PRUDENTIAL REGULATION NO CBL/SD/01/2000

PRUDENTIAL REGULATIONS FOR CAPITAL ADEQUACY REQUIREMENTS

1.00 INTRODUCTION

Consistent with the provisions of Section 15 of the New Financial Institutions Act of 1999 (FIA), the Central Bank of Liberia (CBL) hereby issues the following regulations on Capital Adequacy Requirements for all licensed banks.

In keeping with international standards and the need to have adequate capital in relation to the credit risks inherent in both on and off- balance sheet assets, licensed banks are required to maintain **a minimum ratio of capital to total risk-weighted assets as prescribed in the following paragraphs.** As the banking system develops, the measurement of other risks such as interest rate, and investment risk shall be introduced. However, licensed banks are required not to mismatch interest rates and should ensure that they include the provision for floating rates in loan agreements.

2.00 COMPONENTS OF CAPITAL

The Capital shall consist of two (2) **Tiers** which are described as follows;

i. ***Tier 1 or Primary Capital***

This is the Core or Primary Capital and provides the most permanent and readily available support to a bank against unexpected losses. Tier 1 capital shall consist of the following:

1. **Permanent Shareholders Equity**: Issued and fully Paid-up capital or assigned capital of a foreign financial institution. It includes, by agreement with the Central Bank of Liberia, redeemable share capital or preferred stock. However, it excludes cumulative preferred stock because such stocks do contain restrictive terms that permit redemption by the holder regardless of the financial condition of the issuer.

2. **Disclosed Reserves** which represents appropriations from the profits net of accumulated losses, depreciation, provisions for loans and advances losses, and tax. They are not encumbered and are clearly identifiable in the audited accounts of licensed banks. The reserves include the following;

   2.1 Statutory Reserves.
   2.2 Share Premium (Premium on Capital).
   2.3 Retained Earnings.
   2.4 Other distributable and legal reserves.

3. Deductions from Tier 1 Capital

    3.1 Goodwill and other intangible assets which include the balances of preliminary expenses.
    3.2 Fixed Assets (including revaluation reserves).

ii. ***Tier 2 or Secondary Capital***

Tier 2 Capital represents the secondary or supplemental capital and shall consist of the following;

1. Hybrid (debt/equity)- Capital Instruments.
2. Subordinated term debt or loan stock or debenture stock.

iii. ***Total Qualifying Capital or Adjusted Capital Base***

This represents the total of **Tier 1** and **Tier 2 Capital** after **deducting** the following items;

1. investments in unconsolidated subsidiaries and associates;
2. investments in capital of other banks and financial institutions; and
3. connected lending of capital nature.

iv. ***Limitations and Restrictions***

The following limitations and restrictions shall apply to the various types of capital listed in the preceding paragraphs.

1. The total of Tier 2 (secondary capital) capital shall be limited to a maximum of fifty (50%) percent of the total of Tier 1 capital. This means that where the Tier 1 capital is negative, the Tier 2 capital shall not be taken as qualifying capital.

2. The hybrid capital shall be unsecured, subordinated and fully paid up. It shall not be redeemable at the discretion of the holder or without the prior approval of CBL. It shall also be available to absorb losses without the bank being obliged to cease trading. It should also allow interest obligations to be deferred where the profitability of the bank cannot support such payment (e.g. cumulative preference shares).

3. Subordinated term debt should be unsecured, without any restrictive covenant and have a minimum residual maturity of five (5) years. Such instruments are not normally available to absorb losses of the bank while trading. Limited life preference shares that meet that criteria can be

included in such group. It shall also be limited to a maximum of fifty (50%) percent of Tier 2 capital.

4. Connected lending of capital nature include any form of lending of a long-term nature to an unconsolidated subsidiary or associate or other related person.

3.00 RISK - WEIGHTED ASSETS

The risks inherent in each category of assets or off-balance sheet items have been evaluated. The assets have been grouped in to two and assigned risk weights of either zero (0%) or one hundred (100%) percent. The risk weight factors for each category of the assets are as follows;

i. ***On- Balance Sheet Assets***

The following weights shall apply.

