GOVERNMENT OF ZAMBIA

STATUTORY INSTRUMENT No. 184 of 1995

The Banking and Financial Services Act
(Act No. 21 of 1994)

The Banking and Financial Services (Capital Adequacy) Regulations, 1995

In EXERCISE of the powers contained in sections *eighty-three and eighty-four* of the Banking and Financial Services Act, 1994, and on the recommendation of the Bank of Zambia, the following Regulations are hereby made:

1. These Regulations may be cited as the Banking and Financial Services (Capital Adequacy) Regulations, 1995. Title

2. In these Regulations, unless the context otherwise requires- Interpretation

"associate" means a company in which more than 20 per cent but not more than 50 per cent of the outstanding voting shares (except any qualifying directors' shares) are owned directly or indirectly by the reporting bank or financial institution and the business activities and financial affairs of which the reporting bank or financial institution or its subsidiaries are able to materially influence;

"capital deficiency" means a shortfall in the minimum capital required by these Regulations.

"common shareholders equity" includes common shares and related contributed surplus, retained earnings, general reserves and the statutory reserve fund;

"goodwill" means the difference between cost and the acquired company's interest in the identifiable net assets;

"off balance sheet risks" means all items not shown on the balance sheet where the bank's or financial institution's capital is potentially at risk, and includes letters of credit, guarantees, commitments to re-purchase loans or securities, acceptances, performance bonds and other items deemed to constitute credit risk by the Bank of Zambia;

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regulatory capital" means instruments comprising the capital resources of a bank or financial institution, and the total of which is used by the Bank of Zambia for compliance by a bank or financial institution with the minimum capital standard and for assessing capital adequacy;

"general reserves" means an appropriation of retained earnings to reflect additional potential losses based on an assessment of the bank's overall situation by management;

"revaluation reserves" means the increment in the recorded or book value of a bank or financial institution's own premises, fixed assets or long term equity investments arising from a formal revaluation to reflect their current value or an amount closer to their current value than historical cost;

"subordinated debt" means a security which is, by its terms, subordinated in right of payment to all deposit liabilities and all other liabilities of the entity that issued the security other than liabilities that, by their terms, rank equally with, or are subordinated to, that security;

"subsidiary" means a company in which more than 50 per cent of the issued voting shares of the company (except any qualifying director's shares) are owned directly or indirectly by the reporting bank or artificial institution.

Minimum capital of a bank

3. (1) Every bank shall commence operations with primary paid-up capital of not less than two thousand million kwacha, or such other higher amount as may be prescribed by the Bank of Zambia from time to time and shall maintain this minimum amount at all times.

(2) A bank which does not meet the minimum capital requirement at the coming into force of these Regulations shall enter into negotiations with the Bank of Zambia to progressively build up its primary capital to at least one billion, two hundred and fifty million kwacha by not later than 30th June, 1996, and to two billion by 31st December, 1996.

Minimum capital of a financial institution

4. (1) Every financial institution shall, subject to such other higher amounts as may be prescribed by the Bank of Zambia commence operations with primary paid-up capital of not less than, for-

(a) deposit-taking institutions, two thousand million kwacha;
(b) leasing companies, two hundred and fifty million kwacha; and

(c) other types of financial institutions, an amount prescribed by the supervisory authority, to be not less than twenty-five million kwacha;

and shall maintain that minimum amount at all times.

(2) A financial institution which is operational at the coming into force of these Regulations which does not meet the applicable minimum capital requirement at the coming into force of these Regulations shall enter into negotiations with the Bank of Zambia to progressively build up its primary capital to at least the level prescribed by the Bank of Zambia by not later than 12 months after the coming into force of these Regulations.

Application of regulation 4 to subsidiary

5. Regulation 4 applies to a bank or financial institution which is a subsidiary of an adequately capitalised bank or other financial institution, irrespective of the amount of control exercised by the holding bank.

Minimum capital ratio

6. (1) Every bank and financial institution shall at all times maintain a minimum total capital equivalent of not less than 10 per cent of its total risk-weighted assets and off balance sheet exposures.

(2) Primary or tier one capital shall be a minimum of 5 per cent of the bank's or financial institution's total risk-weighted assets.

