

The End of Capital as We Know It

What Does The BIS Proposal Mean For Asia's Banks?

The New Capital Accord Benefits Large Banks and Will Spur Consolidation

- **New Capital Accord:** The Basel Committee of bank supervisors has released what is likely to be the final draft of its new capital adequacy framework, which will replace the existing 1988 risk-based capital methodology by 2004.
- **Much is the Same:** The concept of capital adequacy ratios (CAR), Tier 1 and Tier 2 capital will not change, and overall systemic capital requirements are expected to remain unchanged.
- **Key Changes:** There are, however, key changes which will impact Asian banks. Market and interest rate risk will become explicit factors in determining capital adequacy, and credit risk weights will become more fluid depending on the credit rating of the obligor. Banks will need well-developed internal models and processes to take advantage of the new system.
- **Asian Banks Lag Behind:** Overall, Asia has poor risk measurement and management systems and controls. This will need to change as a precondition to moving to the new capital measurement system, and we expect risk management to be a hot topic for the next several years.
- **Benefits to the Few:** The banks best positioned to benefit are those with robust existing systems for measuring risk across their portfolios (and making certain that they receive credit for offsetting exposures and hedges), as well as those with the highest proportion of A to AAA – rated borrowers, whose risk weighting will fall from 100% currently to as little as 20%. These are generally the largest and most international banks—HSBC, DBS, Hang Seng, and StanChart spring to mind.
- **Laggards Will Consolidate:** Bad news for bad banks: those with high risk and low capital will see their risk weightings rise from an automatic 20% to as high as 150%, effectively pricing them out of the interbank markets. We expect that this will spur mergers or takeovers of the weak. Alternatively, weak markets such as Thailand will go their own way, but be shut out of the international market.

INSIDE: New Risk Weightings, Risk-based Capital Primer, and more.

Paul Sheehan
852-2869-3001
psheehan@lehman.com

Grant Chan
852-2869-3818
grchan@lehman.com

Patrick Pang
852-2869-3120
ppang@lehman.com

Priscilla Yow
852-2869-3138
pyow@lehman.com

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<http://www.lehman.com>

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Except for the con men borrowing money they shouldn't get and the widows who have to visit with the handsome young men in the trust department, no sane person ever enjoyed visiting a bank.

—Martin Mayer, *The Money Bazaars*

The End of Capital as We Know It

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ASIAN FINANCIALS

Executive Summary

The BIS has proposed to alter the way bank capital adequacy is calculated. The new methodology will be finalized by year end, and will take effect in 2004.

We expect that Asian bank regulators will adopt the new methodology, or pay a stiff price as their banks are locked out of global interbank markets.

Beneficiaries of the change will be large regional and multinational banks with well-developed risk management and the highest quality corporate borrowers, as their capital requirements may go down.

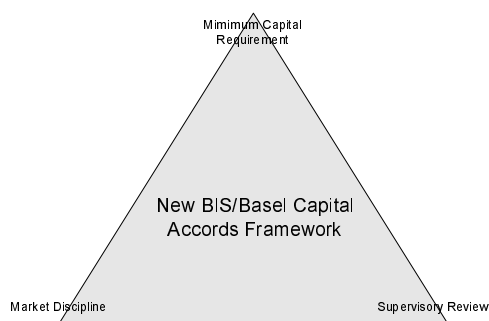
Asian banks such as HSBC, DBS, Standard Chartered, and Hang Seng will be well-positioned to benefit from the new accord.

Smaller and weaker Asian banks will face pressure to consolidate so as to be able to afford systems upgrades and additional capital.

Methodology Changes:

1. Loans will now be risk-weighted at 20-100% depending on the credit rating of the borrower, rather than automatically at 100%.
2. Regulators will place more reliance on banks' internal models for credit risk—as they do with market risk—and may risk-weight loans based on banks' estimates of loss.
3. Loans to corporate borrowers will not be limited by the rating of the borrower's sovereign.
4. Interbank credit will no longer be automatically weighted at 20%, but may be bucketed as high as 150% for weak institutions.
5. Capital standards are designed to be applied on a consolidated basis for financial holding companies including banks and securities operations.
6. Market risk (as with the 1996 RBC extension) and interest rate risk will be explicitly factored into capital adequacy and must be measured.
7. Banks will be required to hold capital against settlement and operational risks.
8. Improved disclosure and stepped-up supervision are intended to guard against unrealistic internal assumptions and artificially low capital.