Risk Asset		**Risk Weight**	**%**
1.	Cash		0
2.	Balances with CBL		0
3.	Clearing Items		0
4.	Treasury Bills/ Central Bank Bills		0
5.	Government of Liberia Stocks		0
6.	Overnight money at designated money market institutions		0
7.	Balances with banks in Liberia		0
8.	Investments in unconsolidated Subsidiaries and associates		0
9.	Investments in the capital of other Banks and financial institutions		0
10.	Connected lending of capital nature		0
11.	Goodwill and other intangible assets		0
12.	Fixed Assets (including revaluation reserves)		0
13.	All other Assets not listed in 1 to 12 above		100

The assets listed as items 10, 11 and 12 above are assigned zero (0%) weights because they are required to be deducted in full from the capital of the capital. This implies that banks are required to provide 100% capital cover for such assets. The assets listed in item no.13 above shall be net of provisions where applicable.

Only cleared balances with the Central Bank should be included in the Balances with the Central Bank of Liberia.

ii. ***Off-Balance Sheet Items***

The credit risk exposure inherent in the Off-balance sheet items shall be treated as on balance sheet items and shall carry one hundred (100) percent risk weights. The off balance sheet items shall include the following;

1. Commercial letters of credit outstanding.
2. Guarantees, indemnities issued and outstanding.
3. Acceptances.
4. Endorsements.
5. Revolving under writing facilities.
6. Note issuance facilities.
7. Stand-by letters of credit to other banks and Counter-parties.
8. Others.

Collateral security such as cash margins and/ or other readily marketable investment security may be deducted from each category of asset and the balance / residual obligation should be included.

iii. ***Adjusted Assets Base***

The total risk - weighted on - balance sheet and off - balance sheet assets as computed in paragraphs **3.0 [i] and [ii]** above shall represent the adjusted asset base.

4.00 CAPITAL TO RISK - WEIGHTED ASSETS RATIO

The ratio shall be computed by dividing the **Total Qualifying Capital or Adjusted Capital Base** as derived in Section 2.00 [iii] by the **Risk - Weighted Assets or Adjusted Assets Base** calculated as per Section 3.00 [iii] of this regulation. The ratio is, therefore, measured as the percentage of the adjusted capital base to adjusted asset base. The minimum applicable ratio shall be **eight (8%) percent**. The Central Bank of Liberia may, where necessary after taking in to account the risk profile of a licensed bank, require the bank to maintain a higher ratio than the prescribed minimum ratio.

Notwithstanding the requirement for a minimum capital ratio of 8%, banks are reminded of the provisions of Section 14(1) of FIA which requires every bank to maintain the minimum unimpaired capital, either paid-up or assigned as specified by Section 15 of the FIA.

5.00 REPORTING REQUIREMENTS

Licensed banks are required to submit to the Central Bank of Liberia, on quarterly basis, a Capital Adequacy Return. The format for reporting is attached as **Appendix 1.**

<u>SUPERVISION DEPARTMENT</u>
<u>CENTRAL BANK OF LIBERIA</u>
<u>APRIL, 2000</u>

APPENDIX 1

Private and Confidential FORM SD

CAPITAL ADEQUACY RETURN

As At ____

Name of reporting institution ____________________________

Name (block letters) and signature of authorized official _________________________________

NOTES:

Address all questions/inquiries to the Head of Supervision, CBL

1. This Form should be completed as at the end of every quarter beginning with 2000

2. Enter amounts to nearest thousand, omitting 000s

3. Submit the return within 21 CALENDAR DAYS of reporting date, clearly addressed to:
SUPERVISION DEPARTMENT
CENTRAL BANK OF LIBERIA MONROVIA

C B L Use Only			
Logged in	**Date Checked**	**Date input**	**Amendment input**

(Sections 15, 16 of New Financial Institutions Act 1999) FORM SD

CAPITAL ADEQUACY RETURN

A **<u>ADJUSTED ASSETS BASE</u>**

1. Total assets as per Balance Sheet (excluding contra items.)
2. Cash ( )
3. Treasury Bills/Central Bank Bills ( )
4. Government Stocks ( )
5a. Overnight money at designated money market institutions ( )
5b. Balances with local banks ( )
6. Balances with Central Bank of Liberia ( )
7. Investments in unconsolidated subsidiaries and associates ( )