(3) A bank or financial institution operating at or near the level referred to in sub-regulation (2) but which has serious weaknesses in the quality of its assets, diversification of risk, liquidity or earnings, shall maintain capital levels well in excess of those prescribed in sub-regulation (1).

Determination of regulatory capital.

7. (1) In determining which funds should be included in the capital base of a bank or financial institution for purposes of the required minimum capital and for measuring capital adequacy, three criteria shall be considered, namely-

(a) permanence;
(b) being free of mandatory fixed charges against earnings; and
(c) the subordinated legal position to the rights of depositors and other creditors of the bank or financial institution.

(2) Regulatory capital shall be determined in accordance with the Second Schedule.

Primary or tier one capital

8. For purposes of assessing capital adequacy for regulatory purposes, a bank's or financial institution's primary or tier one capital includes-

(a) common shareholders' equity; and
(b) the following categories of preferred shares-
  (i) perpetual preferrers;
  (ii) compulsory convertible preferrers, where conversion to securities which would qualify as primary capital represents the only redemption option; and
  (iii) preferrers which have an original term to maturity of 20 years or more, where no redemption occurs within the first ten years, and where the maximum redemption obligation in any one year is restricted to five per cent or less of the original amount.

Conditions for securities of subsidiaries to qualify as primary or tier one capital

9. Minority interests or common shareholders' equity attributable to consolidated subsidiaries shall qualify as primary or tier one capital if they possess the three essential criteria for capital and shall be designated as a legitimate add-on component of the consolidated primary or tier one capital.

Secondary or tier two capital

10. For purposes of assessing capital adequacy for regulatory purposes, a bank's or financial institution's secondary or tier two capital includes preferred shares issued by a bank or financial institution which meet the requirements under regulation 13.

Failure to meet preferred dividend payment not to constitute grounds for bankruptcy

11. Failure by a bank or financial institution to meet a preferred dividend payment shall not constitute grounds for bankruptcy, but an omission or an interest payment on any form of debt shall constitute grounds for bankruptcy.

Conditions for securities of subsidiaries to qualify as secondary or tier two capital

12. Notwithstanding the separate legal status of secondary or tier two capital, securities of subsidiaries shall qualify for inclusion in consolidated secondary or tier two capital for measuring capital adequacy for regulatory purposes, provided that:

(a) there are no parent guarantees or other contractual features governing the issue that could in effect rank the investors' claims equal to or ahead of the claims of depositors; and
(b) they are fully subordinated to the other liabilities of the subsidiary;

(c) they meet the minimum criteria referred to in paragraph (b) of sub-regulations (1) and (3) of regulation 13 for qualifying debentures.

Qualifications for inclusion in secondary or tier two capital

13. (1) A preferred share shall qualify as secondary or tier two capital if-

(a) there is subordination to all of the deposit obligations of the bank; and
(b) it has an initial term greater than five years, with no redemptions permitted in the first five years.

(2) A share referred to in sub-regulation (1) may be redeemed before maturity only with the prior written approval of the Bank of Zambia.

(3) A loan stock or capital and other subordinated debentures issue shall not be included in secondary capital unless it meets the standards set in sub-regulation (1) and is free of restrictive covenants which could potentially interfere with a bank's or financial institution's ability to conduct normal banking operations, such as covenants mandating accelerated redemption in the event of failure to meet particular earnings coverage tests or in the event of missing dividend.

Bank's opinion to be sought

14. Any bank or financial institution intending to issue capital instruments shall seek the opinion of the Bank of Zambia as to whether or not these instruments qualify as capital.

Submission of state of affairs and results of operations to bank

15. (1) For purposes of determining adequacy under these regulations, a bank or financial institution shall submit to the Bank of Zambia its state of affairs, and the results of its operations and those of all of its subsidiaries and associates which conduct banking or financial services business.

(2) A bank or financial institution shall provide the Bank of Zambia with details of the activities of each subsidiary and associate to enable the Bank of Zambia to verify which enterprises, if any, should not be considered.

