Guidelines on
Computation of Capital Adequacy Ratio
(Revised Framework – Basel II)
CONTENTS

1 Introduction
   1.1 Approaches to Implementation of the Basel II Framework
   1.2 An initial step towards adopting Basel II

2 Scope of Application

3 Minimum Capital Ratio

4 Reporting Format

5 Submission dates

6 Instructions for Completion the Return
   6.1 Part 1- Computation of Capital Adequacy Ratio
   6.2 Part II (a) – Computation of Total Capital Base (Regulatory Capital)
   6.3 Part II (b) – Computation of Eligible Tier III for Market Risk
   6.4 Part III (a) – Computation of Risk-weighted Amount for Credit Risk
   6.5 Part III (b)-Computation of Credit Equivalent Amount of Off-Balance Sheet Items
   6.6 Part III © – Exposures Recognized under Credit Risk Mitigation (CRM)
   6.7 Part IV – Computation of Risk-weighted Amount for Market Risk
   6.8 Part V - Computation of Risk-weighted Amount for Operational Risk.
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMA</td>
<td>Advanced Measurement Approaches</td>
</tr>
<tr>
<td>BIA</td>
<td>Basic Indicator Approach</td>
</tr>
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<td>BIS</td>
<td>Bank for International Settlements</td>
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<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
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<td>CAR</td>
<td>Capital Adequacy Ratio</td>
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<td>CBSL</td>
<td>Central Bank of Sri Lanka</td>
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<td>CCR</td>
<td>Counterparty Credit Risk</td>
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<td>CIPC</td>
<td>Cash Items in the Process of Collection</td>
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<td>CRM</td>
<td>Credit Risk Mitigation</td>
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<td>ECAI</td>
<td>External Credit Assessment Institution</td>
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<td>GOSL</td>
<td>Government of Sri Lanka</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>LKR</td>
<td>Sri Lanka Rupee</td>
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<td>MDB</td>
<td>Multilateral Development Bank</td>
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<tr>
<td>NPA</td>
<td>Non Performing Assets</td>
</tr>
<tr>
<td>PSE</td>
<td>Public Sector Entities</td>
</tr>
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<td>SA</td>
<td>Standardised Approach</td>
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<td>SLECIC</td>
<td>Sri Lanka Export Credit Insurance Corporation</td>
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<td>SME</td>
<td>Small and Medium Enterprise</td>
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<td>SMM</td>
<td>Standardised Measurement Method</td>
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<td>LCB</td>
<td>Licensed Commercial Bank</td>
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<td>LSB</td>
<td>Licensed Specialised Bank</td>
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1 Introduction


1.2 As an initial step towards adopting Basel II, all licensed commercial banks (LCBs) and licensed specialized banks (LSBs) are required to apply the following approaches in computing the capital adequacy ratio.

1.2.1 The Standardised Approach for credit risk

1.2.2 The Standardised Measurement Method for market risk

1.2.3 The Basic Indicator Approach for operational risk.

2 Scope of Application

2.1 The revised capital adequacy norms will be applicable, in the case of all LCBs and LSBs incorporated in Sri Lanka:

2.1.1 on the solo basis - All positions of the bank and its local and overseas branches / offices.

2.1.2 on the consolidated basis – All position of the bank (including its local and overseas branches / offices ) and its subsidiary companies.

2.2 In the case of LCBs incorporated outside Sri Lanka, the revised capital adequacy norms will be applicable to the branch operations in Sri Lanka and subsidiaries in Sri Lanka, established with the assigned capital of the branch, if any.

2.3 All LCBs and LSBs are required to use the attached reporting format (Schedule - II) for reporting capital adequacy, commencing 2008.

3 Minimum Capital Ratio

All LCBs and LSBs shall at all times maintain the capital adequacy ratios determined by the Monetary Board in term of Sections 19(7)(a) and 76J (1) (a) of the Banking Act, commencing from 1st January 2008.
4 Reporting Format

4.1 The attached reporting format (Schedule II) collects information on the capital adequacy position of licensed banks. The return comprises 5 major parts.

