

CENTRAL BANK OF NIGERIA



REGULATORY CAPITAL MEASUREMENT AND MANAGEMENT FRAMEWORK FOR THE IMPLEMENTATION OF BASEL II/III FOR THE NIGERIAN BANKING SYSTEM



INTRODUCTION

The CBN pursuant to Section 13 of the Banks and Other Financial Institutions Act (BOFIA), 1991 as amended and in line with its core mandate of ensuring financial system stability as contained in Section 2 (d) of the Central Bank of Nigeria Act, 2007, herewith issues this **Regulatory Capital Measurement and Management Framework for The Implementation Of Basel II/III for the Nigerian Banking System**. The document contains guidance notes that outline the expectations of CBN with respect to the implementation of Basel II¹/III by banks and banking groups in Nigeria.

It specifies the approaches for quantifying the risk weighted assets for credit risk, market risk and operational risk. The computations are consistent with the requirements of Pillar I of Basel II which is expected to ensure that banks have sufficient high quality capital to support their risk taking activities and that they establish effective risk management systems commensurate with their level of operations.

Banks and Banking groups are expected to adopt the basic approaches for the computation of capital requirements for credit risk, market risk and operational risk as follows:

- | | | |
|------|------------------|--------------------------------|
| i. | Credit Risk | Standardized Approach |
| ii. | Market Risk | Standardized Approach |
| iii. | Operational Risk | Basic Indicator Approach (BIA) |

Within the first **two years** of the adoption of these approaches under Pillar 1, it is hoped that an effective rating system would have developed in Nigeria. Banks and banking groups are projected to have gathered more reliable data and gained experience that would prepare them to consider the adoption of more sophisticated approaches. The

¹ International Convergence Of Capital Measurements and Capital Standards: a Revised Framework, issued by the Basel Committee on Banking Supervision, June 2006



adoption of the Standardized Approach (TSA) for operational risks and other advanced approaches will be subject to the approval of the CBN.

These Guidelines emphasize the need for banks to have comprehensive risk management policies and processes that effectively identify, measure, monitor and control their risk exposures in addition to having appropriate board and senior management oversight.

The assessment of adherence to the standards and requirements set out by the CBN under the supervisory review process is key to ensuring that all risks are identified and appropriate actions are taken in a timely manner as well as ensuring that banks and banking groups have adequate internal capital management plans. A template to aid banks carry out their Internal Capital Adequacy Assessment Process is included in the relevant Guidance Note.

Minimum standards for both qualitative and quantitative disclosures are given to ensure that relevant material information are disclosed by banks and banking groups for enhanced transparency and related market discipline.

While the definition of regulatory capital has not significantly changed from those contained in the 1998 Accord, a section on the definition and constituents of regulatory capital is included to provide expectation on the calculation of capital under Basel II.

Although the document complies significantly with the requirements of the Basel II framework, certain sections were adjusted to reflect the peculiarities of our environment. From time to time; the CBN will also issue additional guidance notes to clarify its expectations on compliance with the technical provisions of these Guidelines.

The minimum capital requirement is retained as 10 percent and 15 percent for national and internationally active banks respectively.

This document is applicable to all banks and banking groups licensed to operate in Nigeria and should be applied on a solo and consolidated basis.



AREAS OF NATIONAL DISCRETION

PARAGRAPH IN BASEL DOCUMENT	DESCRIPTION OF THE AREAS OF NATIONAL DISCRETION	EXERCISED BY THE CBN (YES / NO)*
49 xiii	Employ a third tier of capital ("Tier 3": Short-term subordinated debts)	NO
54	Lower Risk weight to claims on sovereign (or central bank) in domestic currency if funded in that currency	YES
55	Recognition of Export Credit Agencies	NO
57	Claims on domestic Public Sector Entities (PSE) like banks	YES
58	Claims on domestic Public Sector Entities (PSE) like sovereigns	YES
60 – 64	Claims on banks	NO
64	Preferential treatment of claims on banking institutions with a maturity of 3 months or less	YES
65	Allow security firms to be treated like banks	NO
67	Increase standard risk weight for unrated claims when a higher risk weight is warranted by the default experience in their jurisdiction	NO
68	To risk weight all corporate exposures at 100% risk weight without regard to	NO



	external ratings	
69	Claims (exposures) included in regulatory retail portfolio	NO
70	Granularity criterion for the retail portfolio limit of 0.2% of the overall retail portfolio	NO
71	To increase risk weights for regulatory capital exposures	NO
72	Claims secured by residential mortgages	NO
72-73	To increase risk weight for claims secured by residential mortgages	YES
74	Commercial real estate 50% risk weight subject to compliance with certain conditions	NO
75&78	Risk weight for the unsecured portion of a loan past due, net of specific provisions, reduced to 50% when specific provisions are more than 50%	NO
75	Past due treatment for non-past due loans to counterparties subject to 150% risk weight	NO
76	Transitional period of three years for recognition of wider range of collateral for higher risk categories (past due assets)	NO
77	If past due loan is fully secured by other forms of collateral, a 100% risk weight may apply when provisions	NO



	reach 15% of the outstanding amount	
80	150% or higher risk weight to other assets	NO
81	Risk weight gold bullion at 0%	NO
92	Mapping External Credit Assessment Institutions' assessments to the risk weights	NO
102	Use a borrower's domestic currency rating for exposure in foreign exchange transactions when loan extended by a Multilateral Development Agency	NO
108	Use of unsolicited ratings	YES
201	Lower risk weight to claims guaranteed by the sovereign (or central bank) when denominated and funded in domestic currency	YES
170	Banks can apply a H=0 for certain types of repo style transaction	YES
171	Definition of core market participants	NO
650	Definition of gross income	NO
652	Allow banks to use Alternative Standardized Approach	NO
654	Treatment of negative gross income	NO



663	Impose criteria for non-internationally active banks using standardized approach	YES
718xxii	4% Charge to be applied for specific risk of equity securities if the portfolio is both liquid and diversified	NO
718xLii	Exemption from capital requirement for foreign exchange risk	NO