

Implementation of the BIS "Rules" on Capital Adequacy Assessment: A Comparative Study of the Approaches Adopted in the UK, the USA and Japan *

Introduction

In December 1987 the Basle Committee of Supervisors, operating under the auspices of the Bank for International Settlements, published guideline proposals for the measurement and assessment of the capital adequacy of "internationally-active" banks (see Hall, 1989 for a critique). With minor amendments, these proposals were formally accepted by the bank supervisors of the "Group of Ten" (G10) countries (plus Luxembourg) in July 1988. The purpose of this article is to compare and contrast the approaches adopted in three of the most financially-developed economies – the UK, the USA and Japan – towards the implementation of this agreement. The discussion highlights the kind of disparities with which internationally-active banks will have to contend.

Comparison of the UK,¹ US² and Japanese approaches adopted towards the implementation of the agreed "Rules"

A. *The Definition of Capital*

(i) *Tier 1 Capital*. As can be seen from Table 1, there is little difference in the approaches adopted towards the classification of

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¹ The UK approach reflects the modifications to the 1988 agreement necessitated by adoption of the European Community's "Own Funds" (89/299/EEC of 17 April 1989) and "Solvency Ratio" (89/647/EEC of 18 December 1989) Directives. The Bank of England's implementing "notices" accommodating these policy adjustments were both published in December 1990 (see BANK OF ENGLAND 1990a and 1990b).

² The analysis of US policy is focused mainly on the approach adopted towards state

capital components eligible for inclusion in Tier 1 capital by the three countries. Unlike in the UK and the US, however, Japanese banks have not, to date, been able to make any issues of non-cumulative, perpetual preferred stock because, under Japanese company law, preference shares cannot be issued in Japan. The competitive position of Japanese banks would improve, though, if the Basle Committee of Supervisors gives its permission for such stock issues, where made by the banks' *overseas vehicle subsidiaries*, to rank as Tier 1 capital and the Director General of the Banking Bureau at the Ministry of Finance sanctions such overseas issues.³

(ii) *Tier 2 Capital*. Close inspection of policies adopted in the three countries indicates that it is here that the fundamental differences in approach to the definition of capital reside. As is evident from Table 2, UK-incorporated banks have by far the most scope for raising Tier 2 capital. This is due partly to differences in accounting conventions (which, for example, preclude the inclusion of *any* revaluation reserves by US banks and the inclusion of undisclosed reserves and unpublished retained profits by either US or Japanese banks), to differences in company law (which, for example, as noted above, prohibit preference share issues in Japan) but also to differences in the *discretionary* policies adopted by the supervisory authorities.

This last point can be illustrated by contrasting the UK and Japanese approaches to the treatment of *revaluation reserves*. In Japan, the authorities take full advantage of the concession granted under the BIS "rules" enabling banks to count up to 45 per cent of their latent gains on securities holdings as Tier 2 capital but choose to disallow property and fixed asset revaluation reserves;⁴ in stark contrast, the Bank of England chooses (it is now also obliged under the EC's Own Funds Directive) to disallow undisclosed latent gains on securities holdings (which are insignificant for most UK banks

member (*i.e.* of the Federal Reserve System) banks, although the main differences in their treatment *vis-à-vis* bank holding companies are noted in the text.

³ The outcome of the Committee's deliberations on this issue is expected some time in 1992. (It should be noted that preference share issues made by overseas *banking* subsidiaries, as opposed to special-purpose offshore subsidiaries, would rank as Tier 1 capital at the consolidated level.)

⁴ The prevailing tax situation (in respect of capital gains tax) also deters banks from revaluing property.

anyway) while allowing property revaluation reserves, a portion of which, indeed, may be counted as Tier 1 capital on capitalisation⁵ (at least until 1 January 1993).

Further disparities arising from differences in the discretionary policies adopted by the supervisory authorities are evident in the treatment of *general provisions/loan loss reserves*. As annotated in Table 2, the Bank of England excludes from Tier 2 all provisions which reflect lower valuations of particular assets, notably against "less developed country" (LDC) debt; the remaining, un earmarked provisions are eligible for inclusion up to an agreed limit. No such exclusion of sovereign debt provisions is insisted upon in either the US or Japan although the latest *Basle Committee* proposals (BIS, 1991), if adopted, would ensure their exclusion in both countries by the end of 1993 at the latest.

Turning to the treatment of *hybrid capital* instruments, it is clear that Japanese banks are at a comparative disadvantage by virtue of their limited availability in Japan. For, although convertible subordinated bond issues have been sanctioned since 1987, with associated restrictions being removed in January 1990,⁶ no perpetual debt issues have been forthcoming in Japan.

Finally, in comparing the treatment of *subordinated term debt* instruments, it is clear that, once again, the Japanese banks are at a competitive disadvantage, despite their ability (since June 1990) to issue subordinated bonds and take subordinated loans. This is because of the restrictions placed on the latter – the lenders must be financial institutions – and the complications created for the former issues by the legal separation of long term credit and commercial banking in Japan, which confines debenture issues to the long term credit banks.⁷

⁵ This was agreed by the Basle Committee in 1990. The Bank of England, on a bank by bank basis, agrees what proportion of such revaluation reserves should be capitalised, which to date has taken place through scrip issues. The Bank of England's view is that a "reasonable" proportion of the reserve should remain uncapitalised in order to absorb future declines in property values before the current year's profit and loss account is affected.

⁶ Prior to this date, the money so raised had to be restricted to "investment (*i.e.* physical) facilities" and not used as a general fund for lending.

⁷ The Sumitomo Bank was the first bank to circumvent the rules by using a Caribbean-based subsidiary to make subordinated bond issues in the US and Europe in June 1990, the proceeds being on-lent by the subsidiary on a subordinated basis to the parent bank. Later issues involved parent companies being distanced even further as the proceeds were used to repay loans made by foreign banks to the Japanese banks' overseas affiliates.

With respect to the differences in the UK and US approaches, it should be noted that those instruments qualifying as Tier 2 in the US are excluded once they fall under the one year to maturity threshold whereas in the UK (and Japan) 20 per cent of the amounts outstanding would still be eligible for inclusion.