Figure 1: The New Basel Accord Framework



Source: BIS

The accord is designed around strict minimum capital requirements, improved supervision of bank risk management, and market discipline and transparency.

EXECUTIVE SUMMARY

Asian Banks

Paul Sheehan
852-2869-3001
psheehan@lehman.com

Grant Chan
852-2869-3818
grchan@lehman.com

Patrick Pang
852-2869-3120
ppang@lehman.com

Priscilla Yow
852-2869-3138
pyow@lehman.com

Capital: Leaders and Laggards

Figure 2: Top and Bottom 10 Banks in Asia, by Total CAR

Bank	Total CAR	Bank	Total CAR
Panin Bank	51.0%	Philippine National Bank	6.0%
Bank Central Asia	44.6%	Koram Bank	8.5%
Oversea-Chinese Banking Corp.	25.0%	Bangkok Bank	9.0%
Dao Heng Bank	22.1%	Chinatrust Commercial	9.2%
Public Bank	21.9%	Taishin International	9.2%
Wing Lung Bank	21.0%	Housing and Commercial Bank	9.3%
United Overseas Bank	20.8%	Kookmin Bank	9.4%
DBS Bank Group	20.1%	Hana Bank	10.0%
Lippo Bank	19.7%	Bank of Ayudhya	10.5%
Bank of the Philippine Islands	18.9%	Thai Farmers Bank	11.7%

Source: Company reports; Lehman Brothers estimates

Figure 3: Top and Bottom 10 Banks in Asia, by Tier 1 CAR

Bank	Tier 1 CAR	Bank	Tier 1 CAR
Oversea-Chinese Banking Corp.	20.9%	Koram Bank	4.3%
Public Bank	19.8%	Philippine National Bank	4.8%
Dao Heng Bank	19.0%	Bangkok Bank	5.3%
Bank of the Philippine Islands	18.9%	Kookmin Bank	6.0%
United Overseas Bank	18.0%	Bank of Ayudhya	6.7%
Metrobank	16.5%	Thai Farmers Bank	7.1%
Bank of East Asia	16.4%	Hana Bank	7.3%
Overseas Union Bank	15.6%	Housing and Commercial Bank	8.0%
DBS Bank Group	15.5%	Shinhan Bank	8.5%
Bank SinoPac	15.3%	Thai Military Bank	8.8%

Source: Company reports; Lehman Brothers estimates

Key to Investment Rankings: This is a guide to expected total return (price performance plus dividend) relative to the total return of the stock's local market over the next 12 months. 1 = **Strong Buy** (expected to outperform the market by 15 or more percentage points); 2 = **Buy** (expected to outperform the market by 5-15 percentage points); 3 = **Market Perform** (expected to perform in line with the market, plus or minus 5 percentage points); 4 = **Market Underperform** (expected to underperform the market by 5-15 percentage points); 5 = **Sell** (expected to underperform the market by 15 or more percentage points); V = **Venture** (return over multiyear time frame consistent with venture capital; should only be held in a well-diversified portfolio).

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Risk Based Capital Gets An Overhaul

The new BIS proposals will challenge Asian bankers and regulators, and will produce increasing pressure for consolidation

The Basel Committee on Banking Supervision, a conference of major bank regulators convened under the aegis of the Bank for International Settlements (BIS), has released its long-awaited proposed update to the 1988 capital accord which, among other things, created the risk-based capital (RBC) system in use in most major jurisdictions today. The proposal is in fairly final form, incorporating comments on the first draft, which was released in June, 1999, and is expected to be finalized by year-end, with implementation taking place by 2004.

Figure 4: Capital Standards Timeline

Basel Committee Capital Standards Timeline	
July, 1988	Current capital accord (RBC 1.0, or 1988 accord) published; creates risk-based capital framework.
December, 1992	Final implementation deadline for RBC 1.0.
June, 1999	First consultative package on RBC 2.0 published.
January, 2001	Second consultative package on RBC 2.0 published.
December, 2001 (est.)	Final publication of RBC 2.0.
2004 (est.)	Final implementation deadline for RBC 2.0.

Source: BIS; Basel Committee on Banking Supervision

While adoption and implementation rules for the new accord (RBC 2.0) will of course be at the discretion of individual country central banks and bank supervisors, the BIS guidelines have become *de facto* standards for banks in all major markets, and the existing RBC 1.0 conventions are generally followed by all supervisors in Asia. Although capital adequacy levels differ from market to market and enforcement and implementation has sometimes lagged, minimum CAR in all our covered markets is at or above that mandated by the accord.