4.1.1 Part I - Computation of capital adequacy ratio.

4.1.2 Part II- (a) Computation of total capital base. (b) Computation of eligible Tier III capital for market risk.

4.1.3 Part III- (a) Computation of risk-weighted amount for credit risk. (b) Credit equivalent of off-balance sheet items. (c) Exposures recognized under credit risk mitigation (CRM).

4.1.4 Part IV- Computation of risk-weighted amount for market risk.

4.1.5 Part V- Computation of risk-weighted amount for operational risk.

5 Submission dates

5.1 The return should show the position as at the last calendar day of each quarter/each financial year, and should be submitted through the web-based system as follows. Regional Developments Banks are required to submit the attached return (schedule II) in the manual form.

5.1.1 Quarterly return/s – within 1 month after the end of each quarter.

5.1.2 Annual audited return/s - within 6 months after the end of the financial year of the respective bank.

5.1.3 If the submission deadline falls on a bank holiday, it will be deferred to the next working day.

5.2 The Statement of Certification on the information submitted in the above return/s and the capital adequacy ratio should be forwarded to Bank Supervision Department in manual form. For this purpose, banks may use the existing format (copy attached), which was issued under the implementation of the new web-based returns in July 2006.
6 Instructions for Completion the Return

The instructions for completion of the capital adequacy return are divided into eight parts. The details/definitions of each element in these eight parts are described with the web-based return code (WBRC).

6.1 Part 1- Computation of Capital Adequacy Ratio

The values of the items in this form are updated automatically on the web-based return.

6.1.1 Eligible Core Capital (Eligible Tier I) (WBRC 11.1.1.0.0.0)
The amount must agree with item 6.2.2.1 of part II (a) Computation of total capital base below.
(= WBRC 11.2.1.1.0.0 of Part II (a))

6.1.2 Capital Base (Regulatory Capital) (WBRC 11.1.2.0.0.0)
The amount must agree with item 6.2.2.9 of part II (a) Computation of total capital base below.
(= WBRC 11.2.1.5.0.0 of Part II (a))

6.1.3 Total Risk-Weighted Amount (WBRC 11.1.3.0.0.0)
Total risk-weighted assets are determined by adding the resulting figures to the sum of risk-weighted assets for credit risk, market risk and operational risk.
Total of risk-weighted amount for credit risk (6.1.3.1), market risk (6.1.3.2) and operational risk (6.1.3.3).
(WBRC 11.1.3.1.0.0+11.1.3.2.0.0+11.1.3.3.0.0)

6.1.3.1 Risk-Weighted Amount for Credit Risk (WBRC 11.1.3.1.0.0)
The amount must agree with item 6.4.3.1 of part III (a) Computation of risk-weighted amount for credit risk below.
(=WBRC11.3.1.0.0.0 of Part III (a))

6.1.3.2 Risk-Weighted Amount for Market Risk (WBRC 11.1.3.2.0.0)
The amount must agree with item 6.7.8.2 of part IV Computation of risk-weighted amount for market risk below.
(= WBRC 11.4.2.0.0.0 of Part IV)
6.1.3.3 Risk-Weighted Amount for Operational Risk
(WBRC 11.1.3.3.0.0)
The amount must agree with item 6.8.2.3 of part III (a) Computation of risk-weighted amount for operational risk below.
(= WBRC 11.5.3.0.0.0 of Part V)

6.1.4 Core Capital (Tier 1) Ratio, %
(WBRC 11.1.4.0.0.0)
Eligible core capital (6.1.1) divided by Total risk-weighted amount (6.1.3)
(WBRC 11.1.1.0.0.0/11.1.3.0.0.0)*100

6.1.5 Total Capital Ratio, %
(WBRC 11.1.5.0.0.0)
Total capital base (6.1.2) divided by Total risk-weighted amount (6.1.3)
(WBRC 11.1.2.0.0.0/11.1.3.0.0.0)*100
6.2 Part II (a) - Computation of Total Capital Base (Regulatory Capital)

6.2.1 Constituents of Capital Base
Capital base consists of eligible core capital (Tier I), eligible supplementary capital (Tier II) and eligible short term subordinated debt covering market risk (Tier III).