(iii) *Deductions From Capital.* Although *goodwill* must be deducted from Tier 1 capital by the banks incorporated in each of the three countries,^{8,9} potentially serious disparities arise from the treatment of items to be deducted from total capital (see Table 3). The main point at issue here is the treatment of *holdings of the capital instruments of other depository institutions*. The Bank of England, once again, adopts the toughest stance, insisting upon full deduction of all holdings of other banks' and building societies' capital instruments for all UK-authorized institutions other than those which qualify for concessions as primary or secondary market makers in such instruments (see Bank of England, 1986). The concessions granted, however, will be subject to certain limits after 1 January 1993 in line with Articles 2(12) and 2(13) of the EC's Directive on Own Funds (89/299/EEC April 1989). By way of contrast, banks incorporated in the US and Japan need only deduct "*intentional*" reciprocal holdings of banking organisations' capital instruments, creating doubts about the extent of *de facto* deduction in those countries. While, on the face of it, this would appear to put UK-incorporated banks at something of a competitive disadvantage, close monitoring of the policies adopted by commercial banks in the US and Japan by their respective supervisory authorities and the allocation of a 100 per cent risk weight to such investments not so deducted (see below) is likely to mitigate the competitive distortions in practice.

Finally, with respect to *investments in unconsolidated subsidiaries and associates*, competitive equality is more or less assured by virtue of the fact that, although not formally obliged to deduct such items from total capital (as are UK- and US-incorporated banking organisations), all banking and financial subsidiaries and associated companies have

⁸ In the US, bank holding companies may postpone deduction of goodwill acquired before 12.3.88 until the end of 1992.

⁹ In the US, previously-grandfathered goodwill approved in supervisory mergers is exempt from deduction.

to be consolidated for accounting purposes in Japan, regardless of the "significant impact rule".¹⁰

B. The Risk Weight Framework

Table 4 provides a comparison of the three sets of risk weights applied in the three countries to banks' balance sheet items. The differences arise, of course, in those instances where the Basle Committee determined to allow for national discretion. In virtually all such cases,¹¹ the Japanese authorities have seen fit to adopt the lowest weights permissible under the BIS agreement. In the process, no attempt is made in Japan to capture either interest rate risk or foreign exchange rate risk within the risk weight framework, in stark contrast to the situation obtaining in the UK and, for some items,¹² in the US. The cumulative effect of this policy is to lighten the regulatory burden imposed on Japanese banks as compared with the positions faced by banks incorporated in the US and, more especially, the UK, *ceteris paribus*.

In contrasting the policies adopted within the UK and the US, it is clear that, overall, UK-incorporated banks face the stricter regime although, on certain items (e.g. items 4, 9 and 16), they are treated more favourably than their US counterparts. The implications of this disparity in treatment are less clear, however, when it comes to the setting of "trigger" or "target" risk asset ratios (see Hall, 1990b), as a

¹⁰ Under the Securities and Exchange Law, a parent company need not consolidate any of its subsidiaries the assets, the sales and the profits of which are all below ten per cent of those of the combined total for the parent company and its consolidated subsidiaries.

¹¹ The exceptions to the rule are: (i) claims on multilateral development banks and claims fully-guaranteed or fully-collateralised by the securities issued by these institutions (a risk weight of 20 per cent is adopted, despite the availability of an option to impose a zero risk weight); and (ii) claims on OECD public-sector entities (excluding central government) and loans guaranteed by such entities (risk weights of either 10 or 20 per cent are adopted in the light of options which would allow for the adoption of zero, 20 or 50 per cent risk weights).

¹² Interest rate risk proxies are applied to items (9) and (11). Separate studies are still being conducted on market risk, exchange rate risk, interest rate risk and liquidity risk, the outcome of which is likely to be further modification of the risk weight framework. (A draft proposal on a methodology for incorporating interest rate risk within risk-based capital adequacy assessment procedures used within the thrift industry was released for comment by the Office of Thrift Supervision in July 1990 - see OFFICE OF THRIFT SUPERVISION, 1990.)

whole host of factors (such as interest rate risk, liquidity risk, funding risk, market risk, asset quality, managerial competence and skill, the quality and level of earnings, investment and loan portfolio concentrations, and loan and investment policies)¹³ are taken into account in determining a final assessment of an organisation's capital adequacy.

C. The Treatment of Off-Balance-Sheet (OBS) Items

The conversion factors applied to the OBS activities of banks incorporated in the UK, the US and Japan in the conversion of OBS risks to balance sheet "credit risk equivalent amounts" are identical and presented in Tables 5 and 6. The main competitive distortion introduced¹⁴ thus relates not to the conversion factor framework adopted but rather to the range of institutions forced to adopt the *current exposure method* (see Hall, 1990b) in their assessment of the credit risks associated with interest rate-related and exchange rate-related activities. As noted in Table 6, *all* banking organisations in the US have to adopt this approach, whereas in Japan and the UK the *original exposure method* may instead be adopted by some. In Japan, this concession applies to banking organisations which do not conduct a "significant" volume of business in such transactions or, as an interim measure, to those which do not have the proper office facilities or procedures for adopting the current exposure method. And, in the UK, it applies mainly to banks which do not actively trade in such instruments or for whom such instruments form an insignificant part of their treasury operations.¹⁵

D. The Exercise of Discretion in Other Areas

As noted by Dale (1990), the actual impact of the BIS agreement on the world's internationally-active banks will depend in large

¹³ These are the factors addressed in the US. For a contrast with the approach taken by the Bank of England see HALL, 1990b.

¹⁴ The UK and US authorities have, however, exercised the discretion granted in the Basle Committee's proposals to allow their banks the option of measuring *commitments* on a residual maturity basis until the end of 1992, rather than on an original maturity basis. The decision was taken with a view to facilitating data collection in the two countries and to minimising the reporting costs incurred by banks.

¹⁵ Those which are actively engaged in trading such instruments may, exceptionally, also be allowed to adopt this approach, subject to agreement with the Bank of England.

degree on the manner in which national supervisory authorities exercise the discretion available to them under the agreement. The areas in which such discretion resides encompass the following (Hall, 1990a):

(i) in the specification of risk weights and conversion factors;

(ii) in the determination of which, and to what degree, items are included in supplementary capital, subject to the limits and restrictions laid down by the Basle Committee;

(iii) in the approach adopted towards the deduction, from total capital, of banks' holdings of capital issued by other banks or deposit-taking institutions;¹⁶

(iv) in the general approach adopted during the transitional period (*i.e.* until end-1992, according to the BIS document, although the Japanese authorities have interpreted this to mean the end of fiscal 1992, namely 31 March 1993); and

(v) in the specification of the "target standard ratios" for individual banks, subject to the minimum ratio prescribed by the Basle Committee.¹⁷

The exercise of discretion in areas (i)-(iii) listed above has already been covered, leaving items (iv) and (v) for further comment.