We expect that Asian bank supervisors will be forced to adopt at least the framework and majority of components of RBC 2.0, lest their banks be shut out of international markets for lack of compliance with global standards. As the proposal moves towards final form and implementation, we will be periodically reporting on new developments and refining our view of its impact on individual Asian banks.

Impact on Asian Banks

Due to provisions which reduce the level of risk-weighting for high quality corporate loans, permit some forms of netting and credit derivative support, eliminate the sovereign rating floor¹ for corporates located in distressed countries, and give additional flexibility to banks with well-developed internal systems for measuring and managing credit, market, interest rate, and operational risk, we expect that large global and regional

¹ In other words, a corporate borrower domiciled in a non-investment grade rated country may now have a credit rating higher than that of its sovereign.

banks will be beneficiaries of this change. This group includes such banks as HSBC, Hang Seng, DBS, and Standard Chartered.

Non-Asian banks such as Citibank and Chase should also reap comparative rewards, improving their competitiveness in Asia vis-a-vis local banks.

Major Changes Under The RBC 2.0 Accord

Bias towards additional capital in Asia

While the 1988 BIS accord had the effect of materially reducing capital requirements for many large global banks in order to promote efficiency and revive what was at that time a distressed low-margin business, the new accord explicitly states that its aim is to "at least maintain the current overall level of capital in the system." We believe that the existing measures have not resulted in Asian banks holding capital commensurate with their risk, and so expect a more robust capital adequacy framework to increase overall capital requirements in Asia.

Matching Capital to Risk

At the same time, the RBC 2.0 framework is intended to match capital requirements more closely with actual risk. We have seen from the events of the past several years in Asia that both markets and regulators have done a poor job of pricing and managing banks' risks, in particular credit risks. RBC 2.0 is an attempt to reverse this trend by grading banks on a wider spectrum of risk, while permitting greater variation in required capital levels between banks with differing levels of portfolio risk.

New Framework Incorporates Three Risk Aspects

The new accord incorporates not only the credit risk measurements implicit in the original 1988 accord and the 1996 market risk capital provisions, but for the first time includes a measure of banks' operational risks, along with an explicit capital charge.

Figure 5: New Capital Adequacy Calculation

$$\text{Capital Adequacy Ratio ("CAR")} = \frac{\text{Total Capital}}{\text{Credit Risk} + \text{Market Risk} + \text{Operational Risk}}$$

Source: BIS

Greater Flexibility in Using Internal Ratings

The biggest change under the RBC 2.0 standards is that the framework explicitly provides for the calculation of capital adequacy using banks' internal estimates of loss and severity. While this has been a recent hallmark of the Committee's thinking (viz. the 1996 Market Risk accords and associated discussion), RBC 2.0 marks the first time that internal credit risk-rating will play a role in supervisory calculations.

We expect that most Asian regulators and banks will implement the accord on a progressive modular basis, with the initial phase permitting only the use of the standardized methodology and not the internal ratings based (IRB) approach; however, the phase-in period will permit (and in some cases compel) banks to develop their own internal credit methodologies and measurements, which are still at a generally low level compared with those of US and European banks.

Application on Consolidated Basis

Due to the increasing popularity of financial holding companies with diverse subsidiaries and businesses, as opposed to pure bank holding companies which act as ownership shells for a bank or banks, the Basel Committee envisions that these minimum capital standards and calculation methodologies will be applied on a consolidated basis, with the important proviso that capital standards for insurance operations are not included in this proposal, and will likely be addressed on a country-by-country basis. Furthermore, the current proposal calls for the deduction of investments in any non-finance-related companies from capital—a fairly strict turnabout. The banks most affected by this provision would have been the Singaporeans, as this would eliminate significant amounts of their capital; however, the MAS—perhaps in anticipation of this new accord—has already directed the banks to offload these assets prior to the imposition of RBC 2.0.

Credit Risk

The Standardized Approach

We anticipate that all or almost all Asian banks will make use of the standardized approach to calculating credit risk. This approach is conceptually similar to the system now in use (see *Risk-Weighted Assets*, below), but has more weighting baskets and lowers capital requirements for highly-rated corporates. Because corporates which are 1) rated and 2) highly rated tend to be much larger than average, with commensurate borrowing needs, we believe that the AAA to A- business in Asia will be mainly centered in the large banks, and that they will receive the bulk of any reduction in capital requirements on loans.