6.2.2 Specific instructions for elements of Capital

6.2.2.1 Eligible Core Capital (Eligible Tier I) (WBRC 11.2.1.1.0.0)
The Eligible Core Capital shall be the total core capital less total amount of deductions/adjustments to core capital. Total eligible core capital should represent at least half of total capital base, i.e. the sum total of eligible supplementary capital plus eligible Tier III capital should not exceed total eligible core capital. The amount must agree with core capital (6.2.2.2) less Tier I adjustments (6.2.2.3).
(WBRC 11.2.1.1.0 - 11.2.1.1.2.0)

6.2.2.2 Core Capital (Tier I) (WBRC 11.2.1.1.1.0)
Core capital includes only permanent shareholders' equity (issued and fully paid ordinary shares/common stock and perpetual non-cumulative preference shares), assigned capital and disclosed reserves (created or increased by appropriations of retained earnings or other surplus, e.g. share premiums, retained profit, general reserves and statutory reserves). The amount must agree with the sum of the following elements from 6.2.2.2.1 to 6.2.2.2.10
(WBRC 11.2.1.1.1.1 to 11.2.1.1.10)

6.2.2.2.1 Paid-up Ordinary Shares/ Assigned Capital (WBRC 11.2.1.1.1.1)
In the case of LCBs and LSBs incorporated in Sri Lanka: Issued and fully paid ordinary shares in terms of the Banking Act. For the computation only the paid up portion of partly paid shares should be counted as capital. (will be revised in terms of the Companies Act No.7 of 2007)
LCB incorporated or established outside Sri Lanka: Equity capital that shall be assigned by the Head Office of a LCB incorporated or established outside Sri Lanka.
6.2.2.2 Non-cumulative, Non-redeemable Preference Shares  
(WBRC 11.2.1.1.1.2)  
Issued and fully paid non-cumulative, non-redeemable preference shares where the payment of dividend could be reduced or waived permanently in the event of profitability being inadequate to support such payment in part or full.

6.2.2.3 Share Premium  
(WBRC 11.2.1.1.1.3)  
The excess of issue price over the par value of the ordinary shares or common stock or non-cumulative, non-redeemable preference shares. (will be revised in terms of the Companies Act No.7 of 2007)

6.2.2.4 Statutory Reserve Fund  
(WBRC 11.2.1.1.1.4)  
Balance in the Reserve Fund as per last audited statement of accounts and set up by banks in terms of the Banking Act.

6.2.2.5 Published Retained Profits/(Accumulated Losses)  
(WBRC 11.2.1.1.1.5)  
Balance in the profit and loss account brought forward from the previous financial years and as reported in the last audited statement of accounts. Accumulated losses should be reported in parenthesis and deducted from the other capital constituents.

6.2.2.6 General and Other Reserves  
(WBRC 11.2.1.1.1.6)  
Disclosed reserves in the form of general or other reserves created or increased by appropriation of retained earnings, share premium or other surplus as per last audited financial statements.

6.2.2.7 Gain/(Loss) After Tax Arising from the Sale of Fixed and Long-term Investments  
(WBRC 11.2.1.1.1.7)  
Any gain/(loss) after tax arising from the sale of fixed and long-term investments since the closing date of the last audited accounts. Net loss arising from the sale of fixed and long-term investments should be reported in parenthesis and deducted from the other capital constituents.

6.2.2.8 Unpublished Current Year’s Profit/(Loss)  
(WBRC 11.2.1.1.1.8)  
Current year profit (excluding any profit/ (loss) after tax arising from the sale of fixed and long term investments) earned/incurred since the closing date of the last audited accounts
and subject to certification by the institution’s external auditor. Current year loss should be reported in parenthesis and deducted from the other capital constituents. For this purpose, the banks are required obtain the audit certificate based on the Sri Lanka Auditing Practice Statements 1 (SLAPs 1) “The Auditor’s Report on Special Purpose Audit Engagements

6.2.2.9 Minority Interests (consistent with the above capital constituents)  
(WBRC 11.2.1.1.1.9)  
Minority interests on consolidation of capital items.