The Transitional Period

The discretion exercised within permissible bounds during this period by the UK, US and Japanese supervisory authorities is contrasted in Table 8. It is clear that the Japanese authorities have

¹⁶ Although the Basle Committee fully recognised the potential systemic dangers of such "double gearing" it balked at demanding full deduction of all holdings of other banks' capital on the grounds that "to do so could impede certain significant and desirable changes taking place in the structure of domestic banking systems" (BIS, 1987, p. 9). Notwithstanding this, the Committee determined to monitor closely the situation and did not rule out the possibility of introducing constraints at a later date.

¹⁷ In December 1987 the Committee had not endorsed any particular minimum figure for this standard, but it was agreed during 1988 that the minimum ratio should be set at the eight per cent level.

availed themselves of most of the opportunities¹⁸ for delaying implementation of the "final" BIS requirements,¹⁹ in stark contrast to the approach taken by the Bank of England. Accordingly, the interim and final standard target ratios will be adopted at the latest possible moment in Japan, whereas the final standard has served as a floor to the individually-agreed, trigger RARs in the UK since the end of June 1989. (All the major UK-incorporated banks had risk asset ratios in excess of the eight per cent minimum standard by this date.) In a similar vein, the maximum advantage is taken in Japan from the transitional arrangements allowing the inclusion of supplementary elements of capital within core capital and limiting the inclusion of term subordinated debt within supplementary capital. In the UK, the "final" arrangements (*i.e.* those agreed for the post-1992 period) have applied since the new capital adequacy assessment regime was first implemented at the end of June 1989.²⁰ While this disparity in approach no doubt reflects market realities – compared with their UK-incorporated counterparts, Japanese banks have traditionally operated with lower levels of capital – it does serve as a reminder of the competitive inequalities that internationally-active banks (and, indeed, other credit institutions)²¹ will face, at least until the end of March 1993, as a result of the differential application of capital requirements, a situation that will be worsened by the Japanese treatment of the agreed minimum standard target ratios as *de facto maxima* requirements.

As for the US approach to the transitional period, the Federal Reserve, like their Japanese counterparts, have seen fit to avail

¹⁸ Though not all! The discretion to wait until the end of 1992 before deducting goodwill from Tier I capital has not been exercised (although, presumably, this is ruled out by local standard accounting practices); nor has any attempt been made to seek "exceptional" status for general loan loss reserves.

¹⁹ It might also be argued that the Japanese interpretation of the end of calendar year requirements as end of *fiscal* year requirements has allowed them to extend the periods of grace beyond those provisionally agreed. Moreover, their interpretation of the amounts of supplementary capital allowed to be included in core capital during the transitional period – they assess it as a maximum percentage of total core, *including* supplementary elements (see item 3 in Table 8) – further indicates their determination to stretch the rules to the limit!

²⁰ Apart from the Bank of England's decision, noted earlier, to exercise the discretion granted in the Basle Committee's proposals to allow UK-authorized banks the option of measuring commitments on a *residual* maturity basis until the end of 1992, rather than on an original maturity basis.

²¹ It should be noted that the EC's Solvency Ratio Directive applies to *all* credit institutions operating within the EC.

themselves of some of the discretionary provisions which allow for a temporary shielding of their charges from the full rigours of the agreed final proposals. (Calls from a number of US banks, mirroring the demands of some of their Japanese counterparts, for a "go slow" on the implementation of the 1988 agreement have, to date at least, been resisted by the Basle Committee.) Thus, for example, full advantage is taken of the provisions allowing for the inclusion of general loan loss reserves within Tier 2 capital; full advantage is taken of the provisions allowing for the temporary inclusion of supplementary elements of capital within core capital; and the agreed minimum target standard risk asset ratio is to be phased in (no standard was specified for the period before the end of 1990). Contrariwise, state member banks have been required to deduct goodwill from Tier 1 capital throughout the period, in spite of the available concession to delay implementation of this policy until end-1992, although this reflects internal accounting conventions rather than a conscious policy choice on the part of the Federal Reserve.

The Specification of Target Standard Ratios

The final, but overwhelmingly important, factor which impinges upon the competitiveness of internationally-active banks is the choice of "trigger" risk asset ratios which the banks are actually asked to observe. Whilst we know that these will be set, for all banks subject to the BIS "rules" in Japan,²² at the agreed minimum of eight per cent from the end of March 1993, the bulk of their UK and US competitors will be subjected to much higher requirements, according to their individual circumstances.²³ This, more than anything else, indicates how dependent internationally-active banks are on the dis-

²² *i.e.* Japanese banks which either maintain overseas business establishments or which otherwise *voluntarily* choose to adopt the BIS "rules".

²³ It is also likely that UK and US banks will eventually be asked to observe the requirements, on a (moving?) average daily basis rather than just on reporting dates, so that less "window-dressing" than in Japan is likely to be tolerated.

cretionary policies adopted by their supervisors within the field of capital adequacy assessment.²⁴

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²⁴ The concern most frequently expressed by the banks whose views on the impact of the Basle agreement were recently canvassed by Price Waterhouse was about "the inter-country differences emerging in the areas of national discretion, particularly with regard to the elements of Tier 2 capital and the setting of individual target ratios above the eight per cent minimum" (PRICE WATERHOUSE, 1991, p. 8). The banks which feel most strongly about being disadvantaged *vis-à-vis* banks in other countries are located in the UK, Germany, Norway, Canada, Belgium, France and Spain, according to this study. Of the UK respondents, almost two thirds cited the setting of minimum target ratios substantially in excess of the agreed eight per cent minimum as a cause for dissatisfaction.

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TABLE 1

ALLOWABLE COMPONENTS OF TIER 1 (i.e. "CORE") CAPITAL

UK APPROACH	JAPANESE APPROACH	US APPROACH ⁵
<p>1. Permanent shareholders' equity</p> <p>(i) Allotted, called up and fully paid share capital/common stock (net of any own shares held at book value)</p> <p>(ii) Perpetual, non-cumulative preferred shares, including such shares redeemable at the option of the issuer and with the Bank's prior consent; and such shares convertible into ordinary shares</p>	<p>1. Permanent stock-holders' equity</p> <p>(i) Common stock</p> <p>(ii) Non cumulative, perpetual preferred stock³</p>	<p>1. Permanent stock-holders' equity⁶</p>
<p>2. Disclosed reserves in the form of general and other reserves created or increased by appropriations of retained earnings, share premiums and other surplus¹</p>	<p>2. Disclosed reserves</p>	<p>2. Qualifying non-cumulative perpetual preferred stock⁷</p>
<p>3. Published interim retained profits²</p>	<p>3. Published retained earnings⁴</p>	<p>3. Minority interest in equity accounts of consolidated subsidiaries</p>
<p>4. Minority interests arising on consolidation from interests in permanent shareholders' equity</p>	<p>4. Consolidated subsidiaries' minority interests</p>	

Notes:

¹ Including capital gifts and capital redemption reserves.

