CBN GUIDANCE SUMMARY ON CAPITAL ADEQUACY COMPUTATION

Banks are required to maintain a minimum regulatory capital adequacy ratio (CAR) of **10%** (Others) and **15%** (for Systemically Important Banks) on an on-going basis.

A bank shall compute its regulatory capital adequacy ratio in the following manner:

$$Regulatory\ CAR = \frac{\text{Qualifying Capital (Tier 1+Tier 2- Deductions from capital)}}{Total\ RWA\ (Credit\ RWA + Market\ RWA + Operational\ RWA)}$$

Tier 1 capital would include the following elements:

1) Paid-up share capital;

2) Irredeemable preference shares;

3) Share premiums;

4) General reserve (retained profit),

5) Statutory reserve;

6) Other reserves as may be determined by the CBN.

*** There is no limit on the inclusion of Tier 1 capital for the purpose of calculating regulatory capital.*

Tier 2 capital would include the following elements:

1) Hybrid Capital Instruments

2) Revaluation Surplus

3) Subordinated Debt

4) Other Comprehensive Income Items

***The maximum amount of Tier 2 capital that can be included is limited 1/3 of Tier 1.*

Deductions from capital

1) Goodwill, other intangibles and deferred tax assets (DTA)

2) Under impairment

3) Treasury shares

4) Securitization transactions

5) Reciprocal cross holdings in the common shares of banking, financial and insurance entities

6) Investments in the capital of banking and financial institutions

7) Investment in capital of financial subsidiaries

Notes on Deductions from Capital

a. All items that are deducted from capital are excluded from total assets in calculating the capital adequacy ratio.

b. If a bank is required to make a deduction from Tier 2 capital and it does not have sufficient capital to make that deduction, the shortfall will be deducted from Tier 1 capital.

Total RWA

Risk Weighted Assets value is calculated as the product of the amount of exposures and supervisory determined risk weights. It is weighted according to risks.

The total RWA are calculated as the sum of

1) Risk weighted on-balance sheet and off balance sheet assets computed according to Standardized Approach for Credit Risk
2) 12.5 times the sum of the capital charges determined for [1]Market risk and Operational risk

The Capital adequacy ratio adjusts for assets that are less risky by allowing banks to discount lower-risk assets because different types of assets have different risk profiles.

SYSTEMICALLY IMPORTANT BANKS (SIBs) IN NIGERIA

CBN describes SIBs as financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity. Hence, the Central Bank of Nigeria (CBN) and Nigeria Deposit Insurance Corporation (NDIC), have developed a supervisory framework for SIBs in Nigeria. This initiative is to limit the economic impact of bank distress and promote financial system stability.

The indicator-based measurement approach as well as supervisory judgment were used to determine SIBs in Nigeria, using criteria such as size, interconnectedness, substitutability and complexity.

Requirements

1) SIBs are required to carry out stress test of their capital and liquidity on a quarterly basis and the result of the stress test would be reviewed by the Central Bank of Nigeria.

2) SIBs are required to maintain a minimum CAR of 15% out of which Tier 2 capital should not constitute more than 25% of the qualifying capital. In other words, Tier 1 capital should be at least 75% of the bank's qualifying capital.

3) In addition, SIBs in Nigeria are required to set aside Higher Loss Absorbency5 (HLA) or additional capital surcharge of 1% to their respective minimum required CAR. This should be met with Common Equity Tier 1 (CET1) capital6. The aim of the additional loss absorbency requirement is to ensure that the SIBs have a higher share of their balance sheet funded by instruments that re-enforce the resilience of the institution as a going concern.

4) There shall be greater frequency and intensity of on-site and off-site supervision of SIBs. Monthly monitoring of the key performance indicators of the SIBs shall be carried out by the CBN in order to ensure their safety and soundness as well as the going concern status of the banks. Banks shall be expected to provide high quality data to the regulatory authorities for

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[1] Standardized approach is to be used to compute market risk while Basic indicator approach should be used to compute operational risk

the purpose of the enhanced supervision. In the event that an SIB has a High Composite Risk rating, half-yearly meetings shall be held with the board and management to address issues of supervisory concern

Reporting

1) ICAAP

Banks are to carry out ICAAP on an annual basis and forward copies of the report to CBN no later than 4 months after year end.

2) SIBs

SIBs shall make quarterly disclosures of their financial condition and risk management activities to the regulators as prescribed by the Central Bank of Nigeria. The disclosures shall:

- Risk governance and risk strategies/business model
- Capital adequacy and risk weighted assets
- ICAAP Policy and Computation
- Liquidity/Funding
- Market risk
- Credit risk
- Operational risk
- Other identified risks

SIB reports shall include:

- Total Credit and their classification, growth, sectoral spread or concentration.
- Non-performing credit to Total credit.
- Director-related credit.
- Recoveries.
- Top 100 Users of fund.
- Liquidity Ratio.
- Capital Adequacy Ratio.
- Net-Interbank placement.
- Government Bond and Treasury Bills holding and their Mark to Market gain/loss.
- Unaudited Profit/Loss.
- Net Open Position.
- Shareholders' Fund.
- Gain/Loss on Foreign Exchange Derivative.

In addition to the above, the under-listed shall also be monitored by all banks:

- The top 100 users of funds should be further analyzed and related to the industry.
- Top 50 providers of funds