Components of primary or tier one capital

16. Primary or tier one capital includes-

(a) paid-up common shares;
(b) qualifying preferred shares referred to in regulation 8;
(c) contributed surplus (including premium on issues of shares, less any payments of premium on redemption; and capital contribution by shareholders without the issuance of shares);

(d) retained earnings;
(e) general reserves;
(f) statutory reserves; and
(g) minority interests (in the equity of subsidiaries which are less than wholly owned).

Components of secondary or tier two capital

17. Secondary or tier two capital is composed of residual financial instruments which possess some of the features of capital and which meet the standards set out in regulation 13 and any other form of capital as may be determined and announced by the Bank of Zambia, and includes-

(a) forty per cent of the reserves arising from the revaluation of tangible fixed assets;
(b) subordinated term debt, or loan stock or capital with a minimum original term of maturity of over five years, subject to a straight-line amortization during the last five years leaving no more than 20 per cent of the original amount outstanding in the final year before redemption; and
(c) other instruments or forms of capital which the Bank of Zambia may allow:

Provided that no part of accumulated goodwill shall be considered as capital.

Deductions from primary or tier one capital

18. In determining the amount of available capital for purposes of computing the minimum capital and the capital ratio required under these Regulations, the following items shall be deducted from the amount of capital derived under regulations 16 and 17:

(a) goodwill and other intangible assets;
(b) investments in unconsolidated subsidiaries and associates where the bank or financial institution has a direct and indirect ownership of 20 per cent or more;
(c) lending of a capital nature to subsidiaries and associates;
(d) holdings of other banks' or financial institutions' capital instrument; and
(e) the value of assets pledged to secure liabilities if such assets are not available to meet the liabilities of the bank or financial institution.

Limitations and restrictions

19. In computing the minimum total capital required under regulation 6-

(a) part of revaluation reserves shall not be considered as primary capital;
(b) the total of secondary or tier two capital shall be

limited to a maximum of 100 per cent of primary or tier one capital;

(c) revaluation reserves shall only qualify as secondary capital if-

(i) they relate to the revaluation of long-term investments and immovable fixed assets which have been formally identified as strategic long term investments by the board of directors of the bank of financial institutions;

(ii) the revaluation is made by an independent appraiser or another appropriate independent party, whose qualifications are considered appropriate by the respective bank's auditors, at intervals in accordance with the accounting policy of the reporting institution and generally accepted accounting practice;

(iii) the assets being revalued are of a similar nature, e.g., investments in premises, and the revaluation of all such assets is undertaken at the same time;

(iv) a reduction in the value of any such assets is taken into account where current market values are no longer supportive of balance sheet values; and

(v) details of all such revaluations are disclosed in the annual financial statements of the reporting institution.

Amortization of outstanding balances

20. (1) Eligible supplementary capital described in sub-regulation (b) of regulation 17 components shall be subject to straight-line amortization in the final five years prior to maturity or the effective dates governing shareholders' retraction rights.

(2) When subordinated debentures and qualifying subsidiary debt instruments approach maturity, redemption or retraction, outstanding balances shall be amortized on the basis of the following criteria:

YEARS TO MATURITY	AMOUNT INCLUDED IN CAPITAL
5 years or more	100%
4 years but less than five years	80%
3 years but less than 4 years	60%
2 years but less than 3 years	40%
1 year but less than 2 years	20%
Less than 1 year	0%

21. (1) For the purposes of this regulation, risk assets in relation to a bank or financial institution means assets that are normally recorded on the balance sheet and obligations which are assumed by the bank or financial institution and which are recorded off balance sheet. Risk weighted assets

(2) For the purposes of calculating the risk-weighted capital ratio, risk assets are classified into the following categories-

(a) cash and equivalent items, generally considered riskless, carrying a risk weight of zero per cent;
(b) assets with little risk and a high degree of liquidity, carrying a risk weight of twenty per cent;
(c) assets with a moderate degree of risk and having more credit and liquidity risk than those in paragraphs (a) and (b), carrying a risk weight of fifty per cent;
(d) the remaining assets typically found in the portfolio of a bank or financial institution, carrying a risk weight of one hundred per cent.

(3) Assets and their associated risk weights are as set out in parts 1 and 2 of the First Schedule.

