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CLIENT MEMORANDUM

September 13, 2010

Agreement on Quantification and Timing of Basel III Capital Standards

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision (the "Basel Committee Oversight Body" and the "Basel Committee," respectively), announced agreement on the calibration and phase-in of new capital standards proposed by the Basel Committee and the timing of their implementation (the "September 12 Press Release"). The capital standards and new capital buffers will require banks to hold more capital, predominantly in the form of common equity, than under current rules.[1] The new leverage and liquidity ratios, and the proposed, stricter criteria for inclusion in capital and for calculating risk-weighted assets, will lead to the same result.

The new capital, leverage and liquidity standards, commonly referred to as "Basel III," were first proposed in a pair of consultative documents released by the Basel Committee on December 17, 2009, Strengthening the Resilience of the Banking Sector and International Framework for Liquidity Risk Measurement, Standards and Monitoring (together, the "December 2009 Consultative Documents"), and modified as reported in the Basel Committee Oversight Body's July 26, 2010 press release (the "July 26 Press Release").

Undoubtedly influenced by concerns about the impact of higher capital requirements on bank lending and the current pace of economic recovery, the new capital standards will be phased in over a longer period than first expected: from January 1, 2013 until January 1, 2019. The timeline for implementation of the new requirements is summarized in Annex A to this memorandum.

In connection with the September 12 Press Release, the U.S. federal banking agencies issued a press release endorsing the calibration and phase-in agreements reached by the Basel Committee Oversight Body.

Higher Minimum Tier 1 Common Equity Requirement

- ***Higher Common Equity Ratio***. The minimum Tier 1 common equity ratio (Tier 1 common equity to total risk-weighted assets) will be increased by Basel III from 2% to 4.5%. The ratio will be set at 3.5% as of January 1, 2013, 4% as of January 1, 2014 and 4.5% as of January 1, 2015.
- ***Phase-in of Regulatory Adjustments***. The new common equity ratio will be calculated after applying certain regulatory adjustments, which will be phased in between January 1, 2014 and January 1, 2018. During this transition period, an increasing percentage of deductions will be made from common equity for purposes of calculating the Tier 1 common equity ratio, while the remaining, undeducted amount will continue to be subject to existing national rules.

New Capital Conservation Buffer

- ***New Capital Conservation Buffer***. Basel III introduces a new, additional capital conservation buffer to be used to absorb losses in periods of financial and economic stress. Banks that do not maintain the capital conservation buffer are subject to limitations on dividends and other earnings distributions, including discretionary compensation bonuses. The Basel III capital conservation

[1] Except where noted, the term 'banks' refers to banks and their respective holding companies.

buffer requires banks to maintain an additional 2.5% ratio of Tier 1 common equity – net of regulatory deductions – to total risk-weighted assets. Unlike the new countercyclical capital buffer discussed below, the capital conservation buffer must be met exclusively with common equity. As a result, banks will be required to have common equity equal to at least 7% of their risk-weighted assets – 4.5% common-equity ratio and the 2.5% capital conservation buffer.

- ***Phase-in of Capital Conservation Buffer***. The new conservation buffer will be phased in between January 1, 2016 and January 1, 2019, but banks that in that transition period are below the 7% common equity level are urged to maintain prudent earnings retention policies to meet the conservation buffer as soon as reasonably possible. In addition, national authorities can impose shorter transition periods and "should do so where appropriate," and countries that experience excessive credit growth are urged to accelerate the phase-in.