² i.e. net of anticipated tax, dividends and any other appropriations. These must be verified by external auditors with effect from 1 January 1993.

³ They are allowed, in principle, although Japanese company law precludes preference share issues in Japan. (It does not preclude, however, foreign issues by overseas subsidiaries.)

⁴ i.e. net of anticipated tax and value of outflow (dividend and executive directors' bonus payments).

⁵ For state member banks: the main difference in treatment *vis-à-vis* that of bank holding companies is that the latter may include cumulative, as well as non-cumulative, perpetual preferred stock in Tier I capital, subject to a limit of 25% of Tier 1 capital.

⁶ Includes common stock, related surplus and retained earnings, including capital reserves and adjustments for the cumulative effect of foreign currency translation, net of any treasury stock.

⁷ Adjustable-rate non-cumulative perpetual preferred stock may be included but *not* auction rate perpetual preferred stock (although this may be included in Tier 2 capital). Banks are also asked to avoid placing undue reliance on such preferred stock as a source of Tier 1 capital.

Sources: BANK OF ENGLAND, 1990a, p. 4;

JAPANESE MINISTRY OF FINANCE, 1988;

FEDERAL RESERVE SYSTEM, Board of Governors, 1989, Attachment II, p. 21.

TABLE 2

ALLOWABLE COMPONENTS OF TIER 2 (i.e. "SUPPLEMENTARY") CAPITAL

UK APPROACH	JAPANESE APPROACH	US APPROACH ¹²
<p>1. Undisclosed reserves and unpublished current year's retained profits¹</p> <p>2. Reserves arising from the revaluation of tangible fixed assets² and, from 1 January 1993, of fixed asset investments (currently included in Tier 1 capital)</p> <p>3. General provisions (i.e. those held against possible or latent loss but where these losses have not as yet been identified), subject to a limit^{3,4}</p> <p>4. Hybrid capital instruments</p> <p>(i) Perpetual, cumulative preferred shares, including such shares redeemable at the option of the issuer and with the prior consent of the Bank, and such shares convertible into ordinary shares</p> <p>(ii) Perpetual subordinated debt which meets the conditions for "primary" perpetual subordinated debt (see Bank of England, 1986), including such debt which is convertible into equity</p> <p>5. Subordinated term debt, subject to a limit⁵</p> <p>(i) Dated preferred shares (irrespective of original maturity)</p> <p>(ii) Convertible subordinated bonds not included in 4(ii) above</p> <p>(iii) "Allowable" subordinated term loan capital⁶</p> <p>6. Minority interests arising on consolidation from interests in Tier 2 capital items.</p>	<p>1. 45% of latent revaluation reserves related to securities holdings</p> <p>2. General loan loss reserves, subject to a limit⁷</p> <p>3. "Allowable" hybrid capital instruments.⁸</p> <p>(i) Convertible subordinated bonds</p> <p>(ii) Perpetual, cumulative preferred stock and limited life redeemable preferred stock</p> <p>4. "Allowable" subordinated term debt,⁹ subject to a limit¹⁰</p> <p>(i) Subordinated loans¹¹</p> <p>(ii) Subordinated bonds</p>	<p>1. Allowance for loan and lease losses,¹³ subject to a limit¹⁴</p> <p>2. Hybrid capital instruments and qualifying¹⁵ mandatory convertible debt securities in the form of equity-contract notes</p> <p>3. Perpetual preferred stock¹⁶</p> <p>4. Subordinated debt and intermediate-term preferred stock (with an original weighted average maturity of five years or more),¹⁷ subject to a limit¹⁸</p>

Sources: BANK OF ENGLAND, 1990a, pp. 4-5; JAPANESE MINISTRY OF FINANCE, 1988; BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, 1989, Attachment II, p. 21.

Notes:

¹ Undisclosed reserves will only be allowed until the end of 1992, in accordance with the EC's "Bank Accounts Directive" (1986). (N.b. Funds for "general banking risks" are not relevant in the UK.) Unpublished current year's retained profits must be verified by internal audit from 1 January 1993.

² Capitalised property revaluation reserves can, however, be counted as Tier 1 capital until 1 January 1993.

³ At the moment, the limit is up to 1.5% of weighted risk assets until the end of 1992 and 1.25% of weighted risk assets thereafter. Provisions earmarked or held specifically against lower valuations of particular claims or classes of claims are *not* included in capital.

⁴ This policy remains in force pending further agreement in Basle on a more precise definition of unencumbered provisions. (For the latest Basle Committee proposals see BIS, 1991.)

⁵ *i.e.* up to 50% of Tier 1 capital.

⁶ *i.e.* it has an original term to maturity of over five years and otherwise meets the conditions set out in Bank of England, 1986 (*e.g.* it is subject to a straight line amortisation in the last five years, leaving no more than 20% of the original amount outstanding in the final year before redemption).

⁷ *i.e.* up to 1.5 percentage points of weighted risk assets for the period running from the end of fiscal 1990 to prior to the end of fiscal 1992 (*i.e.* 31 March 1993) and 1.25 percentage points of weighted risk assets thereafter.

⁸ *i.e.* they must be unsecured, subordinated, fully paid-up, available to participate in losses and redeemable only at the initiative of the issuer.

⁹ *i.e.* it must have an original term to maturity of over five years and be subject to straight line amortisation in the last five years.

¹⁰ This limit, which comes into force only at the end of fiscal 1992, is a maximum of 50% of Tier 1 capital.

¹¹ The recipients are confined to banks which abide by the BIS capital adequacy "rules" and the lenders must be financial institutions whose business is lending money.

¹² For state member banks (although basically the same approach is adopted with respect to bank holding companies).

¹³ Excluding "allocated transfer risk reserves" and reserves created against identified losses.

¹⁴ *i.e.* up to 1.25 percentage points of weighted risk assets from the end of 1992 (for transitional arrangements see Table 8). Amounts in excess of limitations are permitted but do not qualify as capital.

