publications/article.asp?id=8416&nid=6. Our July 2010 update regarding "broad agreement" on the Basel III terms, including certain modifications to the December 2009 proposal, is available at http://www.mayerbrown.com/publications/article.asp?id=9420&nid=6. Finally, our September 2010 update regarding announcement of the Basel III minimum capital ratios and transition arrangements is available at http://www.mayerbrown.com/publications/article.asp?id=9659&nid=6.

3 Actions of the Committee do not have direct legal effect in participating countries, and therefore must be implemented through a domestic legislative or rule-making process.

4 The Committee has indicated that participating jurisdictions should have implementing laws and regulations in place in time to meet the general Basel III effective date of January 1, 2013 – i.e., the beginning of the phase-in period for the new capital standards.

5 The final Basel III text continues to permit minority interests in *nonbank* subsidiaries to be recognized as parent bank capital other than common equity – i.e., additional tier 1 capital or tier 2 capital.

6 As previously announced, permitted DTAs, significant (i.e., greater than 10 percent) investments in the common shares of unconsolidated financial institutions, and mortgage servicing rights, each would be limited to 10 percent of the bank's common equity (after application of all deductions), and all three items in the aggregate could not exceed 15 percent of common equity (after application of all deductions). However, the final text specifies that the non-deducted amounts of these assets would be risk-weighted at 250 percent.

7 The Committee's August 2010 proposal regarding the role that contingent convertible capital should play under the Basel III regulatory capital framework is available at http://www.bis.org/press/p100819.htm.

8 In fact, the final text states that "banks should not choose in normal times to operate in the buffer range simply to compete with other banks and win market share," and instructs that supervisors should use their discretion "to impose time limits on banks operating within the buffer range on a case-by-case basis."

9 Our July 2010 Legal Update, which includes a brief summary of the initial countercyclical capital buffer proposal, is available at http://www.mayerbrown.com/publications/article.asp?id=9420&nid=6.

10 Among other consequences, the heightened capital requirements applicable under the revised CCR framework should increase incentives to move OTC derivative exposures to central counterparties (CCPs). In connection with the CCR reform measures, the Committee on December 20 issued a proposal to impose a "modest" 2 percent risk-weight on exposures to "qualifying CCPs" – generally those subject to standards set by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) – as opposed to the zero percent risk-weight permitted under the current Basel II framework. An exposure to a non-qualifying CCP, like any

other bilateral OTC derivative exposure, would attract the significantly higher capital charges applicable under Basel III. The proposal, which requests comment by February 4, 2011, is available at http://www.bis.org/publ/bcbs190.htm.

[11] Banks do not include in the calculation of CVA capital charge: (i) transactions with a CCP, or (ii) securities financing transactions (SFT), such as repos and securities lending transactions, unless a supervisor determines that the bank's CVA loss exposures arising from SFT transactions are material.

[12] The Committee will review the "level and reasonableness" of the CVA capital charge calculated under the standardized method, including how it compares to the charge incurred under the advanced approach, during the course of a final impact assessment to be completed during the first quarter of 2011.

[13] Several aspects of Basel III have been criticized as being too draconian with respect to trade finance, including the requirement to apply a 100 percent CCF to trade-related off-balance sheet instruments such as letters of credit under the leverage ratio.

[14] For instance, the Committee's December 2010 report on its study of the macroeconomic impact of a transition to higher capital concluded that the strengthened capital requirements proposed by the Basel Committee were "likely to have a relatively modest impact" on economic growth (as measured by gross domestic product across affected jurisdictions). *See, Final Report: Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements* (December 17, 2010), which is available at http://www.bis.org/publ/othp12.htm. This conclusion presumably provided some comfort to Committee members as they deliberated on the publication of the final Basel III text.

[15] The Collins Amendment is contained in Section 171 of the Dodd-Frank Act. Among other things, the Collins Amendment generally requires the US banking agencies to establish minimum risk-based capital requirements applicable to US banking organizations (including insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Federal Reserve) that are not less than "generally applicable" risk-based capital requirements, which must serve as a floor for any future capital requirements. It also prohibits the agencies from establishing any future leverage or risk-based capital requirements that are "quantitatively" lower than the generally applicable requirements in effect for depository institutions as of July 21, 2010. In addition, the treatment of trust preferred securities under the Collins Amendment is more stringent than under Basel III for larger US bank holding companies, and less stringent for smaller bank holding companies.

