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APRA

17 September 2010

To All Authorised Deposit-taking Institutions (ADIs)

REFORMS TO GLOBAL MINIMUM CAPITAL STANDARDS ANNOUNCED

On 12 September 2010, the Group of Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee on Banking Supervision, announced a substantial strengthening of existing capital requirements for banking institutions. The full details of the reforms can be located on the Bank for International Settlements' website www.bis.org.

In brief, the reforms will increase the minimum common equity capital requirement from 2 per cent to 4.5 per cent. In addition, institutions will be required to hold a capital conservation buffer of 2.5 per cent to withstand future periods of stress, bringing the total common equity requirement to 7 per cent. The total Tier 1 capital requirement will be 8.5 per cent. The new capital requirements are to be phased-in from 1 January 2013.

These capital reforms, together with the introduction of a global liquidity standard, will be presented to the G20 Leaders Summit in Seoul in November. The Basel Committee will publish its final package of reforms in December 2010.

As a member of the Basel Committee, APRA has been actively involved in developing these global reforms and it fully supports the package announced by the GHOS. APRA has begun work on developing draft prudential standards, prudential practice guides and reporting requirements to give effect to these reforms in Australia. APRA anticipates that it will begin consultation on the reforms in 2011 and continue into 2012.

As part of this consultation, APRA will consult on appropriate transitional arrangements for ADIs. In our letter of 18 December 2009, APRA flagged that capital instruments that are issued subsequent to the release of the Basel Committee's December 2009 Consultative Document, and that are clearly inconsistent with the proposals contained therein, would be unlikely to be eligible for transitional arrangements. A number of ADIs have sought further clarity on this matter. APRA can confirm that:

- Tier 1 and Tier 2 capital instruments that are issued subsequent to the publication of the December 2009 Consultative Document and contain so-called 'incentives to redeem' or other features clearly at odds with the proposals will not be eligible for whatever transitional arrangements are ultimately determined; but
- capital instruments issued subsequent to the December 2009 Consultative Document need not, at this stage, include clauses that give effect to the Basel Committee's proposals to improve the loss-absorbency of regulatory capital, as described in the Consultative Document of 19 August 2010.

Yours sincerely,

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