¹⁵ *i.e.* those that meet the criteria set out in Regulation Y (12 CFR 225), Appendix B.

¹⁶ Including related surplus and long-term preferred stock with an original maturity of 20 years or more (with maturity being defined as the earliest date at which the holder can put the instrument back to the issuing bank).

¹⁷ Such instruments must be amortised for capital purposes as they approach maturity, and those with a remaining maturity of less than one year are excluded from Tier 2 capital. Prior approval from the Federal Reserve must also be received if banks wish to redeem subordinated debt before the stated maturity.

¹⁸ *i.e.* a combined maximum of 50 per cent of Tier 1 capital.

TABLE 3

TYPE OF DEDUCTION	DEDUCTIONS TO BE MADE FROM CAPITAL		
	UK APPROACH	JAPANESE APPROACH	US APPROACH ⁴
Deductions from Tier 1	(i) Goodwill and other intangible assets ¹ (ii) Current year's unpublished losses	(i) Goodwill	(i) Goodwill ⁵
Deduction from Total Capital (<i>i.e.</i> Tier 1 + Tier 2 capital)	(i) Investments in unconsolidated subsidiaries and associates (ii) Connected lending of a capital nature (iii) All holdings of other banks' and building societies' capital instruments ²	(i) "Intentional" reciprocal holdings ⁶ of capital instruments of banks aimed at raising capital ratios (ii) "Intentional" reciprocal holdings of banking organisations' capital securities ⁶ (iii) Investments ⁷ in unconsolidated subsidiaries (iv) Other deductions (such as other subsidiaries or joint ventures) as determined by supervisory authority	(i) "Intentional" reciprocal holdings of banking organisations' capital securities ⁶ (ii) Investments ⁷ in unconsolidated subsidiaries (iii) Other deductions (such as other subsidiaries or joint ventures) as determined by supervisory authority

Sources: BANK OF ENGLAND, 1990a, pp. 4-5; JAPANESE MINISTRY OF FINANCE, 1988; FEDERAL RESERVE SYSTEM, Board of Governors, 1989, Attachment II, p. 21.

Notes:

¹ This includes mortgage servicing rights unless it can be demonstrated that there is an active and liquid market in which they can be reliably traded (as in the US). Existing concessions (as set out in Bank of England, 1986), which apply to primary and secondary market makers in such instruments, will remain in place after 1992 but will be subject to amendment to accommodate Articles 2(12) and 2(13) of the EC's Own Funds Directive of April 1989.

² All such holdings are, in principle, to be deducted, although individual banks are given the opportunity to explain to the authorities why this should not occur.

³ For state member banks: the treatment of bank holding companies differs to the extent that, until the end of 1992, the latter may count goodwill acquired before 12 March 1988 as Tier 1 capital.

⁴ Except previously-grandfathered goodwill approved in supervisory mergers.

⁵ This may be done on a case-by-case basis or as a matter of policy after formal rule-making.

⁶ Generally, investments for this purpose are defined as equity and debt capital investments and any other instruments that are deemed to be capital in the particular subsidiary.

⁷ "Advances", even if deemed not to be capital may, however, also be deducted at the discretion of the Federal Reserve.

RISK WEIGHTS TO BE APPLIED TO ASSET ITEMS

Asset Item	BIS-Recommended Risk Weight (%)	Risk Weight Applied in the UK (%)	Risk Weight Applied in Japan (%)	Risk Weight Applied in the US (%)
1. Cash ¹	0	0	0	0
2. Gold	0	0	0	0
3. Loans to OECD ² central governments and central banks including claims on the European Communities	0 ³	0	0	0 ²⁴
4. Claims fully-collateralised by cash	0	0	0	20
5. Claims fully-guaranteed by OECD central governments and central banks	0 ⁴	0	0	0 ^{25,26}
6. Loans to non-OECD central governments and central banks denominated in local currency and funded in that currency	0 ⁵	0	0	0
7. Loans guaranteed by non-OECD central governments or central banks, where denominated and funded in local currency	0 ⁶	0	Not available	0 ²⁶
8. Holdings of fixed interest securities issued (or guaranteed) by OECD central governments with a residual maturity of up to one year, and floating rate and index-linked OECD central government securities of any maturity	Zero or a "low" weight (e.g. up to 20%) if an interest rate risk proxy is applied ⁷	10	0	0
9. Claims fully-collateralised by OECD central government fixed interest securities of up to one year, and similar floating rate securities of any maturity	Zero or a "low" weight ⁸	10	0	20 ²⁷
10. Holdings of non-OECD central government securities with a residual maturity of up to one year denominated in local currency and funded by liabilities in the same currency	Zero or a "low" weight ⁹	10	0	0
11. Holdings of OECD central government (guaranteed) fixed interest securities of a residual maturity of over one year or claims collateralised by such securities	Zero or a "low" weight ¹⁰	20	0	0 and 20 respectively
12. Holdings of non-OECD central government securities of a maturity of over one year denominated in local currency and funded by liabilities in the same currency	Zero or a "low" weight ⁹	20	0	0
13. Claims on multilateral development banks ¹¹ and claims fully-guaranteed by or fully-collateralised by the securities issued by these institutions	0, or 20	20	20	20
14. Claims on credit institutions incorporated in the OECD and claims guaranteed (or accepted or endorsed) by OECD-incorporated credit institutions ¹²	20 ¹³	20	20	20 ²⁸
15. Claims on credit institutions incorporated outside the OECD with a residual maturity of up to one year and claims of the same maturity guaranteed by non-OECD credit institutions	20 ¹⁴	20	20	20
16. Claims on OECD public-sector entities (excluding central government) and claims guaranteed by such entities ¹⁵	0, 20 or 50	20 ¹⁴	10 or 20 ¹⁷	20, 50 or 100 ²⁹
17. Cash items in the process of collection	20	20	20	20
18. Loans fully secured by mortgage on residential property owned or rented out by the borrower	50	50 ¹⁸	50 ¹⁹	50 ²⁰
19. Claims on the non-bank private sector	100	100	100	100
20. Claims on credit institutions incorporated outside the OECD with a residual maturity of over one year	100	100	100	100
21. Claims on central governments and central banks outside the OECD (unless denominated in the national currency and funded in that currency)	100	100	100	100
22. Claims guaranteed by non-OECD central governments or central banks which are not denominated in local currency and funded locally	100	100	100	100
23. Claims on commercial companies owned by the public sector	100	100	100	100
24. Claims on PSEs outside the OECD	100	100	100	100
25. Premises, plant, equipment and other fixed assets	100	100	100	100
26. Capital instruments issued by other banks (unless deducted from capital)	100	Not applicable ²⁰	100	100
27. Real estate, trade investments ²¹ and other assets not otherwise specified ²²	100	100	100	100 ^{31,32}
28. Aggregate net-short open foreign exchange position	Not specified	100 ²³	Not applicable	Not applicable

Notes: ¹ Denominated in local and foreign currency. ² Comprises countries which are full members of the OECD or which have concluded special lending arrangements with the IMF under the Fund's "General Agreements to Borrow". In BANK OF ENGLAND 1990b these countries are classified "Zone A" countries.