22. (1) Any guarantees made by a bank or financial institution applicable to the liabilities of a subsidiary and which are already incorporated into the consolidated balance sheet shall be excluded to avoid double counting. Guarantees made by bank

(2) The inclusion for off-balance sheet items shall apply to arms' length contingent liabilities of the bank or financial institution and its subsidiaries, and shall exclude corresponding inter-company commitments.

23. The Bank of Zambia shall, in implementing capital adequacy standards, do so on an individual institution basis and shall rely on the criteria set out below: Implements of capital adequacy standard

(a) the size of the institution;
(b) the diversification of its assets and liabilities;
(c) degree of risk exposures;
(d) level of profitability; and
(e) management strength including liquidity management.

24. The total risk-weighted assets of each bank or financial institution shall be determined by multiplying the outstanding book value of its assets, net of allowance for losses and depreciation, by the prescribed risk weight factors of such assets, and aggregating the risk adjusted values of those assets following the format shown in Parts 1 Calculation of risk weighted assets

and 2 of the First Schedule.

Capital deficiency

25. If the Bank of Zambia, after conducting a review of both on and off balance sheet risks, finds that a bank or financial institution has insufficient capital to meet the requirements under regulation 6, the Bank of Zambia, in accordance with its powers to correct unsafe and unsound practices under Section seventy-seven of the Act, shall direct that such bank or financial institution effect an increase of its capital or a reduction of its assets and off-balance sheet exposures, within a period of three months.

Suspension of banks or financial institutions, branch networks, etc.

26. (1) Any bank or financial institution which, for a continuous period of fourteen days, incurs capital deficiencies shall automatically stop to grant new loans and other credit facilities, including the issuance of letters of credit and guarantees, without the prior approval of the Bank of Zambia.

(2) A bank or financial institution to which sub-regulation (1) applies shall have its branch network and all capital expenditures suspended.

(3) The suspension of a bank's or financial institution's lending privilege, branch expansion and capital expenditures shall remain in force for as long as the bank or financial institution is unable to increase its capital or reduce its assets or off-balance sheet exposures as directed by the Bank of Zambia, or to restructure its balance sheet risks to the satisfaction of the Bank of Zambia.

Suspension of Director

27. (1) Any director, officer or employee of a bank or financial institution who sanctions or votes for the approval of any loan or credit facility, branch expansion or capital expenditure while the bank remains under suspension as provided under regulations 25 and 26 shall be considered automatically suspended from office.

(2) The suspension referred to in sub-regulation (1) shall be without prejudice to any other punitive measures which may be applied against the director, officer or employee and which have been provided for in the Act.

Maintenance of records

28. Every bank and financial institution shall maintain suitable records to facilitate verification of its capital position.

Consolidated reports

29. For the purpose of computing its capital position, the principal office of each bank or financial institution in Zambia, all of its branches, agencies, subsidiaries, and associated companies regardless of country of domicile, shall be considered as a single unit.

Submission of reports

30. Every bank and financial institution shall-

(a) submit to the Bank of Zambia a monthly report on its capital position within 21 days following the reference month, in the form set out in the First and Second Schedules; and

(b) require its external auditors-

(i) to compute its capital position at the end of each financial year taking into account the requirements of the Act and all relevant prudential guidelines and regulations issued by the Bank of Zambia; and

(ii) to render a statement to the bank or financial institution on the adequacy or inadequacy of its capital and send a copy to the Bank of Zambia.

FIRST SCHEDULE
(Regulations 21 and 24)

PART 1
CALCULATION OF RISK-WEIGHTED ASSETS

Name of Bank/Financial Institution……………………………………………………………….
As at……………………………………………………………………………………………….

