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STATUTORY INSTRUMENTS
SUPPLEMENT No. 12

11th May, 2018

STATUTORY INSTRUMENTS SUPPLEMENT

to The Uganda Gazette No. 11, Volume CXI, dated 11th May, 2018

Printed by UPPC, Entebbe, by Order of the Government.

S T A T U T O R Y I N S T R U M E N T S

2018 No. 21.

THE FINANCIAL INSTITUTIONS (CAPITAL ADEQUACY REQUIREMENTS) REGULATIONS, 2018.

ARRANGEMENT OF REGULATIONS.

Regulation

SCHEDULES

SCHEDULE 1: BS 100A: QUARTERLY COMPUTATION OF CAPITAL ADEQUACY FOR CREDIT RISK.

SCHEDULE 2: BS 100B: QUARTERLY COMPUTATION OF CAPITAL ADEQUACY FOR MARKET AND CREDIT RISKS.

STATUTORY INSTRUMENTS

2018 No. 21.

The Financial Institutions (Capital Adequacy Requirements) Regulations, 2018.

(Under sections 27(3) and 131(1) (c) and (d) of the Financial Institutions Act, 2004, Act 2 of 2004)

IN EXERCISE of the powers conferred upon the Central Bank by sections 27(3) and 131(1) (c) and (d) of the Financial Institutions Act, 2004, and in consultation with the Minister responsible for finance, these Regulations are made this 17th day of January, 2018.

PART I—PRELIMINARY

1. Title.

These Regulations may be cited as the Financial Institutions (Capital Adequacy Requirements) Regulations, 2018.

2. Application.

These Regulations apply to all financial institutions in Uganda.

3. Interpretation.

In these Regulations, unless the context otherwise requires—

"Act" means the Financial Institutions Act, 2004;

"banking book" means positions that are not actively managed nor held with a trading intent in the secondary market;

"basis risk" is the risk of loss due to adverse change in the spread arising from imperfect correlation between the bases for pricing of assets and liabilities in the trading book;

"capital adequacy" means maintaining the minimum capital and on-going capital requirements prescribed by the Act;

"foreign exchange risk" means the risk to income and capital arising from adverse movements in foreign exchange rates affecting the open position taken on through spot or forward foreign exchange contracts, including FX-swaps and options;

"general market risk of interest related instruments in the trading book" means the risk of market-to-market price losses calculated at the portfolio level arising from changes in market interest rates;

"hybrid capital instruments" includes debt instruments that are essentially permanent in nature and have close similarities to equity such as irredeemable cumulative preference shares, perpetual debt instruments and mandatory convertible debt instruments;

"interest rate risk in the trading book" means the risk to income and capital arising from the business of holding or taking positions in debt securities and other interest rate related instruments on-balance or off-balance- sheet which include all fixed rate and floating rate debt securities and similar instruments including interest rate related forward contracts and option contracts, interest rate swaps (IRS), non- convertible preference shares and convertible debt instruments which are "out-of-the-money";

"long position" means a position that yields a premium in the event of a rise in prices or fall in interest rates for the relevant security or instrument;

"market risk" means the risk to earnings or capital arising from adverse movements in market prices of foreign exchange positions throughout the financial institution and interest rates related instruments in the trading book;

"net position" means the difference between long position and an offsetting short position in financial instruments;

"netting agreement" means a contractual and legally enforceable agreement by which several bilateral contracts with positive and negative values with the same counterparty can be considered for counterparty credit risk as one contract with a single net exposure value;

"revaluation reserve" means the increase in book value of a fixed asset based on an independent and professional appraisal as to the market value of that asset;

"short position" means a position that yields a loss in the event of a rise in prices or fall in interest rates for the relevant security or instrument;

"significantly under capitalised financial institution" means a financial institution which does not—

(a) hold the minimum capital funds, unimpaired by losses, of at least fifty percent of the requirements prescribed by section 26 of the Act;

(b) hold core capital of at least fifty percent of the requirement prescribed by section 27 of the Act; or

(c) hold total capital of at least fifty percent of the requirement prescribed in section 27 of the Act;

"specific risk of positions in the trading book in interest rate related instruments" means a potentially adverse movement in the price of an individual security owing to factors related to the individual issuers with different risk factors for government;

"subordinated term debts" include non-permanent or limited life debt instruments with an original maturity of at least five years and which are subordinated in right of repayment of principal and interest to all depositors and other creditors of the financial institution such as redeemable preference shares;

"supplementary capital" means general provisions which are held against the future and current unidentified losses that are freely available to meet the losses which subsequently materialize, revaluation reserves on banking premises, and any other form of capital as may be determined by the Central Bank;

"trading book" means positions in financial instruments held either with trading intent or in order to hedge other elements of the trading book;

"under-capitalised financial institution" means a financial institution which does not fully comply with any, or all of the capital requirements;

"yield curve risk of interest rate related trading book positions" means the risk of loss in income and economic value due to adverse change in the slope and shape of the yield curve.