³ The original BIS-recommended risk weight was 100% unless the claim was on a domestic central bank or domestic central government.

⁴ The original BIS-recommended risk weight was 100% unless the claims were fully-guaranteed by domestic central governments.

⁵ The original BIS-recommended risk weight was 20% and this applied to such loans given to any foreign central government.

⁶ The original BIS-recommended risk weight was 100% as this item was not identified and hence fell within the category of "all other assets".

⁷ The initial BIS view was that such claims on foreign central governments (unless in local currency financed by local currency liabilities - in which case the recommended risk weight was 20%) should attract a risk weight of 100%. Holdings of domestic central government securities, however, were to have been subject to either a zero or "low" risk weight, according to whether or not attempts were being made to take account of "investment risk" by incorporating an interest rate risk proxy.

⁸ Under its initial proposals, these weights would only have been applied to such claims fully-collateralised by domestic central government securities; a risk weight of 100% would have applied in all other cases.

TABLE 4 NOTES

⁹ The initial BIS-recommended risk weight was 20% and this would have been applied to all such claims on foreign central governments.

¹⁰ See notes 7 and 8 for the initial stance adopted by the BIS.

¹¹ As far as the Bank of England is concerned, the list comprises the IBRD (including the IFC), the IADB, the AsDB, the AfDB, the EIB, the EBRD, the CDB and the NIB. (For an explanation of the abbreviations used see BANK OF ENGLAND, 1990b, Annex 6, p. 15.)

¹² The Bank of England includes building societies within this context.

¹³ Initially, the BIS took the view that this weight should only apply to claims on domestic and foreign banks with an original maturity of under one year and to claims on domestic banks with an original maturity of one year and over and to loans guaranteed by domestic banks. All other claims and banks would have attracted a risk weight of 100%.

¹⁴ Loans with a residual maturity of one year guaranteed by non-OECD banks were not separately distinguished in the original BIS paper and so, presumably, would have attracted a risk weight of 100%.

¹⁵ In the UK such entities (PSEs) are defined as regional governments, local authorities and "other PSEs", as identified in BANK OF ENGLAND, 1990b, Annex 5.

¹⁶ In line with Article 7(2) of the EC's "Solvency Ratio" Directive, the Bank will consider applying a zero weighting on a case-by-case basis.

¹⁷ The 10% weight applies to claims on Japanese local governments (as defined in the Local Autonomy Law) and Japanese government agencies (comprising those corporate bodies established by specific laws - but excluding corporations established according to commercial company legislation and agencies which conduct commercial business - and in which (a) the government is a majority shareholder or (b) the government is a shareholder and whose budgets and settlements of account are subject to the approval of the Diet or of the Minister in charge). (Local government securities which are serviced only from the revenue obtained from a specific undertaking are excluded.) It also applies to claims guaranteed by Japanese local governments and Japanese government agencies. The 20% weight applies to claims on and loans guaranteed by non-domestic PSEs.

¹⁸ In the UK, this weight only applies to such loans (either to individuals or to housing associations registered with the Housing Corporation, Scottish Homes and Tai Cymru) where they are for the sole purpose of residential occupation and which are fully secured by a first equitable or legal charge.

The 50% weight is also applied to:

(a) Holdings of securities issued by special purpose mortgage finance vehicles where the risk to the security holders is fully and specifically secured against residential mortgage loans which would themselves qualify for the 50% weight or by assets which qualify for a weight of less than 50% (from 1 January 1993 such claims will be weighted at 100%), as long as the mortgage loans are fully performing on origination of the vehicle;

(b) Mortgage sub-participations, where the risk to the sub-participating bank is fully and specifically secured against residential mortgage loans which would themselves qualify for the 50% weight.

¹⁹ In principle, the concessionary weight is restricted to the first mortgage; and loans to a body engaged in speculative residential construction or property development are given a risk weight of 100%, regardless.

²⁰ Because all such holdings are fully deducted from total capital - see Table 3.

²¹ In the UK, this excludes holdings of capital instruments issued by credit institutions which are deducted from total capital, and holdings of capital instruments of other financial institutions which must be deducted according to Articles 2(12) and 2(13) of the EC's "Own Funds" Directive.

²² In the UK, this excludes items in suspense, except items arising from transactions which can be identified with counterparties which attract a weight of less than 100% - these items will be treated in line with other claims on those counterparties. It also excludes the following items (in a UK context):

(a) Certificates of tax deposit (these attract a 0% risk weight);

(b) Loans to discount houses, gilt-edged market makers, institutions with a money-market dealing relationship with the Bank of England and those Stock Exchange money brokers which operate in the gilt-edged market, where the loans are secured on gilts, UK Treasury bills, eligible local authority and eligible bank bills, or London CDs (these attract a 10% risk weight);

(c) On balance sheet claims in gold and other bullion on the non-bank market-making members of the London Bullion Market Association (these currently attract a 20% risk weight, but from 1 January 1993 such claims will be weighted at 100% unless they are unconditionally, explicitly and irrevocably guaranteed by an OECD bank);

(d) Claims on and guaranteed (or accepted) by discount houses which are unsecured or secured on assets other than gilts, UK Treasury bills, eligible local authority and eligible bank bills, or London CDs (these also attract a risk weight of 20%); and

(e) Claims secured by cash deposited with and held by an agent bank acting for a syndicate of which the reporting institution is a member (they also receive a 20% weighting).

²³ This is a proxy weight for a bank's foreign exchange risk, and will remain in effect until an international framework for capturing foreign exchange risk is agreed. Net short open positions in gold, silver, platinum and palladium are included here pending further discussion with the banking community.

²⁴ Including loans to the US Treasury and US government "agencies" (defined as "instrumentalities of the US government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the US government"). The list of government agencies includes the Government National Mortgage Association, the Veterans Administration, the Federal Housing Association, the Export-Import Bank, the Overseas Private Investment Corporation, the Commodity Credit Corporation and the Small Business Administration.

