INFORMATIVE NOTE

BANKING AND FINANCE

BASEL III ACCORD

Strengthening of the minimum requirements for capital reserves for banks

The new accord from the Basel Committee on Banking Supervision on the minimum requirements for capital reserves for banks is already seen as the most important reform to come out of the financial crisis that has left its mark on world markets. This accord, known as the Basel III Accord, has substantially altered the rules of the game for banks in member countries by contributing – it is hoped – to greater stability and growth in the world financial system.

Under the new rules set out in the Basel III Accord, banks will, in future, be required to maintain capital reserves greater than those currently required under Basel II. Namely, the capital ratio that makes up core Tier 1 will increase from the current 2% to a minimum level of 4.5%. Alongside this increase, the minimum ratio of Tier 1 total reserves goes from the current 4% to 6%.

A further innovation in the Basel III Accord is the introduction of 'buffers' or capital margins – namely capital conservation buffers and counter-cyclical buffers. The capital conservation buffers, which will reach a maximum value of 2.5% in 2019, are intended to provide a response to future stress periods in banking activity and to enable the banks to absorb losses in periods of greater economic and financial tension. The requirement for a phased setting up of these capital conservation buffers will, therefore, determine the effective increase in the minimum capital requirements to 8.625% as from 2006, up to the final value of 10.5% set for 2019.

The banks will be allowed to use these capital conservation buffers in the stress periods referred to above, but such use will imply the application of more restrictive rules to issues such as the distribution of dividends and the award of discretionary bonuses. As to counter-cyclical buffers, these are set between 0% and 2.5% and are intended to protect the bank from periods of greater excess in aggregate credit growth. They basically operate as an extension of the capital conservation buffers.

The Basel Committee has stated that systemically relevant banks (that is, whose problems may result in tensions for the financial system as a whole) should exceed the minimum requirements set out in the Basel III Accord. The Committee wants the banks to achieve the capital reserve targets that have now been set through

A further innovation in the Basel III Accord is the introduction of 'buffers' or capital margins – namely capital conservation buffers and counter-cyclical buffers.

"Portuguese Law Firm of the Year"
Chambers Europe Excellence 2009, IFLR Awards 2006 & Who's Who legal Awards 2006, 2008, 2009, 2010

"Corporate Law Firm of the Year - Southern Europe"
ACQ Finance Magazine, 2009

"Best Portuguese Law Firm for Client Service"
Clients Choice Award - International Law Office, 2008, 2010

"Best Portuguese Tax Firm of the Year"
International Tax Review - Tax Awards 2006, 2008

Mind Leaders Awards TM
Human Resources Suppliers 2007

PLMJ
A.M.PEREIRA, SÁRAGGA LEAL, OLIVEIRA MARTINS, JÚDICE E ASSOCIADOS
SOCIEDADE DE ADVOGADOS, RL

a reasonable retention of earnings as well as by having recourse to financing, not anticipating that these two activities may have negative consequences for the granting of credit by these banks to the remaining economic operators.

In summary, the new capital ratios and buffers now introduced reveal a clear concern not only about the need to manage the systemic risk that banking activity represents, but also the need to manage with greater prudence times of plenty in light of possible subsequent cycles of greater difficulty. Regardless of the compromises that these types of accords necessarily require, the speed with which the Committee produced this new Basel Accord merits praise, benefitting as it doubtless did from the greater political alignment that times of crisis demand. We hope that the regulatory objectives targeted by the Basel III Accord stand out over and above the few negative effects that will inevitably result from it and which the Committee has promised to monitor.

This Informative Note is intended for general distribution to clients and colleagues and the information contained herein is provided as a general and abstract overview. It should not be used as a basis on which to make decisions and professional legal advice should be sought for specific cases. The contents of this Informative Note may not be reproduced, in whole or in part, without the express consent of the author. If you should require further information on this topic, please contact
Mariana Villas-Boas-mavb@plmj.pt.