6.2.2.10 Perpetual Debt Capital Instruments  
(WBRC 11.2.1.1.1.10)  
Perpetual debt capital instruments that satisfy the following conditions:
(i) Prior written approval of the CBSL has been obtained.
(ii) Such instruments shall have no maturity.
(iii) Unsecured, fully paid up and subordinated to the interests of creditors
(iv) The perpetual debt capital instruments should contain a clause that the issuing bank shall not be liable to pay interest, if:
   a. The bank’s CAR is below the minimum regulatory requirement in terms of the Direction on CAR, or
   b. The impact of such payment results in the bank’s CAR falling below the minimum CAR, and
   c. Such interest not paid shall not be cumulative or accrued for payment in the future.
(v) Such instruments may contain a call option, which may be exercised in 10 years from the date of issue, provided that the prior approval of CBSL has been obtained to exercise such option.
(vi) Total perpetual debt approved as core capital shall not exceed 15% of the total non-innovative core capital after adjustments and deductions.
(vii) Any other conditions stipulated by CBSL on prudential grounds.

6.2.2.3 Deductions/ Adjustments-Core capital (Tier I)  
(WBRC 11.2.1.1.2.0)  
The amount must agree with the sum of the following items from 6.2.2.3.1 to 6.2.2.3.9
(WBRC 11.2.1.1.2.1 to 11.2.1.1.2.9)
6.2.2.3.1 Goodwill
(WBRC 11.2.1.1.2.1)
Report the amount of goodwill as shown in the balance sheet.

6.2.2.3.2 Net Deferred Tax
(WBRC 11.2.1.1.2.2)
Net debit balance of deferred tax.

6.2.2.3.3 Other Intangible Assets
(WBRC 11.2.1.1.2.3)
Intangible assets and losses in the current period and those brought forward from previous periods should be deducted from core capital.

6.2.2.3.4 Advances granted to employees of the bank for the purchase of shares of the bank under a share ownership plan.
(WBRC 11.2.1.1.2.4)

6.2.2.3.5 Amount due from head office & branches outside Sri Lanka in Sri Lanka Rupees (applicable only to branches of foreign banks).
(WBRC 11.2.1.1.2.5)
Debit balances in VOSTRO current accounts in Sri Lanka Rupees held by Head Office and branches outside Sri Lanka in Sri Lanka Rupees.

6.2.2.3.6 Amount due to head office & branches outside Sri Lanka in Sri Lanka Rupees (-) (applicable only to branches of foreign banks)
(WBRC 11.2.1.1.2.6)
Credit balances in VOSTRO current accounts in Sri Lanka Rupees held by Head Office and branches outside Sri Lanka in Sri Lanka Rupees. Report with negative (-) sign.

6.2.2.3.7 Amount due from head office & branches outside Sri Lanka in Foreign Currency (net) (applicable only to branches of foreign banks)
(WBRC 11.2.1.1.2.7)
Net Debit balances (after netting of credit balances) in NOSTRO current accounts in foreign currency held with Head Office and branches outside Sri Lanka and the net amount of fixed and other deposits placed with and amounts lent to Head Office and branches outside Sri Lanka (after netting of fixed and other deposits and amounts borrowed from Head Office and branches outside Sri Lanka) in foreign currency. Ignore any net credit balance.
6.2.2.3.8 50% of Investments in Unconsolidated Banking and Financial Subsidiary Companies (WBRC 11.2.1.1.2.8)
50% of investments in capital by way of shares, perpetual/hybrid capital instruments or subordinated term debt in unconsolidated banking and financial subsidiary companies.

6.2.2.3.9 50% of Investments in the Capital of Other Banks and Financial Institutions (WBRC 11.2.1.1.2.9)
50% of investments in capital by way of shares, perpetual/hybrid capital instruments or subordinated term debt in other banks and financial institutions.

