Prior to the decline in the stock market, Japanese banks had used capital gains on their shareholdings in order to boost profits. With the fall in equity prices, the banks' latent gains declined, reducing the incentive to sell (and in some cases probably eliminating the possibility of selling) stocks for capital gains.[8] Falling equity prices suggest a reduction in equity sales, at least to the extent they were used to boost bank profits.

- New International Capital Adequacy Standards

In 1988, the Basle Supervisors' Committee (the Committee on Banking Regulations and Supervisory Practices of the Group of Ten Countries and Luxembourg) concluded an agreement on risk-weighted capital adequacy standards that required a minimum 8% ratio of capital to risk-weighted credit exposure by the end of 1992.[9] The agreement made an important distinction between "core capital" (also known as Tier 1 capital) and "supplementary capital" (also known as Tier 2 capital). Core capital, which consists of shareholders' equity and disclosed reserves, must account for at least half of a bank's total recognized capital. Supplementary capital is regarded as lower quality capital and, of particular importance to Japanese banks, can include 45% of the unrealized capital gains on bank equity holdings, as well as general loan-loss provisions, hybrid capital instruments and subordinated debt.

Based on the strength of the Tokyo stock market at the time the agreement was announced, it appeared that Japanese banks would have no problem acquiring the additional core capital of about 6,000 to 8,000 billion yen required to meet the 8% ratio.[10] Concerning supplementary capital, there was no indication that the unrealized capital gains would decline so much that banks would need to issue subordinated debt.

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[8] At the end of 1989, the largest banks held 55.4 trillion yen in unrealized capital gains. By the end of March 1993, holdings were down to 17.3 trillion yen. See R.W. Wright, *op. cit.*, p. 18, and International Monetary Fund, *International Capital Markets Part II*, Washington, D.C., August 1993, p.15.

[9] For a full discussion of the new standards, see D.E. Alford, "Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry", in *Dickinson Journal of International Law*, Vol. 10, No. 2, Dickinson School of Law, Carlisle, PA, Winter 1992, pp. 189-222.

[10] See Bank for International Settlements, *59th Annual Report*, Bank for International Settlements, Basle, 1989, p. 91.