Higher Minimum Tier 1 Capital Requirement

- ***Higher Minimum Tier 1 Capital Ratio***. The minimum Tier 1 capital ratio (Tier 1 capital to total risk-weighted assets) will be increased from 4% to 6%. The ratio will be set at 4.5% as of January 1, 2013, 5.5% as of January 1, 2014 and 6% as of January 1, 2015.
- ***Predominance of Common Equity***. Among Tier 1 capital components, the "predominance" of common equity – which in the past, in the United States, has ranged from 50% of Tier 1 capital to 67% as a result of the U.S. SCAP stress tests and 75% in informal guidance in more recent capital increases by U.S. banks and bank holding companies – will now reach 82.3% of Tier 1 capital, inclusive of the capital conservation buffer.
- ***Other Components of Tier 1 Capital***. The September 12 Press Release did not specify which other financial instruments would qualify as Tier 1 capital, other than to refer to "other qualifying financial instruments based on stricter criteria."
- ***Relevance for U.S. "Adequately Capitalized" and "Well Capitalized" Standards***
  - In the U.S., insured depository institutions and bank holding companies currently must meet a minimum 4% Tier 1 capital ratio to be "adequately capitalized." However, under U.S. bank regulatory standards, insured depository institutions owned by financial holding companies (FHCs) must be "well capitalized," requiring a minimum 6% Tier 1 capital ratio, in order for their parent to engage in the expanded scope of activities permissible to FHCs. From July 2011, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the "well capitalized" requirement will also apply to the FHCs themselves, to thrift holding companies which seek to engage in the same scope of activities, as well as to the acquiring bank holding company and the resulting insured depository institution in an interstate bank merger.
  - It is unclear how U.S. banking regulators will define "adequately capitalized" and "well capitalized" in their implementation of Basel III in the United States. It is likely that the Tier 1 capital ratio will be set by reference to the Basel III minimum, requiring 6% for insured depository institutions and bank holding companies to be adequately capitalized, and a higher percentage to be well capitalized.
  - The capital conservation buffer discussed above would be separately added onto the 6% minimum, but we would not expect it to affect the "adequately capitalized" or "well capitalized" standards. According to the December 2009 Consultative Documents, failure to maintain the capital conservation buffer would result in constraints on distributions, but not operations, which suggests maintaining the buffer will likely be treated by U.S. banking regulators as a separate requirement, unrelated to the "well capitalized" standard.

- The joint press release issued by U.S. banking regulators suggests that they may informally begin implementing the Basel III standards even before the formal U.S. transition rules come into effect, stating that "supervisors will be evaluating an institution's capital adequacy on the basis of the then-applicable standards as well as the strength of an institution's plans to meet future standards as they come into effect."

Countercyclical Buffer

- The Basel Committee Oversight Body has also agreed on a countercyclical buffer, to be in effect during periods of excessive credit growth, that could require banks to hold up to an additional 2.5% of common equity ***or other fully loss absorbing capital***. The September 12 Press Release does not specify what form the "other fully loss absorbing capital" could take.
  - Based on the Basel Committee's July 16, 2010 consultative document, the Countercyclical Capital Buffer Proposal, the countercyclical capital buffer is expected to be imposed under rare circumstances only, estimated to occur once every 10-20 years.
  - Under those circumstances, the buffer would be set, for internationally active institutions, by each national authority with respect to the loan book and other credit exposures located in its jurisdiction, and would be applied on a consolidated level on a weighted average basis.
- Both the amount and timing of implementation of the counter-cyclical buffer are left to "national circumstances." The September 12 Press Release refers to a buffer in the range of 0% to 2.5% and states that whether such a buffer is in effect in "any given country" depends on whether "there is excess credit growth that is resulting in system wide build up of risk." Countries that experience excessive credit growth are encouraged to accelerate introduction of both the countercyclical buffer and the build-up of the capital conservation buffer.

Minimum Total Capital Ratio

- The Basel Committee Oversight Body leaves the minimum total capital ratio (sum of Tier 1 and Tier 2 capital ratios to risk-weighted assets) at 8.0%. However, the addition of the capital conservation buffer increases the total amount of capital a bank must hold to 10.5% of risk-weighted assets, of which 8.5% must be Tier 1 capital. Not only has common equity become the predominant form of Tier 1 capital; Tier 1 capital has become the predominant form of total capital.
  - The current Basel standards require that of the minimum total capital ratio of 8%, 4% must be Tier 1 capital. The same percentage is required for an institution to be "adequately capitalized" in the United States.
  - For an institution to be "well capitalized" in the United States, its total capital ratio currently must be at least 10%. As noted above, it is unclear what the new minimum ratios to be considered "well capitalized" will be.

Systemically Important Banks

The Basel Committee Oversight Body states that systemically important banks should have higher "loss absorbing capacity" than required by the new Basel III capital standards, and that it continues to work with the Financial Stability Board to develop a "well integrated approach," potentially including combinations of capital surcharges, contingent capital and bail-in debt, in addition to the work to strengthen resolution regimes. It refers to the Basel Committee's August 19, 2010 consultative document, the Proposal to Ensure the Loss Absorbency of Regulatory Capital at the Point of Non-viability, endorsing that proposal's "aim to strengthen loss absorbency of non-common Tier 1 and Tier 2 capital instruments." The Dodd-Frank Act also imposes similar general principles in these areas and, like Basel III, their eventual implementation will require rulemaking.