4. Objectives.

The objectives of these Regulations are—

(a) to prescribe the minimum capital requirement for financial institutions;

(b) to prescribe the computation of on- going capital adequacy requirements;

(c) to ensure strict adherence to the capital requirements prescribed by the Act;

(d) to help ensure that financial institutions hold and maintain a level of capital which is adequate to protect their depositors and creditors against the risk of loss that may arise out of their business activities;

(e) to ensure that financial institutions maintain capital standards recognised internationally as being prudent;

(f) to help promote and maintain public confidence in the Ugandan financial sector;

(g) to promote and enhance proper control and monitoring of the elements of market risk as it exists in financial institutions, including interest rate risk in the trading book positions and foreign exchange risk in the trading and in the non-trading book;

(h) to establish and incorporate capital adequacy requirements for both market risk and credit risk.

5. Rationale.

The rationale of these Regulations is derived from the following—

(a) a key purpose of capital in a financial institution is to provide a stable resource to absorb any losses incurred by it, and thus protect its depositors and potential depositors from the risk of loss;

(b) financial institutions need to maintain a level of capital commensurate with their risk activities in order to minimise the incidence of failure, provide adequate protection to their depositors and thus promote public confidence in the financial system;

(c) as a regulatory and supervisory authority, the Central Bank has a duty to ensure that financial institutions, at all times, satisfy the minimum and ongoing capital requirements prescribed by the Act;

(d) as financial institutions expand their business internationally, it is of importance to demonstrate that financial institutions in Uganda maintain a level of capital that conforms to international standards;

(e) financial institutions in the course of their operations take on several risks that are commonly recognized in banking, consequently, in addition to providing adequate capital as a cushion for credit risk, financial institutions need to hold an additional amount of capital as a cushion for market risks which exist in their securities portfolios and foreign exchange activities;

(f) market risk as defined exists in the supervised financial institutions, especially through interest rate risk and foreign exchange risk;

(g) supervision of financial institutions must take into account the measurement and extent of market risks as well as how it is managed;

(h) placing a capital adequacy requirement for market risk of securities in the trading book and for foreign exchange positions in the trading and non-trading book has become a common international norm for effective banking supervision, these regulations are in line with well-recognized international best practices for determining capital adequacy for financial institutions.

PART II—REGULATORY REQUIREMENTS

6. Minimum paid-up capital requirements for financial institutions.

(1) The minimum capital funds unimpaired by losses of a licensed bank shall, at any one time, not be less than Uganda shillings twenty five billion.

(2) The minimum capital funds unimpaired by losses of a licensed non-bank financial institution shall at any one time not be less than Uganda shillings one billion.

7. Minimum on-going capital requirements for financial institutions.

(1) A financial institution shall at all times maintain a core capital of not less than 10% and a total capital of not less than 12% of the total risk adjusted assets plus risk adjusted off balance sheet items as set out in the Quarterly Computation for Capital Adequacy in Schedule 1 and Schedule 2.

(2) The core capital of a financial institution shall at all times be equivalent to at least the minimum capital funds set out in regulation 6 and shall be reduced by goodwill and similar intangible assets, investments in unconsolidated financial subsidiaries and future income tax benefits.

(3) In meeting the core capital requirements, a financial institution may include 50% of their year-to-date net profits.

(4) In meeting the total capital requirement, a financial institution wishing to include elements of supplementary capital, which in the aggregate should not exceed 100% of core capital, shall apply to the Central Bank for inclusion of any revaluation reserves on fixed assets, general provisions for losses, hybrid capital instruments and subordinated term debts.

(5) In considering an application submitted under sub regulation (4), the Central Bank shall take into account, in the case of—

(a) revaluation reserves on fixed assets, the independence of the source of the revaluation, the reasonableness of the revaluation amount and if the revaluation reserves have been either excessive in total or in frequency;

(b) general provisions for losses, the unencumbered nature of the provision and, that such general provisions are created against the possibility of losses not yet identified and are subject to a limit of 1.25% of the weighted risk assets;

(c) hybrid capital instruments, that they are unsecured, subordinated and fully paid up, they are not redeemable at the initiative of the holder or without the prior consent of the Central Bank, they are able to participate in losses without the financial institution being obliged to cease trading and they allow interest payments to be deferred where profitability does not support payment; and

(d) subordinated term debt, that they are unsecured, subordinated and fully paid up, they have a minimum original fixed term of over five years which shall be subject to cumulative discount factor of 20% per year during the last five years to maturity, they are not normally available to participate in the losses of a financial institution on a going concern basis, and they are subject to a maximum aggregate of 50% of core capital.

(6) Not with standing sub section (1) of this regulation, the Central Bank may prescribe higher on-going capital requirements for a financial institution if the supervisory review process reveals existing risks in the financial institution warranting the increase.

8. Computation of capital adequacy.

(1) A financial institution shall at all times maintain adequate records, including daily balance sheets and periodic statements of income and expense to enable proper computation of its capital adequacy.

(2) Every financial institution shall submit to the Central Bank Forms BS 100A and BS 100B as set out in Schedules 1 and 2 respectively of these Regulations to be prepared at the end of the months of March, June, September and December and submitted along with Form BS 100 on the same date.