Figure 6: Risk Weightings For Standardized Approach

Claims on:	Rating or Assessment					
	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Sovereigns	0%	20%	50%	100%	150%	100%
Banks (1)	20%	50%	100%	100%	150%	100%
Banks (2) LT	20%	50%	50%	100%	150%	50%
Banks (2) ST*	20%	20%	20%	50%	150%	20%
Corporates	20%	50%	100%**	150%***	150%	100%

*Obligations with maximum maturity of three months.

**to BB-

***Below BB-

Source: BIS

Under the standardized approach, most claims are classified according to their external credit ratings. Clearly there will be potential for mischief here if Asian bank regulators implement this plan in a manner which gives credence to the ratings of unreliable local

rating agencies; we believe that the improved disclosure on credit exposure calculation accompanying this provision will act as a counterweight on unrealistic ratings.

Supervisors may elect to implement the financial institution risk weightings in either of two ways. Method one is dependent on the sovereign rating of the country which is the primary domicile of the bank. Under this method, banks take a risk weighting one basket below that of their sovereign, with a 150% cap. Under the second method, banks are graded on their external credit ratings (generally for senior debt), with short-term obligations receiving more favorable treatment. This method allows strong banks in weak countries to transcend the sovereign rating cap.

Other categories of loans (see Figure 7) continue to be weighted based on type rather than by obligor grade, although a final proposal for the treatment of non-mortgage consumer credit is still pending. We see these loans as likely to be weighted at 100% under the standardized methodology, with most large banks eventually moving to a statistical portfolio loss method under the internal ratings based approaches.

Figure 7: Risk Weighting of Other Claims

Consumer Loans	Pending further review, likely to be 100% under standardized methodology.
Residential Mortgages	50%
Commercial Mortgages	100%
Low-rated Securitization Tranches	150%
NPLs, Net of Collateral and Specific Provisions	150%
Undrawn Loan Commitments:	
With Unconditional Cancellation	0%
Original Maturity Up To 1 Year	20%
Original Maturity Over 1 Year	50%

Source: BIS; Lehman Brothers

The Internal Ratings Based Approach (IRB):

Because every bank's exposure is different, no single methodology can effectively relate capital to risk. Efforts to settle on a single means of assessing risk tend, like "one size fits all" clothing, to fit no one well. Large banks generally favor a more complex methodology which will take into account their diverse products, off-balance-sheet claims, hedges, and greater proportion of short-term trading assets, while small banks generally want simple guidelines which are cheap and easy to apply. Each one of these approaches works fairly well for the banks which advocate it, but can not be applied to the entire universe of banks.

With the current RBC 1.0 framework having reached the maximum degree of specificity which can be reasonably applied across-the-board, the BIS has turned to more individualized modes of risk measurement for its new proposed RBC 2.0 accord. On the theory that the best knowledge of a bank's risk position is contained (barring exceptional circumstances) within the bank, RBC 2.0 places an unprecedented degree of reliance on banks' internal classifications of their loans and estimates of potential losses.

While we suspect that this sort of discretion might be abused in places like Thailand, Korea, and Taiwan, the BIS as part of the proposal also mandates a high level of disclosure about calculation methodologies, assumptions, and historical losses, on the theory that market discipline will prevent banks and regulators from making deliberately misleading assumptions. Although we do not necessarily share their confidence, we also prefer better disclosure to more rigorous but less transparent guidelines.

Before implementing either the foundation or advanced IRB, regulators must first establish a clear set of minimum qualifications banks must demonstrate prior to being permitted to switch over from the standardized method. These will generally include compliance with existing capital requirements, removing a temptation by weak banks to switch methods and understate their capital needs. Implementation of the IRB obviously requires considerable attention from and ongoing supervision by the local regulator.

IRB Weighted Exposure Calculations:

- **Classification of exposures by type:** Banks must classify each potential exposure as corporate, sovereign, financial institution, consumer, project finance, or equity.
- **Risk components:** For each type of loan, banks must estimate four main risk components—probability of default, degree of loss on default, exposure at default, and maturity.
- **Risk-weight function:** Given an exposure type and a combination of the four risk components, banks must devise a function or grid which will assign a risk-weighting to the exposure. This risk-weighting process may be continuous, as opposed to the bucket function (0%, 20%, 50% et c.) used in the standardized methodology.