6.2.2.4 Supplementary Capital (Tier II) (WBRC 11.2.1.2.1.0)
The amount must agree to sum of following items from 6.2.2.4.1 to 6.2.2.4.5 (WBRC 11.2.1.2.1.1 to 11.2.1.2.1.5)

6.2.2.4.1 Revaluation Reserves (approved by CBSL) (WBRC 11.2.1.2.1.1)
Revaluation reserves may be included within Tier II Supplementary Capital provided that such revaluation is prudently valued reflecting fully the possibility of price fluctuations and forced sale, with prior approval of CBSL, subject to a discount of 50%. Revaluation surplus may be included in Tier II capital not more than once in 7 years.

6.2.2.4.2 General Provisions (WBRC 11.2.1.2.1.2)
General provisions or general loan loss reserves created against the possibility of future losses. Where they are not ascribed to particular assets and do not reflect deduction in the valuation of particular assets, they qualify for inclusion in Supplementary Capital (Tier II). General provisions should not exceed 1.25% of the sum of risk-weighted assets.

6.2.2.4.3 Hybrid Capital Instruments (Debt/Equity) (WBRC 11.2.1.2.1.3)
Capital instruments which combine certain characteristics of equity capital and debt. i.e. cumulative redeemable preference shares, etc. and satisfy the following characteristics:
(i) Prior written approval of CBSL has been obtained for inclusion of such items in the capital.
(ii) Unsecured, fully paid up and subordinated to the interests of creditors.
(iii) Not redeemable in less than 5 years or without the prior approval of CBSL.
(iv) Available to participate in losses without the Bank being obliged to cease trading.
(v) Obligation to pay interest can be deferred where the profitability of the Bank would not support such payment.
(vi) Any other condition stipulated by CBSL on prudential grounds.

6.2.4.4 Minority Interests arising from Preference Shares (WBRC 11.2.1.2.1.4)
Minority interests arising from the consolidation of preference shares.

6.2.2.4.5 Approved Subordinated Term Debt (WBRC 11.2.1.2.1.5)
Subordinated term debt that satisfies the following conditions:
(i) The prior written approval of CBSL has been obtained for inclusion as Tier II capital.
(ii) Unsecured and subordinated to the interests of creditors, at fully paid up value in the case of coupon bonds or paid up value plus accrued interest in the case of zero coupon bonds.
(iii) A minimum original maturity of 5 years.
(iv) Early repayment or redemption shall not be made without the prior consent of CBSL.
(v) The amount counted as capital should be discounted by 1/5th each year during the four years preceding maturity.
(vi) The total approved subordinated term debt should not exceed 50% of total Tier 1 capital.
(vii) Any other conditions stipulated by CBSL on prudential grounds.

6.2.2.4.6 Actual Amount of Approved Subordinated Term Debts (WBRC 0.0.0.0.0.0)
Report total actual amount of approved subordinated term debts.

6.2.2.5 Deductions - Tier II (WBRC 11.2.1.2.2.0)
The amount must agree to sum of following items from 6.2.2.5.1 to 6.2.2.5.2 (WBRC 11.2.1.2.2.1 to 11.2.1.2.2.2)
6.2.2.5.1 50% of Investments in Unconsolidated Banking and Financial Subsidiary Companies (WBRC 11.2.1.2.2.1)
50% of investments in capital by way of shares, perpetual/hybrid capital instruments or subordinated term debt in unconsolidated banking and financial subsidiary companies.

6.2.2.5.2 50% of Investments in the Capital of Other Banks and Financial Institutions (WBRC 11.2.1.2.2.2)
50% of investments in capital by way of shares, perpetual/hybrid capital instruments or subordinated term debt in other banks and financial institutions

6.2.2.6 Total Supplementary Capital (WBRC 11.2.1.2.0.0)
The amount must agree to Supplementary Capital (Tier II) (6.2.2.4) less Tier II deductions (6.2.2.5).
(11.2.1.2.1.0 - 11.2.1.2.2.0)

6.2.2.7 Eligible Supplementary Capital (WBRC 11.2.1.3.0.0)
Eligible supplementary capital (Eligible Tier II) will be restricted to 100% of Total Core Capital (6.2.2.1) (After deductions/adjustments).