Phase-out of Outstanding Capital Instruments

- The September 12 Press Release details the phase-out for capital instruments issued before September 12, 2010 as follows:
  - Existing public sector capital injections will be grandfathered until January 1, 2018.
  - Capital instruments no longer qualifying as non-common equity Tier 1 capital or Tier 2 capital will be phased out over a 10-year period beginning on January 1, 2013, capping their recognition each year at a lower percentage of the original nominal amount outstanding on January 1, 2013. The recognition cap starts at 90% as of January 1, 2013, and is reduced by 10% in each succeeding year. In addition, instruments with an incentive to redeem prior to their stated maturity, if any, will be phased out at their effective maturity date.
    - Among the instruments that are likely not to meet the new requirements for Tier 1 capital are U.S.-style trust preferred securities and cumulative perpetual preferred stock.
    - For certain U.S. institutions, phase-out of these securities from inclusion in Tier 1 capital is scheduled to occur in a shorter time-frame under a provision of the Dodd-Frank Act informally known as the Collins Amendment. Under the Collins Amendment, trust preferred hybrid securities and cumulative perpetual preferred stock will be phased out of Tier 1 capital for U.S. bank holding companies with assets of $15 billion or more between January 1, 2013 and January 1, 2016.
  - Capital instruments that no longer meet the criteria for inclusion in Tier 1 common equity are excluded from Tier 1 common equity as of January 1, 2013, with an exception for non-joint stock companies: If these companies have issued instruments that are treated as equity under prevailing accounting standards, and for which they receive unlimited Tier 1 recognition under current national banking law, the phase-out of such instruments is the same as for capital instruments no longer qualifying as non-common equity Tier 1 capital and Tier 2 capital.

Other Transition and Phase-in Arrangements

- ***Transition for Revision to Risk Weightings***. The Basel Committee has not yet confirmed the time-frame for implementing the stricter asset risk weightings proposed in the December 2009 Consultative Documents, as modified by the July 26 Press Release, which may mean that these changes will be implemented at the end of 2012. The September 12 Press Release reaffirms the Basel Committee's agreement to introduce higher capital requirements on trading, derivatives and securitization activities at the end of 2011, as reported in the June 18, 2010 press release Adjustments to the Basel II Market Risk Framework Announced by the Basel Committee.
  - The U.S. regulators' implementation of the stricter asset risk weightings on trading, derivatives and securitization activities may be constrained by their obligations under Section 939A of the Dodd-Frank Act to remove references to external credit ratings from capital adequacy standards.
- ***Leverage Ratio***. As announced in the Basel Committee Oversight Body's July 26 Press Release, a non-risk-based leverage ratio will be phased in between 2013 and 2017, designed as a back-stop to the risk-based measures discussed above:
  - After a supervisory monitoring period beginning in January 2011, a parallel run period will extend from January 2013 to January 2017, applying a minimum leverage ratio of 3%.

  - After any final adjustments to the leverage ratio in the first half of 2017, the Basel Committee proposes to migrate the leverage ratio to a Pillar 1 treatment on January 1, 2018 after "appropriate review and calibration."

- ***Liquidity Ratios***. The July 26 Press Release proposed that the two liquidity ratios — the liquidity coverage ratio and the net stable funding ratio — would each undergo observation periods prior to their introduction as minimum standards. The September 12 Press Release confirms the Basel Committee's agreement on these transition rules.
  - The observation period of the liquidity coverage ratio will begin in 2011, and the liquidity coverage ratio itself will become effective on January 1, 2015.
  - The net stable funding ratio's observation period will begin in 2012 and the ratio will become effective on January 1, 2018.
  - The Basel Committee will implement "rigorous reporting processes" during the observation period to monitor the liquidity ratios and will "continue to review the implications of these standards for financial markets, credit extension and economic growth, addressing unintended consequences as necessary."

Market Impact Considerations

- ***Common Equity***. The Basel Committee Oversight Body expects, based on preliminary results of the Basel Committee's impact study, that, as of December 31, 2009, "large banks" needed to raise, in the aggregate, a "significant amount" of additional capital to meet the new capital standards, while smaller banks for the most part already met the requirements. Given the new predominance of common equity, a significant portion of these additional capital needs will have to be satisfied by raising common equity.
- ***Hybrid and Other Non-Common Equity Capital Products***. The new level of predominance of common equity is also likely to reduce the market for hybrid and other Tier 1 and Tier 2 capital products, given the reduced capacity of banks to count any such instruments towards capital. Among the uncertainties affecting this market is the question of the extent to which instruments satisfying the new Basel III requirements will be marketable, especially in light of the August 19, 2010 consultative document, which would mandate write-off or conversion features for all capital instruments at the point of non-viability of the bank. Clarification regarding the loss absorbency requirement for the countercyclical buffer, and regarding the features of contingent capital and bail-in debt that are being considered for systemically important banks, will help shape this potential new use for capital instruments.