Interest Rate Risk

Although the Basel proposal does not include explicit capital charges for excess interest rate risk (IRR), as have already been implemented by some jurisdictions including the US, it makes clear that interest rate risk must be factored in when assessing overall capital adequacy, which will produce a similar result.

The proposal relies on the following key principles:

- **Risk Appetite:** The Board of Directors must approve the bank's overall strategy with respect to IRR, as a means of delineating the institution's appetite for permissible IRR. The Board is responsible for keeping up to date on the bank's risk position and senior management's handling of exposure measurement and management.
- **Measurement:** Having set an appetite for risk, banks must take appropriate steps to ensure that all sources of IRR, including rate optionality, basis risk, and the traditional yield curve and repricing risks, are captured across all products and businesses, including contingent liabilities. This principle includes both conceptual and systems imperatives for managers.
- **Limits:** Management must set limits on net risk, gross exposure, and concentration of IRR commensurate with the bank's risk appetite, and monitor excesses closely.
- **Scenario Testing:** Banks should be regularly informed about their sensitivity to different types of rate scenarios (*i.e.*, stress-testing) and to breakdowns in their assumptions (*e.g.* correlations).

Asian Banks have a long way to go in Interest Rate Risk management

Asian banks as a class lag far behind in recognizing and measuring these risks, which has tended to exacerbate their losses in financial crises. In order to fulfil the requirements of RBC 2.0, banks will have to move away from the still-common contractual maturity/repricing gap method of IRR management and towards equity duration (MVPE) and net interest income simulation models.

Operational Risk

The operational risk guidelines are short on specifics, and will likely be a marginal factor for Asian banks

In principle it is clear that banks require additional capital beyond the sum of their credit and market exposures, in order to act as a cushion against losses from fraud, processing errors, unexpected or unforeseeable events, and the like. While the RBC 2.0 proposal leaves room for operational risk assessment as part of a determination of capital adequacy, it is notably short on workable methodology.

Hence, we expect individual supervisors in Asia to implement operation risk capital components either as a multiplier on credit and market risk (e.g., operational risk will be deemed to be 20% of aggregate credit and market risk) or as an asset-based charge (i.e., banks will be assessed operational capital as a percentage of their gross assets, over and above credit and market risk capital).

The Committee does offer some suggestions of risk indicators to use when calculating operational capital requirements for different businesses within a bank or holding company, as seen in the following table.

Figure 8: Operational Risk Indicator Guidelines

Business Units	Business Lines	Indicator
Investment Banking	Corporate Finance	Gross Income
	Sales and Trading	Gross Income
Banking	Retail Banking	Average Assets
	Commercial Banking	Average Assets
	Payment and Settlement	Annual Settlement Throughput
Other	Retail Brokerage	Gross Income
	Asset Management	Funds Under Management

Source: BIS

A Risk-Based Capital Primer

Risk-based capital (RBC) standards have been adopted by banks and regulators in most major countries, generally in the form first promulgated by the Basel Committee and the BIS in 1988. The major objective of risk-based capital is to more accurately measure and associate the required levels of bank capital with the actual risk incurred by a specific organization. This is both more efficient and safer than determining minimum capital based on asset size alone. In summary, the risk-based capital methodology has a number of advantages over a straight capital/assets or capital/loans test:

- Riskier credit extensions (naturally enough) require more capital under a RBC methodology. Conversely, sovereign or other, less-risky loans and securities have a lower RBC requirement, so that banks are not comparatively penalized for holding liquid secure assets.
- Off-balance sheet exposures—loan commitments/lines, derivative contracts, and the like—which expose the bank to risk but do not generate asset bookings are taken into account when determining the overall risk level of the bank, and capital must be held against them.
- Bank capital levels, as they are more closely related to underlying exposures, become a better indicator of firm risks both on absolute and comparative levels.

The existing risk-based capital methodology has at its heart the following simple ratios:

Figure 9: Existing Capital Adequacy Formulas

$$\text{Capital Adequacy Ratio ("CAR")} = \frac{\text{Total Capital}}{\text{Risk-weighted Assets}}$$

$$\text{Tier 1 Capital Ratio} = \frac{\text{Tier 1 Capital}}{\text{Risk-weighted Assets}}$$

$$\text{Tier 2 Capital Ratio} = \frac{\text{Tier 2 Capital}}{\text{Risk-weighted Assets}}$$

$$\text{Total Capital} = \text{Tier 1 Capital} + \text{Tier 2 Capital}$$

Source: Federal Reserve Bank of New York; BIS

Risk-Based Capital Components

Total capital consists of two classes: Tier 1 (also known as "core" or "primary") capital and Tier 2 (also known as "supplementary" or "secondary") capital. Tier 3 does exist in some jurisdictions, but is extremely rare and not applicable to any Asian banks at this time.