6.2.2.8 Short Term Subordinated Debt (Tier III) (WBRC 11.2.1.4.0.0)
Short term subordinated debt may be used for the sole purpose of meeting a proportion of the capital requirements for market risk. For short-term subordinated debt to be eligible as supplementary capital, it needs, if circumstances demand, to be capable of becoming part of a bank's permanent capital and thus be available to absorb losses in the event of insolvency. It must, therefore, at a minimum:

(i) be unsecured, subordinated and fully paid up
(ii) have an original maturity of at least two years
(iii) not be repayable before the agreed repayment date unless the prior consent of CBSL is obtained
(iv) be subject to a lock-in clause which stipulates that neither interest nor principal may be paid (even at maturity) if such payment means that the bank falls below or remains below its minimum capital requirement
6.2.2.8.1 Approved Short Term Subordinated Debt 
(WBRC 11.2.1.4.1.0) 
Total amount of approved short-term subordinated debts under above conditions.

6.2.2.8.2 Eligible Supplementary Capital (Eligible Tier III)-Utilised 
(WBRC 11.2.1.4.2.0) 
The amount must agree with item 6.3.3.6.1 of part II (b) subject to the following conditions. (=WBRC 11.2.2.6.1.0 of part II (b))

(i) A minimum of about 28½% of market risk needs to be supported by eligible core capital that is available to support market risk.
(ii) Tier III capital will be limited to 250% of a bank's eligible core capital that is available to support market risk after meeting credit risk and operational risk.

6.2.2.9 Capital Base 
(WBRC 11.2.1.5.0.0) 
The amount must agree with the sum of items of eligible core capital (6.2.2.1), eligible supplementary capital (6.2.2.7) and eligible tier III capital (6.2.2.8.2)
(WBRC 11.2.1.1.0.0+11.2.1.3.0.0+11.2.1.4.2.0)

6.2.3 An indicative list of institutions which may be deemed to be financial subsidiaries/institutions for the purposes of items 6.2.2.3.8, 6.2.2.3.9, 6.2.2.5.1 and 6.2.2.5.2 above is as under:
(WBRC 11.2.1.1.2.8, 11.2.1.1.2.9, 11.2.1.2.2.1 and 11.2.1.2.2.2)

(i) LCBs and LSBs,
(ii) Insurance Companies,
(iii) Registered Finance Companies,
(iv) Specialised Leasing Companies,
(v) Merchant Banks,
(vi) Primary Dealers.

6.2.4 Subsidiary companies referred to in items 6.2.2.3.8, 6.2.2.3.9, 6.2.2.5.1 and 6.2.2.5.2 above will be as defined in the Banking Act.
6.3 Part II (b) - Computation of Eligible Tier III for Market Risk

6.3.1 Rule of Short-Term Subordinated Debt Covering Market Risk (Tier III Capital)
For short-term subordinated debt to be eligible as Tier III capital, it needs, if circumstances demand, to be capable of becoming part of a bank's permanent capital and thus be available to absorb losses in the event of insolvency. Short-term subordinated debt may be used for the sole purpose of meeting a proportion of the capital requirements for market risk. It must, therefore, at a minimum:

(i) be unsecured, subordinated and fully paid up
(ii) have an original maturity of at least two years
(iii) not be repayable before the agreed repayment date unless the prior consent of CBSL is obtained
(iv) be subject to a lock-in clause which stipulates that neither interest nor principal may be paid (even at maturity) if such payment means that the bank falls below or remains below its minimum capital requirement.

6.3.2 Eligible Tier III capital

(i) Tier III capital will be limited to 250% of a bank's eligible core capital that is available to support market risk after meeting credit risk and operational risk.

(ii) The minimum of about 28½% of market risk needs to be supported by eligible core capital that is available to support market risk.

(iii) Tier 2 elements may be substituted for Tier III up to the same limit of 250% so far as the overall limits stated in paragraphs 6.2.2.4.5 and 6.2.2.7 are not breached, i.e. eligible supplementary capital may not exceed eligible core capital, and long-term subordinated debt may not exceed 50% of core capital.