²⁵ Including claims fully-guaranteed by the US Treasury and US government agencies (see note 24). Claims on, and the portions of claims that are guaranteed by, US "government-sponsored agencies" (defined as agencies "originally established or chartered to serve public purposes specified by the US Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the US government") attract a risk weight of 20 per cent.

²⁶ Claims conditionally guaranteed attract a risk weight of 20 per cent.

²⁷ This includes claims fully-collateralised by any securities issued or guaranteed by the US Treasury, the central governments of other OECD countries, US government-sponsored agencies or US government agencies.

²⁸ This includes claims on, and the portions of claims that are guaranteed by, US depository institutions (defined to include branches - foreign and domestic - of federally-insured banks and depository institutions chartered and headquartered in the 50 states of the US, the District of Columbia, Puerto Rico, the US territories and possession).

²⁹ General obligation claims on, and the portions of claims that are guaranteed by, the full faith and credit of local government and political subdivisions of the US and other OECD local governments, attract a 20 per cent risk weight. Revenue bonds or similar claims that are obligations of US state or local governments, or other OECD local governments, but for which the government entity is committed to repay the debt only out of revenues from the facilities financed, attract a risk weight of 50 per cent. Obligations issued by US state or local governments, or other OECD local governments (including industrial-development authorities and similar entities), repayable solely by a private party or enterprise, attract a risk weight of 100 per cent.

³⁰ To attract this risk weight, the loans must be fully secured by first liens on one-to four-family residential properties and have been made in accordance with prudent underwriting standards (including a conservative loan-to-value ratio), are performing in accordance with their original terms, and are not past due or in nonaccrual status. The 50 per cent weight also applies to certain privately-issued mortgage-backed securities representing indirect ownership of such loans.

³¹ The trade investments relate to those investments in any unconsolidated subsidiaries, joint ventures or associated companies - if they are not deducted from capital.

³² The 100 per cent risk weight does not apply to:

(i) certain privately-issued securities representing indirect ownership of mortgage-backed US government agency or US government-sponsored agency securities (these attract a risk weight of 20 per cent);

(ii) investments in shares of a fund whose portfolio is permitted to hold only securities that would qualify for the zero or 20 per cent risk categories (these also attract a risk weight of 20 per cent).

Sources: BANK OF ENGLAND, 1990b, Annex 1, pp. 7-9; BIS, 1987; HALL, 1990b; JAPANESE MINISTRY OF FINANCE, 1988; FEDERAL RESERVE SYSTEM, Board of Governors, 1989, Attachment III, pp. 22-3.

TABLE 5

CREDIT CONVERSION FACTORS TO BE APPLIED TO BANKS'
OFF BALANCE SHEET TRANSACTIONS TO DETERMINE
THE CORRESPONDING "DEEMED CREDIT RISK EQUIVALENTS"

Instruments	Credit conversion factor applied in the UK, the US and Japan (%)
1. Direct credit substitutes, including general guarantees of indebtedness, standby letters of credit serving as financial guarantees, acceptances and endorsements (including <i>per aval</i> endorsements)	100
2. Sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank	100
3. Forward asset purchases, forward deposits placed and the unpaid part of partly-paid shares and securities, and any other commitments with a certain drawdown	100
4. Certain transaction-related contingent items not having the character of direct credit substitutes (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions)	50
5. Short-term, self-liquidating, trade-related contingent items (e.g. documentary credits collateralised by the underlying shipments)	20
6. Note issuance facilities and revolving underwriting facilities	50
7. Other commitments (e.g. formal standby facilities and credit lines) with an original maturity of over one year	50
8. Similar commitments with an original maturity of up to one year, or which can be unconditionally cancelled at any time	0
9. Endorsements of bills (including <i>per aval</i> endorsements) which have previously been accepted by a bank	0

Sources: BANK OF ENGLAND, 1990b, Annex 2, p. 10;
JAPANESE MINISTRY OF FINANCE, 1988;
FEDERAL RESERVE SYSTEM, Board of Governors, 1989, Attachment IV, p. 24.

TABLE 6

CONVERSION FACTORS TO BE USED TO DETERMINE THE "DEEMED CREDIT RISK EQUIVALENTS" ASSOCIATED WITH INTEREST RATE-RELATED AND EXCHANGE RATE-RELATED OFF BALANCE SHEET ACTIVITIES (ACCORDING TO THE CURRENT EXPOSURE METHOD*) BY UK-INCORPORATED, JAPANESE AND US STATE MEMBER BANKS AND BANK HOLDING COMPANIES¹

Residual Maturity	Interest Rate Contracts	Exchange Rate Contracts
One year or less	0	1.0%
Over one year	0.5%	5.0%

Sources: BANK OF ENGLAND, 1990b, Annex 3, p. 11; JAPANESE MINISTRY OF FINANCE, 1988; FEDERAL RESERVE SYSTEM, Board of Governors, 1989, Attachment IV, p. 24.

* This method has to be adopted by all US state member banks and bank holding companies. In Japan and the UK, however, the *original exposure method* may instead be adopted by some banking organisations. (For details of the conversion factors to be used by these banks see Table 7.)

¹ In the US, exchange rate contracts with an original maturity of 14 days or less and instruments traded on exchanges that require daily payment of variation margin are excluded from the risk-based ratio calculation.

TABLE 7

CONVERSION FACTORS TO BE USED BY THOSE JAPANESE AND UK BANKS ALLOWED TO ADOPT THE ORIGINAL EXPOSURE METHOD FOR DETERMINING THE "DEEMED CREDIT RISK EQUIVALENTS" ASSOCIATED WITH INTEREST RATE-RELATED AND EXCHANGE RATE-RELATED OFF BALANCE SHEET ACTIVITIES

Maturity	Foreign Exchange Related Transactions	Interest Rate Related Transactions
One year or less	2.0%	0.5%
Over one year	*	**

* 3.0% times years of original maturity minus 1.0%.

** 1.0% times years of original maturity minus 1.0%. (Fractions of years count as one whole year.)

Sources: BANK OF ENGLAND, 1990b, Annex 3, p. 12; JAPANESE MINISTRY OF FINANCE, 1988.