Tier 1 Capital

Tier 1 contains the most common and senior capital elements: common equity, including capital stock, surplus, and undivided profits, as well as mandatory profit reserves; and qualifying noncumulative perpetual preferred stock, such as the Super CAPs issued by certain Thai banks. From these accounts are subtracted goodwill, unrealized losses in available-for-sale securities, and intangible assets that do not qualify within capital. Tier 1 capital is permanent equity.

Tier 2 Capital

Tier 2 capital elements under most Asian regimes are as follows: land and property revaluation (except in Singapore); the portion of the allowance for loan and lease losses which is held as a reserve against performing assets; and subordinated debt with an original maturity greater than five years (as Tier 2 debt comes to have a maturity of five years or less, 20% of the outstanding amount is removed from capital calculations each year). The overall balance of Tier 2 capital is limited to 100% of Tier 1 capital.

The BIS minimum global standard calls for minimum Tier 1 CAR of 4% and total CAR of 8%. Countries within Asia vary slightly as to their statutory requirements; however, bear in mind that most have informal requirements which are higher than the legal minimum.

Figure 10: Asian Statutory Capital Requirements

Country	Minimum Total CAR	Minimum Tier 1 CAR
Hong Kong	8%	4%
Singapore	12%	8%
Korea	8%	4%
Taiwan	8%	4%
Thailand	8.5%	4.25%
Malaysia	8%	8%
Indonesia²	8%	8%
Philippines³	10%	10%

Source: Central Banks; Lehman Brothers

Upper and Lower Tier 2 Capital Instruments

The RBC capital standards have been further complicated by the division of Tier 2 instruments into upper and lower Tier 2. Regular and convertible subordinated debt eligible for Tier 2 inclusion is considered lower Tier 2, which is limited to 50% of Tier 1 capital.

Recently, some Asian jurisdictions such as Thailand⁴ have broadened their definition of Tier 2 to permit Hybrid Capital Instruments as qualifying upper Tier 2 securities. As

² After phase-in period, current minimum CAR is 4%.

³ Commercial banks only.

upper Tier 2, these securities can be considered as capital (along with other Tier 2 components) in an amount up to 100% of the amount of Tier 1 capital held by the bank. In order to qualify as upper Tier 2, securities must meet the following characteristics:

- They must be unsecured;
- They must have maturity of at least ten years, and during the last five years, an amortization factor of 20% per annum must be applied;
- They cannot be redeemed prior to maturity, except with prior approval from the central bank or bank regulator;
- They must be subordinated to all depositors and general creditors;
- Banks must have the right to defer interest payments in a period if they have no current-year profit, and are unable to make dividend payments to common and preferred stockholders;
- Principal and interest payments on hybrid debt capital must be deferred if such payment will result in negative capital of the issuing bank, or if a regulator has intervened by ordering a capital write-down and recapitalisation.

Risk-weighted Assets

The denominator of the risk-based CAR calculations, and the heart of the RBC system, is the amount of risk-weighted assets. Each asset or off-balance-sheet item (referred to collectively as claims) is assigned to one of four risk categories based on the credit risk of the obligor or guarantor.

The gross amount of each balance sheet asset is assigned a risk weighting of 0%, 20%, 50%, or 100%, reflecting the perceived default risk of the credit. Off-balance-sheet items are first converted to a "credit-equivalent amount" by multiplying their notional value by a credit-conversion factor, and then assigned to one of the risk weighting categories.

The sum of all claims at a bank, multiplied by their respective risk weightings, determines the institution's risk-weighted assets. Note that the base RBC methodology⁵ only takes into account credit risk, and that even securities risk-weighted at 0% may have substantial price or yield risk.

⁴ Please refer to our recent report: *Thai Bank Upper Tier 2: Can The Banks Afford The Capital They Need?*, dated September 27, 2000, for additional details.

⁵ The Basel Committee has drafted extensions to the RBC methodology which incorporate market risk charges, but these are by no means universally accepted or consistently applied, and are not currently in use in Asia.