(iv) In addition, eligible core capital should represent at least half of total capital base, i.e. the sum total of supplementary capital plus Tier III capital should not exceed eligible core capital.

(v) In determining the level of eligible core capital for the purposes of determining eligible Tier III capital, all adjustments required in arriving at the total capital base (as stated in 6.2.2.3 and 6.2.2.5) should be taken into consideration.
6.3.3 Specific instructions for Computation of eligible Tier III for market risk
The values of the items in this form are updated automatically, except item 6.3.3.5.1 below.
(WBRC 11.2.2.5.1.0)

6.3.3.1 Total Risk Weighted Assets (RWA) (WBRC 11.2.2.1.0.0)
The amount must agree with the sum of the following items from 6.3.3.1.1 to 6.3.3.1.2
(WBRC 11.2.2.1.1.0 to 11.2.2.1.2.0)

6.3.3.1.1 Total Risk Weighted Assets for Credit and Operational Risks (WBRC 11.2.2.1.1.0)
The amount must agree with the sum of item 6.4.3.1 of Part III (a) Computation of risk-weighted amount for credit risk and item 6.8.2.3 of Part V Computation of risk-weighted amount for operational risk below.
(WBRC 11.3.1.0.0.0 of Part III (a) and 1.5.3.0.0.0 of Part V)

6.3.3.1.2 Total Risk Weighted Assets for Market Risk (WBRC 11.2.2.1.2.0)
The amount must agree with item 6.7.8.2 of Part IV Computation of risk-weighted amount for market risk
(WBRC 11.4.2.0.0.0 of Part IV)

6.3.3.2 Minimum Capital Charge (WBRC 11.2.2.2.0.0)
The amount must agree with the sum of the following items from 6.3.3.2.1 to 6.3.3.2.2 (WBRC 11.2.2.2.1.0 to 11.2.2.2.2.0)

6.3.3.2.1 Capital charge for Credit and Operational Risk (WBRC 11.2.2.2.1.0)
The amount must agree with 10% of the total risk weighted assets for credit and operational risks item 6.3.3.1.1 above.
(10% of WBRC11.2.2.1.1.0)

6.3.3.2.2 Capital Charge for Market Risk (WBRC 11.2.2.2.2.0)
The amount must agree with 10% of total risk weighted assets for market risk item 6.3.3.1.2
(10% WBRC 11.2.2.1.2.0)
6.3.3.3 Total Capital Available to Meet the Capital Charge for Credit and Operational Risks  
(WBRC 11.2.2.3.0.0)  
The amount must agree with the sum of total core capital (6.2.2.1) and eligible supplementary capital (6.2.2.7) of Part II (a) Computation of total capital base above.  
(WBRC11.2.1.1.0.0 and 11.2.1.3.0.0 of Part II (a))

6.3.3.4 Total Capital Base Available to meet Market Risk  
(WBRC 11.2.2.4.0.0)  
Total capital available to meet the capital charge for credit and operational risks (6.3.3.3) less capital charge for credit and operational risks (6.3.3.2.1)  
(WBRC 11.2.2.3.0.0 -11.2.2.2.1.0)

6.3.3.5 Total Available Tier III Capital  
(WBRC 11.2.2.5.0.0)

6.3.3.5.1 Approved Short-term Subordinated Debt  
(WBRC 11.2.2.5.1.0)  
Report total amount of approved short-term subordinated debts under the conditions are stated at item 6.2.2.8.  
(as per WBRC 11.2.1.4.0.0)

6.3.3.5.2 Minimum of 28.5% of Capital Charge for Market Risk to be met by eligible core capital that is not Required for Credit Risk  
(WBRC 11.2.2.5.2.0)  
A minimum of about 28½% of market risk needs to be supported by eligible core capital that is available to support market risk.