(3) The BS 100B return to be submitted to the Central Bank shall include the following—

(a) an overall summary referenced as Part A of BS 100B showing the capital ratio calculation taking into account capital charges for interest rate risk and foreign exchange risk;

(b) a form for computing the charge for interest rate risk in the trading book consisting of a part for General Market Risk and another part for Specific Interest Rate Risk as stipulated in Part B (I) and Part B (II) of BS 100B, respectively;

(c) a form for computing the charge for foreign exchange risk shown as Part C of BS 100B showing net long or net short positions for major currencies indicating all items affecting the net open whether long or short position; and

(d) a form for computing the charge for options shown as Part D of BS 100B showing options based on interest rates and on foreign currency.

(4) Notwithstanding sub regulation (2), a financial institution with small trading positions in interest rate related positions in financial instruments in the trading book are exempted from the capital requirements for market risk for these positions and from submission of Schedule 2 Part B (I) and Part B (II), if the financial institution complies with the conditions set by the de-minimis rule, however the institution includes the relevant trading book positions in form BS 100A where they will be risk weighted for the calculation of capital requirements for credit risk.

(5) For avoidance of doubt, a financial institution may replace the capital requirement for Interest rate risk in the trading book referred to in Schedule 2 BS 100B by a capital requirement calculated in accordance with the capital requirements for credit risk, provided that the size of their on- and off-balance trading book business meets both the following conditions—

(a) it is normally less than 5% of total assets and Shs equivalent of USD 3 million; and

(b) it never exceeds 6% of total assets and Shs equivalent of USD 5 million.

(6) In calculating the size of on- and off-balance sheet business the institution shall apply the following—

(a) debt instruments shall be valued at their market prices or nominal prices and derivatives according to the nominal or the market values of their instruments underlying them; and

(b) the absolute value of the long positions shall be summed with the absolute value of the short positions.

(7) The Central Bank may in accordance with section 79 of the Act inspect a financial institution to verify the accuracy of the form under sub regulation (2) and may direct a financial institution to adjust or make corrections on the form submitted, based on the findings of the inspection.

(8) The Central Bank may call upon the external auditors of a financial institution appointed under section 62 of the Act, to verify the accuracy of any quarterly data reported on Form BS 100A and Form BS 100B in sub regulation (2).

(9) In determining whether a financial institution is in compliance with the capital adequacy requirements, the Central Bank shall have regard to whether the institution has made adequate provisions for losses in accordance with prudential requirements and followed international accounting standards with regard to income recognition, specifically accrual of interest.

(10) Where a financial institution enters into a transaction that it is prohibited from entering into by section 34 of the Act, the Central Bank shall deduct the outstanding amount of any loan or sum granted or extended to the insider when computing the on-going capital requirements of the institution.

(11) The determination of the capital charge for market risk shall be done using the standardized measurement method specified in Schedule 1and 2 of these Regulations.

(12) The market risk capital requirement for interest rate related instruments shall apply to the current market value of items in the financial institution's trading book and for foreign exchange throughout the institution.

(13) To be eligible for trading book capital treatment, financial instruments must either be free of any restrictive covenants on their tradability or able to be hedged completely.

(14) In addition, positions should be frequently and accurately valued and the portfolio should be actively managed.

9. Restrictions on dividends and capital reductions.

Subject to regulation 8(1), a financial institution shall not, pay or declare any dividend, make any transfer from profits or capital or make any other distributions other than to a reserve account, unless it meets all capital adequacy requirements prior to and after the payment of dividends.

10. Penalty for dividends and capital deduction.

The Central Bank shall, subject to section 32(3) of the Act, direct a financial institution which paid any dividend, made any transfer from profits or capital or made any other distributions other than to a reserve account that resulted in non-compliance by the financial institution, or while it was non-compliant with capital requirements, to recall all the dividends, payments or distributions made or make good their full value and in addition, pay a civil penalty equivalent to twice the value of dividends, payments or distribution of payments made.

PART III—PROMPT MANDATORY CORRECTIVE ACTIONS AND MEASURES

11. Prompt mandatory corrective actions.

(1) Where the Central Bank determines that a financial institution which complies with all the capital requirements has incurred or is likely to incur large losses within any financial year, it shall take the prompt corrective actions prescribed in section 85 of the Act.

(2) Where the Central Bank determines that a financial institution is under capitalised, it shall take the prescribed corrective action set out in section 86 of the Act.

(3) Where the Central Bank determines that a financial institution is significantly under capitalised, it shall take any or all the corrective actions provided for in section 87 of the Act.

12. Administrative sanctions.

In addition to the corrective actions available to the Central Bank under sections 85, 86 and 87 of the Act, the Central Bank may impose any or all of the following administrative sanctions with regard to a financial institution that has a capital deficiency—

(a) suspension of expansion into new banking and financial activities;

(b) suspension of access to new credit facilities of the Central Bank;

(c) suspension of acquisition of fixed assets;

(d) suspension of opening letters of credit or issuance of guarantees;

(e) suspension of acceptance of new accounts; and

(f) suspension or restriction of lending and investment operations.

13. Revocation of S.I. No. 42 of 2005.

The Financial Institutions (Capital Adequacy Requirements) Regulations, 2005 are revoked.