On December 30, 2010, the US regulators published a joint notice of proposed rulemaking to implement certain provisions of the Collins Amendment with respect to the small group of internationally active US "core banks" subject to the Basel II advanced approach. Under the proposal, a copy of which is available at http://edocket.access.gpo.gov/2010/pdf/2010-32190.pdf, the agencies are proposing to replace the existing three-year sliding scale transitional floors under the US Basel II advanced approach with a permanent floor consisting of the existing Basel I risk-based capital regime applicable to non-core US banks. The proposal also highlights some of the difficulties the agencies will face in determining whether any future changes to US bank regulatory capital requirements, such as implementation of Basel III, will satisfy the Collins Amendment's requirement that any new capital requirements not be "quantitatively lower" than the requirements in place at July 21, 2010.

[16] Section 939A of the Dodd-Frank Act generally requires the US banking agencies to eliminate any references to credit ratings from their regulations. On August 25, 2010, the US banking agencies published an advanced notice of proposed rulemaking seeking public comment on how best to implement this requirement, including with respect to risk-based capital requirements which currently rely heavily on credit ratings. The notice is available at http://edocket.access.gpo.gov/2010/pdf/2010-21051.pdf.

[17] In 2009, the European Parliament approved a package of amendments, known as CRD II, to the EU Capital Requirements Directive (CRD), including provisions adding to and strengthening the CRD's existing provisions on liquidity risk management. The Directive is available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0097:0119:EN:PDF. EU member states were required to translate these measures into national law by the end of October 2010, with effect from the end of December 2010. The Committee of European Banking Supervisors (the tasks and responsibilities of which were taken over by the European Banking Authority on January 1, 2011) published Guidelines on Liquidity Buffers & Survival Periods in December 2009, available at http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2009/Liquidity-Buffers/Guidelines-on-Liquidity-Buffers.aspx. These guidelines, while different from Basel III proposals, are more akin to the LCR than the NSFR. Among other things, they require stress testing on the basis of a bank-specific stress scenario and a market-wide stress scenario, with high intensity over one to two weeks and lesser intensity over several months.

[18] The European Commission published a *Public Consultation on Credit Rating Agencies* on November 5, 2010 and requested comments by January 7, 2011. That document is available at

http://ec.europa.eu/internal_market/consultations/docs/2010/cra/cpaper_en.pdf. The Public Consultation sets out for consideration a number of potential measures relating to over-reliance on credit ratings and other issues related to credit rating agencies. It proposes consideration of various alternatives or additions to use of external ratings in banks' and other financial institutions' regulatory capital requirements, including requiring use of internal models, requiring two ratings, referring to market measures of credit risk, and requiring use of the Basel II "supervisory formula" for securitization positions.

For more information about the topics raised in this Legal Update, please contact any of the following lawyers:

Scott Anenberg
+1 202 263 3303
sanenberg@mayerbrown.com

Paul Forrester
+1 312 701 7366
jforrester@mayerbrown.com

Kevin Hawken
+44 20 3130 3318
khawken@mayerbrown.com

Charles Horn
+1 202 263 3219
chorn@mayerbrown.com

Jason Kravitt
+1 212 506 2622
jkravitt@mayerbrown.com

Donald Waack
+1 202 263 3165
dwaack@mayerbrown.com

Appendix A

Basel III Capital and Liquidity Requirements

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Leverage Ratio (3.0%)	**Supervisory monitoring**		**Parallel Run Phase (Public Disclosure as of January 2015)**					**Effective January 2018**	
Minimum Common Equity Capital Ratio	2.0%	2.0%	3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer	-	-	-	-	-	0.625%	1.25%	1.875%	2.5%
Minimum Common Equity plus Capital Conservation Buffer	2.0%	2.0%	3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of Deductions (including for FI Investments, MSRs and DTAs)	-	-	-	20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital	4.0%	4.0%	4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus Capital Conversion Buffer	8.0%	8.0%	8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital Instruments Not Qualified for Tier 1 or Tier 2 Capital Treatment			Phased-Out (2013 through 2023)						
Liquidity Coverage Ratio	Observation period				LCR applies as minimum standard				
Net Stable Funding Ratio	Observation period							NSFR applies as minimum standard	