Figure 11: Asset Risk-weighting Categories

Risk Weighting Category	Covered Instruments
0%	<ul style="list-style-type: none"> ▪ Claims on and claims unconditionally guaranteed by OECD⁶ central governments and/or the government of a bank's domiciled country. Essentially or actually sovereign risk. ▪ Unused loan commitments with maturities less than 12 months, or loan commitments cancelable at the bank's discretion.
20%	<ul style="list-style-type: none"> ▪ Claims on and claims unconditionally guaranteed by government agencies (such as FNMA or SLMA in the US). ▪ Claims conditionally guaranteed by OECD central governments and/or the central government of a bank's domiciled country. ▪ Loans to financial institutions (<i>i.e.</i>, interbank claims, Repos, <i>etc.</i>) ▪ Derivative contracts where the counterparty is a financial institution, at credit-equivalent amount.
50%	<ul style="list-style-type: none"> ▪ First mortgage liens on residential property⁷. ▪ Securities backed by first mortgage liens on residential property, except subordinated tranches (100%) or securities guaranteed by government agencies (20%). ▪ Unused loan commitments with maturities of over one year.
100%	<ul style="list-style-type: none"> ▪ Loans and securities not described above. ▪ Property and other assets. ▪ Mortgage securities or tranches which may sustain more than proportional losses (e.g. IOs, POs, Zs). ▪ Derivative contracts with non-bank counterparties, at credit-equivalent amount.

Source: BIS; Federal Reserve Bank of New York; Lehman Brothers.

⁶ Organisation for Economic Co-operation and Development.

⁷ Certain multifamily property loans may be excluded.

FINANCIAL SERVICES

Banks

U.S.

Henry Chip Dickson, CFA.....	1.212.526.5659
Jason Goldberg	1.212.526.8580
Brock Vandervliet	1.212.526.8893
Kristin Nemecek	1.212.526.8284
K.C. Ambrecht	1.212.526.4915
Andrea Jao	1.212.526.8377
Eileen Rooney.....	1.212.526.8646
<i>Europe</i>	
Sheila Garrard.....	44.20.7260.2785
Robert Law	44.20.7260.2715
Alan Broughton	44.20.7260.1532
Jacques.Henri Gaulard.....	44.20.7260.1531
Fiona Swaffield.....	44.20.7260.1537
Colin Hector	44.20.7256.4362
Barbara Pires.....	44.20.7256.4681
Anke Reingen	44.20.7260.1538
Joanna Nader	44.20.7256.4097
<i>Asia</i>	
Nozomu Kunishige	81.3.5571.7482
Patrick Pang	852.2869.3120
Grant Chan.....	852.2869.3818
Paul Sheehan	852.2869.3001

Banks: Latin America

Robert Lacoursiere	1.212.526.2611
Juan Partida, CFA.....	1.212.526.5744

Insurance/Life

U.S.

Eric N. Berg, CPA.....	1.212.526.2805
E. Stewart Johnson.....	1.212.526.8190
Vincent W. Foley	1.212.526.4926
<i>Asia</i>	
Grant Chan.....	852.2869.3818

Insurance/Non-Life

U.S.

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Robin B. Albanese	1.212.526.6121
Vincent W. Foley	1.212.526.4926
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Santo Borsellino.....	44.20.7256.4095
<i>Asia</i>	
Kristine Li, CFA.....	81.3.5571.7467

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Matthew J. Keating.....	1.212.526.8572
<i>Asia</i>	
Kristine Li, CFA	81.3.5571.7467
Paul Sheehan	852.2869.3001
Grant Chan	852.2869.3818

Brokers & Asset Managers

U.S.

Mark Constant.....	1.415.274.5379
Antonio Vitti	1.415.274.5386
<i>Asia</i>	
Kristine Li, CFA.....	81.3.5571.7467

Mortgage Finance/Specialty Finance

U.S.

Bruce W. Harting, CFA	1.212.526.3007
Makiko S. Coakley, CFA	1.212.526.6716

New York

3 World Financial Center
New York, NY 10285 USA
1.212.526.7323

London

One Broadgate
London EC2M 7HA England
44.20.7601.0011

Tokyo

12-32 Akasaka 1-chome
Minato-ku Tokyo 107 Japan
813.5571.7354

Hong Kong

One Pacific Place
88 Queensway, Hong Kong
852.2869.3000

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