	(1) Risk Weight %	(2) Balance (Net Of allowances For losses (K'millions)	(3) Risk Weighted assets (1 x 2) K'millions)
ASSETS			
Notes and Coins			
-Zambian notes and coins			
-other notes and coins	0		
Balances held with the Bank of Zambia	0		
-statutory reserves			
-other balances	0		
Balances held with commercial banks in Zambia	0		
-with residential maturity of up to 12 months			
-with residential maturity of more than 12 months	20		
Abroad	100		
-with residential maturity of up to 12 months			
-with residential maturity of more than 12 months	20		
Assets in transit	100		
-from other commercial banks			
-from branches of reporting bank	50		
Investment in Debt Securities	20		
-treasury bills			
-other government securities	0		
-issued by Local Government Units	20		
-Private securities	100		
Bills of Exchange	100		
-portion secured by cash or treasury bills			
-others	0		
Loans and Advances	100		
-portion secured by cash or treasury bills			
-loans to or guaranteed by the Government of Zambia	0		
-loans repayable in instalments and secured by a mortgage on owner-	50		

occupied residential property			
-loans to or guaranteed by local Government Units	50		
-loans to parastatals	100		
Inter-bank advances and loans/ advances guaranteed by other banks	100		
-with a residual maturity of 12 months			
-with a residual maturity of more	20		
than 12 months	100		
Bank premises 100	100		
Acceptances 100	100		
Other assets 100	100		
Investment in equity of other companies	100		
TOTAL RISK-WEIGHTED ASSETS (on balance sheet)		________	________

PART 2

OFF-BALANCE SHEET OBLIGATIONS

	(1) Risk Weight %	(2) Balance (Net Of allowances For losses (K'millions)	(3) Risk Weighted assets (1 x 2) K'millions)
Letters of Credit			
-sight import Letters of credit	20		
-portion secured by Cash/Treasury bills	0		
-standby Letters of credit	100		
-portion secured by Cash/Treasury bills	0		
-export Letters of credit confirmed	20		
Guarantees and Indemnities			
-guarantees for loans, trade and securities	100		
-portion secured by Cash/Treasury bills	0		
-performance bonds	50		
-portion secured by Cash/Treasury bills	0		
-securities purchased under resale agreement	100		
-other contingent liabilities	100		
-net open position in foreign currencies	100		
TOTAL RISK-WEIGHTED ASSETS (off balance sheet)		________	________
TOTAL RISK-WEIGHTED ASSETS (on and off balance sheets)		________	________

SECOND SCHEDULE
(Regulation 7)

COMPUTATION OF CAPITAL POSITION

As at……………………………………………………………………………….
Name of Bank/Financial Institution…………………………………………………….

I. PRIMARY (TIER 1) CAPITAL		*K millions)*
(a)	Paid-up common shares	___________
(b)	Eligible preferred shares	___________
(c)	Contributed surplus	___________
(d)	Retained earnings	___________
(e)	General reserves	___________
(f)	Statutory reserves	___________
(g)	Minority interests (common shareholders' equity)	___________
(h)	Sub-total	___________
LESS		
(i)	Goodwill and other intangible assets	___________
(j)	Investments in unconsolidated subsidiaries and associates	___________
(k)	Lending of a capital nature to subsidiaries and associates	___________
(l)	Holding of other bank's or financial institution's capital instruments	___________
(m)	Assets pledged to secure liabilities	___________
(n)	Sub-total	___________
(o)	Total primary capital (h-n)	___________
II. SECONDARY (TEIR 2) CAPITAL		
(a)	Eligible preferred shares (regulations 13 and 17)	___________
(b)	Eligible subordinated term debt (regulation 23 (b))	___________
(c)	Eligible loan stock\capital (regulation 23 (b))	___________
(d)	Revaluation reserves (regulation 23 (a))	___________
(e)	Other (regulation 23 (c)) specify	___________
(f)	Total secondary capital	___________
III. ELIGIBLE SECONDARY CAPITAL (the maximum amount of secondary capital is limited to 100% of primary capital)		___________
IV. ELIGIBLE TOTAL CAPITAL (I (o) + III) (Regulatory capital)		___________

	(K'millions)
V. MINIMUM CAPITAL REQUIREMENT: (10% of total on and off balance sheet risk-weighted assets as established in the First Schedule, or K2,000 million, whichever is the higher)	__________
VI. EXCESS (DEFICIENCY) (IV minus V)	__________

LUSAKA
13th November 1995
[MF.101/16/95]

R. D. S. PENZA
Minister of Finance