THE DISCRETION EXERCISED DURING THE TRANSITIONAL PERIOD:
A CONTRAST OF THE APPROACHES ADOPTED IN THE UK, THE US AND JAPAN

The Bounds of Discretion ¹	The UK approach		The Japanese Approach		The US Approach ¹⁶	
		The level prevailing at end-1987 ²	The level prevailing at end-1987 ³	The level prevailing at end-1987 ³	None	None
1. Minimum standard for the risk asset ratio (RAR)		The level prevailing at end-1987 ²	The level prevailing at end-1987 ³	The level prevailing at end-1987 ³	None	None
(a) Initial position:	8% ⁴	8% ⁴	7.25% ⁵	7.25% ⁵	7.25% ⁵	8% ¹⁷
(b) End-1990 position:	8.0%	8% ⁴	8% ⁴	8% ⁴	8% ⁴	8% ¹⁷
(c) End-1992 position:	8.0%	8% ⁴	8% ⁴	8% ⁴	8% ⁴	8% ¹⁷
2. Measurement formula for the RAR		Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸
(a) Initial position:	core elements plus 100%	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸
(b) End-1990 position:	core elements plus 100%	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸
(c) End-1992 position:	core elements plus 100%	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸	Core elements plus 100% ⁸
3. Supplementary elements of capital allowed to be included in core		None ¹²	None ¹²	None ¹²	None ¹²	None ¹²
(a) Initial position:	maximum 25% of total core	None ¹²	None ¹²	None ¹²	None ¹²	None ¹²
(b) End-1990 position:	maximum 10% of total core (i.e. 0.3625%)	None ¹²	None ¹²	None ¹²	None ¹²	None ¹²
(c) End-1992 position:	none	None ¹²	None ¹²	None ¹²	None ¹²	None ¹²
4. Limit for inclusion within supplementary capital of general loan loss reserves/general provisions which reflect lower valuations of assets or latent but unidentified losses present in the balance sheet ⁹		None	None	None	None	None
(a) Initial position:	no limit	None	None	None	None	None
(b) End-1990 position:	up to 1.5 percentage points of risk-weighted assets or, exceptionally, up to 2.0 percentage points of risk-weighted assets	Up to 1.5% of risk-weighted assets ¹⁴	Up to 1.5% of risk-weighted assets ¹⁴	Up to 1.5% of risk-weighted assets ¹⁴	Up to 1.5% of risk-weighted assets ¹⁴	Up to 1.5% of risk-weighted assets ¹⁴
(c) End-1992 position:	up to 1.25 percentage points of risk-weighted assets or, exceptionally, up to 2.0 percentage points of risk-weighted assets	Up to 1.25% of risk-weighted assets ¹⁴	Up to 1.25% of risk-weighted assets ¹⁴	Up to 1.25% of risk-weighted assets ¹⁴	Up to 1.25% of risk-weighted assets ¹⁴	Up to 1.25% of risk-weighted assets ¹⁴
5. Limit on term subordinated debt in supplementary elements		Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²
(a) Initial position:	no limit	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²
(b) End-1990 position:	no limit	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²
(c) End-1992 position:	maximum of 50% of Tier 1	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²	Maximum of 50% of Tier 1 ¹²
6. Deduction for goodwill from core capital		Deducted	Deducted	Deducted	Deducted	Deducted
(a) Initial position:	discretionary	Deducted	Deducted	Deducted	Deducted	Deducted
(b) End-1990 position:	discretionary	Deducted	Deducted	Deducted	Deducted	Deducted
(c) End-1992 position:	compulsory	To be deducted	To be deducted	To be deducted	To be deducted	To be deducted

Sources: BANK OF ENGLAND, 1990a and 1990b; BIS, 1987; HALL, 1990b; JAPANESE MINISTRY OF FINANCE, 1988; FEDERAL RESERVE SYSTEM, Board of Governors, 1989, Attachment VI, p. 26.

Notes:

- As set out in the BIS document of December 1987 (Annex 4). It is important to note, however, that the Japanese authorities have interpreted the calendar years as fiscal years, thereby allowing themselves an extra three months' period of grace in each case.
- In practice, the agreed minimum "trigger" (HALL, 1990b) RARs are likely to have been substantially in excess of this level.
- For those institutions which needed to improve capital levels to attain the interim and final standards (not even temporary diminutions in capital levels were allowed).
- The minimum ratio of eight per cent became effective at the end of June 1989. Henceforth, all "trigger" RARs had to be in excess of this level, with each bank agreeing, on an individual basis, with the Bank of England what its actual "trigger" RAR should be for the ensuing period.
- Again, in practice, the individually-agreed minimum trigger RARs are likely to be substantially in excess of eight per cent for most, if not all, banks.
- This minimum is also likely to be a *de facto* maximum requirement for most, if not all, institutions and no attempt will be made to differentiate between banks so as to tailor requirements to their particular circumstances.
- Including supplementary elements up to a maximum of 25% of core capital.
- From the date of application of the new RAR methodology (i.e. end-June 1989), the minimum trigger RARs became subject to a floor of eight per cent, with a minimum of half of this (i.e. four percentage points) to be represented by core capital. Prior to this date, trigger RARs were calculated using the methodology set out in HALL, 1990b.
- Including supplementary elements up to a maximum of 25% of core capital (including supplementary elements).
- This contribution from core elements includes supplementary elements up to a maximum of 10% of core capital (including supplementary elements).
- Once the new regime took effect at the end of June 1989.
- The limits apply until agreement is reached on a consistent basis for including unencumbered provisions or reserves in capital. (For the latest proposals which push back the end-1992 requirement until the end of 1993 but narrow the limit to a strict 1.25% of weighted risk assets, see BIS 1991.)
- This limit only applies to general provisions which are held against possible or latent loss but where these losses have not yet been identified. All provisions held against value-impaired assets, including provisions against problem country debt, are excluded from capital.
- This limit (equivalent to a limit of 25% of the capital base) was introduced at the end of June 1989 and contrasts with the previous limit applied of 33 1/3% of the capital base (HALL, 1990b).
- For state member banks; the main difference in their treatment *vis-à-vis* that of bank holding companies is that the latter, until the end of 1992, can count goodwill acquired before 1.2 March 1988 as Tier 1 capital (i.e. no deduction is required).
- This is very much a minimum. In general, banking organisations will be expected to operate well above this level, particularly if they are contemplating significant expansion or have high or inordinate levels of risk.
- Including supplementary elements up to a maximum of 25 per cent of the sum of Tier 1 capital plus goodwill.
- Including supplementary elements up to a maximum of 10 per cent of the sum of Tier 1 capital plus goodwill.
- In the US, the limits relate to "allowances for loan and lease losses".
- In the US, this limit relates to subordinated debt and intermediate-term preferred stock.