8. Investment in the capital of other banks and financial institutions ( )
9. Connected lending of a capital nature ( )
10. Goodwill and other intangible assets ( )
11. Fixed Assets (including revaluation reserve) (_______________________)
12. Adjusted Total Assets {1- (2 to 11) } ______________________________

<u>ADD:</u> Off-balance sheet items. (100 % Risk-weighted)

13. Commercial Letters of Credit outstanding
14. Guarantees, indemnities issued and outstanding
15. Acceptances
16. Endorsements
17. Revolving under writing facilities
18. Note issuance facilities
19. Stand-by letters of credit to other bank and counter-parties
20. Others
21. Total off-balance sheet items (13+14+15+16+17+18+19+20) ________________________________
22. Adjusted asset base (12 +21) ________________________________

B. <u>ADJUSTED CAPITAL BASE</u>

23. Ordinary paid-up share capital
24. Disclosed Reserve:

24a. Statutory Reserves

24b. Share Premium

24c. Retained Earnings

24d. Other distributable and legal reserves ______________________________

25. Primary (Tier1) Capital (23+24)
26. Goodwill and other intangible assets ( )
27. Fixed assets (including revaluation reserve) ( )
28. Total deductions ( )
29. Adjusted Primary Capital (25-26-27)
30. Hybrid (debt/equity) capital instruments
31. Subordinated term debt (limited to 50% of secondary capital at 32 below) ______________________________
32. Secondary (or Tier II) capital (30+31) (limited to 50% of total capital at 25 above) _________________________
33. Adjusted primary capital and secondary capital (29+32) _____________________________

Deductions from total capital (33)

34. Investments in unconsolidated subsidiaries and associates
35. Investments in the capital of other banks

and financial institutions
36. Connected lending of a capital nature ______________________________
37 Adjusted capital base (33-34-35-36) ______________________________

2. **CAPITAL RATIO**

38. Adjusted capital base as percentage of Adjusted asset base (37/22 X100) %
39. Regulatory Capital Adequacy Ratio (CAR) %
40. Surplus/Deficit (%) %

NOTES TO CAPITAL ADEQUACY RETURN

Form SD is required to be submitted to the Supervision Department of the Central Bank of Liberia pursuant to regulations issued by the Central Bank under Sections 15 and 16 of the New Financial Institutions Act 1999.

The Capital Adequacy Ratio (CAR) will be measured as the percentage of adjusted paid-up capital and reserves to adjusted total assets inclusive of risk-weighted off balance sheet items.

SD
ITEM #

6. Balances with Central Bank of Liberia "Cleared" balances with the Central Bank only should be included.

9. Connected lending of a capital nature. Include any form of lending of a long term nature to an unconsolidated subsidiary or associate or related persons.

13-20 Collateral Security such as cash margins and/or readily marketable investment security may be deducted from each category of the off balance sheet items and the balance/residual obligation shall be included in the adjusted asset base.

23. Ordinary paid-up capital. Include only permanent shareholders' equity and, by agreement with SD, redeemable share capital.

24. Disclosed Reserves. Include reserves created or increased by appropriation of retained earnings or other surpluses (eg. Share premiums, retained profits, other distributable and legal reserves) net of accumulated losses, depreciation and provisions for loan losses.

26. Goodwill and other Intangible to include balances of preliminary expenses.

30. Hybrid (debt/equity) capital instruments. The following criteria will apply to those instruments;

- They are not a charge on any asset of the bank, subordinated and fully paid-up; they are not redeemable at the initiative of the holder or without the prior written consent of the CBL.

- They are available to absorb losses without the bank being obliged to cease trading.

31. Subordinated term debt include

    - Conventional unsecured subordinated debt capital instruments with a fixed term maturity;

    - Limited life redeemable preference shares with a residual maturity in excess of 5 years.

    These instruments are not normally available to absorb the losses of the bank while trading. Not more than 50% of the total secondary capital can be in subordinated debt.

32. Secondary, or Tier II Capital. Secondary Capital is Limited to a maximum at 50% of the total Primary Capital.