Basel III – Enhancements to the capital management framework

Cape Town, South Africa

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Standard Bank

Contents

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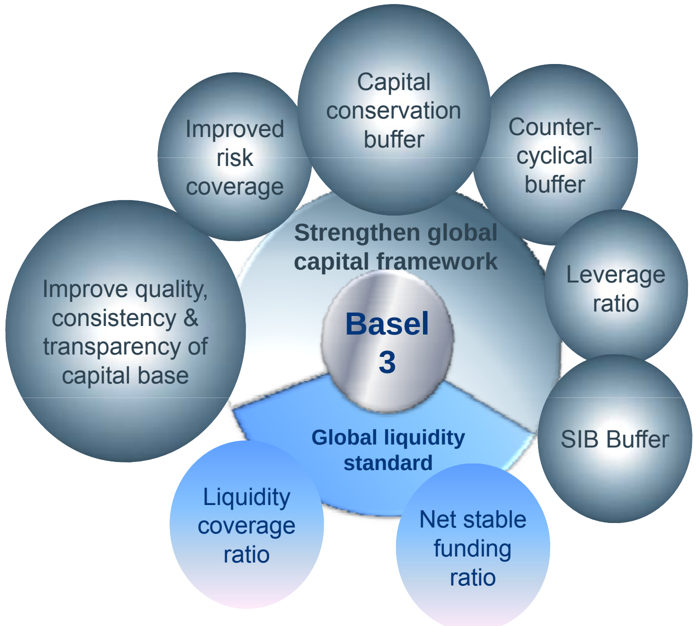
1. Overview

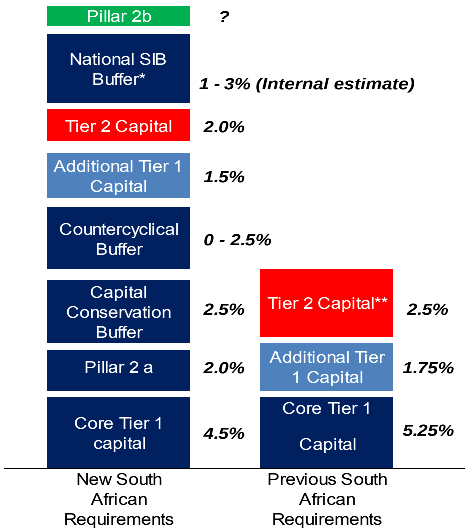


Overview cont.

Overview

- Basel III will be implemented in South Africa starting 2013
  - Focus on improving the quality and consistency of capital, with particular emphasis on Common Equity Tier 1 (CET 1) capital.
  - Existing Tier 2 capital instruments to be grandfathered over 10 years (at 10% p.a.) starting 2013.
  - Introduction of a capital conservation buffer (to decrease pro-cyclicality of capital) and a countercyclical buffer (buffer required in times of excessive credit growth at the discretion of the regulator).
  - Introduction of a Systemically Important Banks (SIB) buffer for national SIBs.
  - Introduction of a leverage ratio requirement, to constrain build up of excessive banking sector leverage.
  - Introduction of the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) to ensure adequate sources of sufficiently liquid quality funding.
- South African Banks are expected to be in a position to meet the minimum Basel 3 requirements from a capital adequacy perspective. Challenges remain on the LCR(1 Jan 2015) and NSFR requirements (1 Jan 2018).
- The Basel 3 grandfathering proposals will necessitate a relook at non CET 1 capital instruments by issuers.

2. Capital Requirements and Buffers



* To be met with core equity tier I

** Includes Pillar 2a

- The "Big 4" SA Banks RWA as at December 2011 stood at approximately R 2 trillion
- The new Basel III minimums would imply capital requirements for the "Big 4" banks of:
  - **Additional Tier 1:**
    - **R 30bn**
    - **(Dec '11 outstanding: ~ R20bn)**
  - **Tier 2:**
    - **R 40bn**
    - **(Dec '11 outstanding: ~ R49bn)**
  - **Capital Conservation Buffer:**
    - **R50bn**
- Any additional buffers would naturally result in increased capital requirements

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3. Regulatory adjustments

Material changes to the definition of capital include:

- Additional deductions applied against CET1:
  - Significant investments and Deferred tax assets that arise from temporary differences above10% of the bank's common equity deducted from CET1 and the amounts below the 10% threshold are risk weighted,
  - Expected loss shortfall is no longer deducted on a 50:50 Tier I/Tier II basis but rather fully deducted from CET1.
  - Deductions for cash flow hedge reserve, defined benefit pension fund assets and debit valuation adjustments have been introduced.
- Minority Interest is now subject to a deduction equivalent to the pro-rata contribution of minority shareholders in the surplus capital of the subsidiary.
- Securitisation exposures –first loss credit enhancement risk weighted instead of being deducted on a 50:50 Tier I/Tier II basis.

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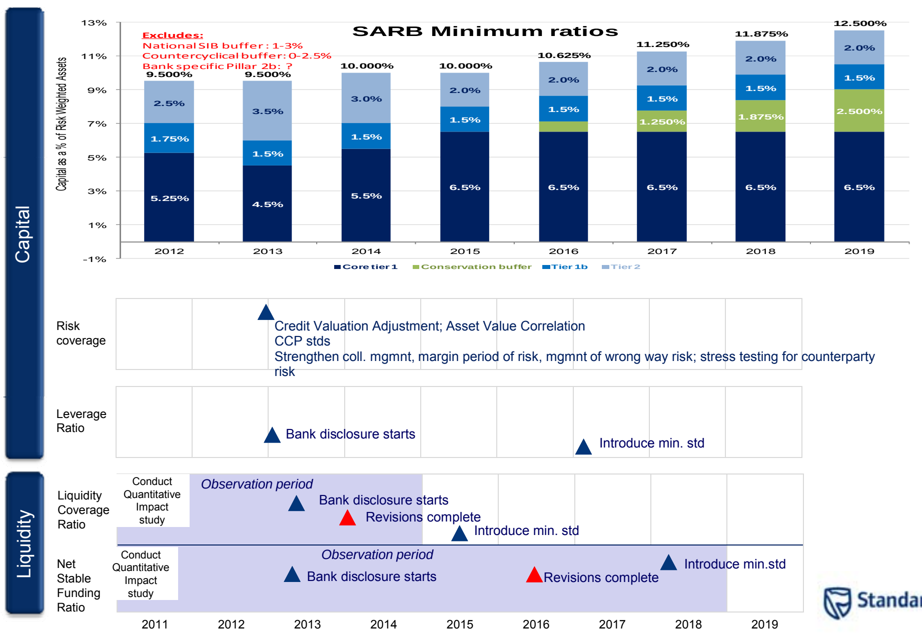
4. Phase-in Arrangements



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5. SARB – 2019 Minimum Capital Requirement

	Core Tier 1 %	Tier 1 %	Total %
BIS Minimum	4.5	6.0	8.0
SARB Pillar 2a	2.0	2.0	2.0
	6.5	8.0	10.0
BIS Capital Conservation Buffer	2.5	2.5	2.5
	9.0	10.5	12.5
BIS Countercyclical Capital Buffer	0 - 2.5	0 - 2.5	0 - 2.5
	9.0 -11.5	10.5 -13.0	12.5 - 15.0
National Systemic Important Banks Buffer (SIB)	1 - 3	1 - 3	1 - 3
	10.0 -14.5	11.5 -16.0	13.5 – 18.0
Pillar 2b	?	?	?
TOTAL	**10.0 –14.5**	**11.5 – 16.0**	**13.5 – 18.0**

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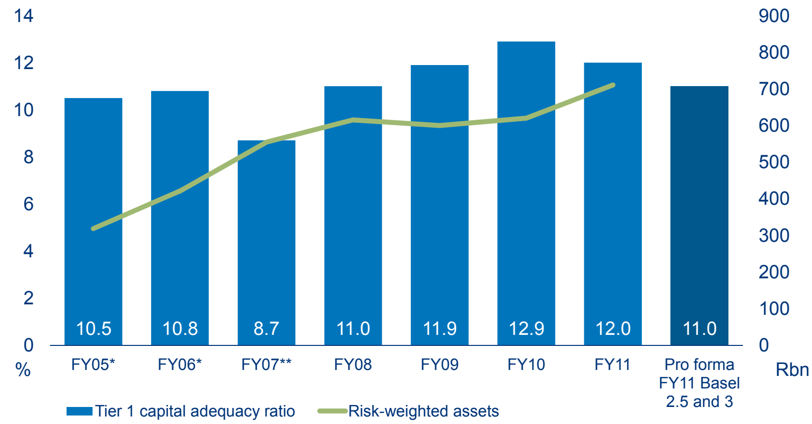
6. Standard Bank Group capital adequacy