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Annex A: Basel Committee — Timeline for Global Minimum Capital Standards

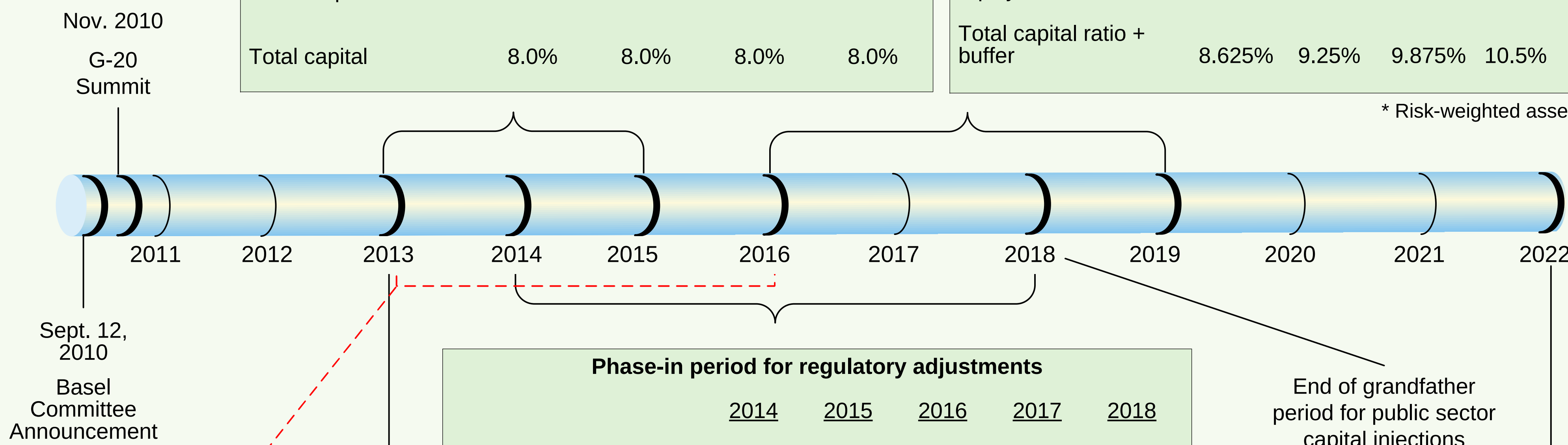
Phase-in period for minimum risk-based capital ratios

	Current	2013	2014	2015
Tier 1 common equity	2.0%	3.5%	4.0%	4.5%
Tier 1 capital	4.0%	4.5%	5.5%	6.0%
Total capital	8.0%	8.0%	8.0%	8.0%

Phase-in period for capital conservation buffer

	2016	2017	2018	2019
Tier 1 common equity/RWAs*	0.625%	1.25%	1.875%	2.5%
Total Tier 1 common equity ratio + buffer	5.125%	5.75%	6.375%	7.0%
Total capital ratio + buffer	8.625%	9.25%	9.875%	10.5%

* Risk-weighted assets



Collins Amendment Tier 1 regulatory capital phase-out period for hybrid securities and cumulative instruments for U.S. bank holding companies with assets of $15 billion or more

Phase-in period for regulatory adjustments

	2014	2015	2016	2017	2018
Required deductions from common equity	20%	40%	60%	80%	100%

End of grandfather period for public sector capital injections

Capital instruments that no longer qualify as Tier 1 common equity will generally be excluded from Tier 1 common equity as of January 2013.

Phase-out period for certain capital instruments that no longer qualify as Tier 1 capital or Tier 2 capital†

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Recognition of non-common equity instruments and certain non-joint stock company instruments that no longer qualify as common equity	90%	80%	70%	60%	50%	40%	30%	20%	10%	0%

† Capital instruments issued after September 12, 2010 do not benefit from the phase-out provisions.

This chart does not include timing for liquidity and leverage ratios.

All dates refer to January 1, except where noted.