** Basel 1basis* *** Pro forma Basel 2 basis*

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7. Basel III qualification criteria for capital instruments

Additional Tier I capital

1. Issued and **paid-in.**
2. **Perpetual,** i.e. there is no maturity date and there are no step-ups or other incentives to redeem with **minimum original maturity of at least 5 years**.
3. Subordinated to depositors, general creditors and subordinated debt of the bank.
4. Neither secured/covered/guaranteed by the issuer that legally or economically enhances the seniority of the claim.
5. The bank must have full discretion at all times **to cancel distributions/payments.** Distributions should be paid out of distributable reserves.
6. Terms and conditions to contain provision that require the instrument at the option of the regulator to be **written off or converted into equity** upon the occurrence of the trigger event, unless duly enforceable legislation is in place.
7. Trigger as a minimum shall be the earlier of (i) **decision by the regulator that a write-off is necessary** without which the bank would become non-viable, or (ii) **decision to make a public sector injection of capital** or equivalent support without which the bank would become non-viable.

Tier 2 Capital

1. Issued and **paid-in.**
2. Subordinated to depositors and general creditors of the bank.
3. Neither secured/covered/guaranteed by the issuer that legally or economically enhances the seniority of the claim.
4. Maturity: a. **minimum original maturity of at least five years**
   b. recognition in regulatory capital in remaining five years before maturity - **amortised** on a straight line basis
   c. there are **no step-ups** or other incentives to redeem.
5. May be callable at the initiative of the issuer only after a minimum of five years: To exercise a call option a bank must receive prior **supervisory approval** and a bank must not do anything that creates an expectation that the call will be exercised.
6. Investor has no rights to accelerate the repayment of future scheduled payment, except in bankruptcy and liquidation.
7. The instrument **cannot have a credit sensitive dividend feature**, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.
8. Terms and conditions to contain provision that require the instrument at the option of the regulator to be **written off or converted into equity** upon the occurrence of the trigger event, unless duly enforceable legislation is in place.
9. Trigger as a minimum shall be the earlier of (i) **decision by the regulator that a write-off is necessary** without which the bank would become non-viable, or (ii) **decision to make a public sector injection of capit**al or equivalent support without which the bank would become non-viable.

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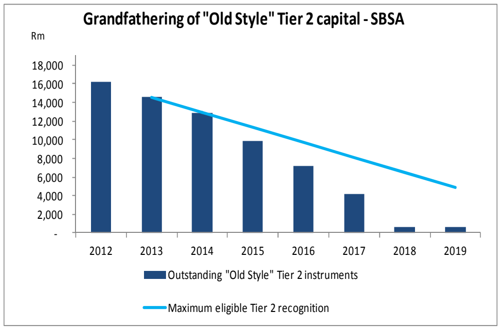
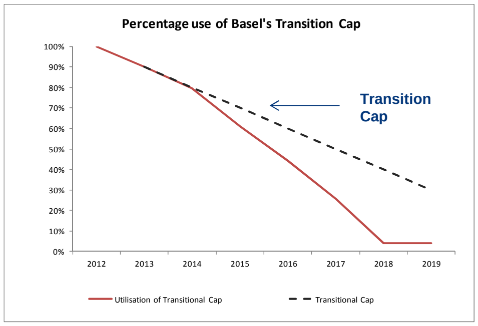
8. Grandfathering of capital instruments





- Existing Tier 2 capital instruments will be grandfathered from 2013 @ 10% per annum over 10 years
- Capital derecognition is not a concern for SBSA.

- SBSA's redemption profile ensures an optimal use of the transition cap in the initial years following Basel 3 implementation
- As fully compliant Basel 3 instruments are issued from 2013 onwards and old style Tier 2 instruments get called / redeemed the transition cap will become less relevant

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