(i)  **Limit**  
(WBRC 11.2.2.5.2.1)  
Limit is computed under condition at 6.2.2.8.2 (i) above. The amount must agree to item 6.3.3.2.2 *28.5%  
(WBRC 11.2.2.2.0*28.5%)

(ii)  **Amount Utilised**  
(WBRC 11.2.2.5.2.2)  
Minimum utilised amount should be equal to above limit.
6.3.3.5.3 Maximum of 250% of eligible core capital that is not Required for Credit and Operational Risks (WBRC 11.2.2.5.3.0)
Tier III capital will be limited to 250% of a bank's eligible core capital that is available to support market risk after meeting credit risk and operational risk.

(i) Limit
(WBRC 11.2.2.5.3.1)
Limit is computed under condition at 6.2.2.8.2 (ii) above. The amount must agree with item 6.3.3.4 *250% (WBRC 11.2.2.4.0.0*250%)

(ii) Amount Utilised
(WBRC 11.2.2.5.3.2)
The utilized amount is computed automatically.

6.3.3.6 Eligible Tier III Capital (WBRC 11.2.2.6.0.0)
Eligible Tier III capital for market risk is computed as follows.

6.3.3.6.1 Eligible Tier III Capital utilised
(WBRC 11.2.2.6.1.0)
Total capital charge for market risk (6.3.3.2.2) less eligible core capital utilized for market risk (6.3.3.5.2 (ii)) (WBRC 11.2.2.2.2.0-11.2.2.5.2.2)

6.3.3.6.2 Eligible but Unutilized Tier III Capital
The approved short-term subordinated debt (6.3.3.5.1) less eligible Tier III capital utilized (6.3.3.6.1). (11.2.2.5.1.0-11.2.2.6.1.0)
6.4 Part III (a) - Computation of Risk-weighted Amount for Credit Risk.

6.4.1 General Rules for Measuring Credit Risk Based on the Standardised Approach (SA)

6.4.1.1 Under the SA, the rating assigned by the eligible external credit assessment institutions (ECAIs) will largely support the measure of credit risk. Banks may rely upon the ratings assigned by the ECAIs recognised by CBSL (See paragraph 6.4.2) for assigning risk weights for capital adequacy purposes as per the mapping furnished in these guidelines.

6.4.1.2 The risk weighting of claims will be as described in paragraphs 6.4.3 (under specific rules for measuring credit risk).

6.4.1.3 Claims (exposures) on a counterpart would include placements with banks, investments, loans and advances or any other credit exposure.

6.4.1.4 On-balance sheet claims (exposures) would be risk weighted applying the risk weight as given in paragraphs 6.4.3 while off-balance sheet items would continue to be converted to credit equivalents using the credit conversion factors given in paragraph 6.5 and thereafter risk weighted according to the risk weight applicable to the counterpart.

6.4.1.5 All exposures should be risk-weighted net of specific provisions and interest in suspense that has been charged to the respective customer account.

6.4.2 External Credit Assessments

6.4.2.1 Recognition of Eligible Credit Rating Agencies

6.4.2.1.1 The Revised Capital Adequacy Framework requires recognizing ECAIs and developing a mapping process to assign the ratings issued by eligible credit rating agencies to the risk weights available under the Standardised Approach. In accordance with the principles laid down in the revised framework, CBSL has identified the following two credit rating agencies operating in Sri Lanka for the purposes of risk weighting claims by banks for capital adequacy purposes:

(i) Fitch Ratings Lanka Ltd. and
(ii) Lanka Rating Agency Ltd.
6.4.2.1.2 The following internationally recognized credit ratings agencies are also accepted as ECAIs.
(i) Moody’s
(ii) Standard and Poor’s and
(iii) Fitch Ratings

6.4.2.1.3 Banks are required to obtain the prior approval of CBSL for the use of other ECAIs.

6.4.2.2 Scope of Application of External Ratings

6.4.2.2.1 Banks should use the chosen ECAIs and their ratings consistently for each type of claim, for both risk weighting and risk management purposes. Banks will not be allowed to “cherry pick” the assessments provided by different ECAIs.

6.4.2.2.2 Banks shall not use one ECAI’s rating for one exposure, while using another ECAI’s rating for another exposure to the same counterpart, unless the respective exposures are rated by only one of the chosen ECAIs, whose ratings the bank has decided to use. External assessments for one entity within a corporate group cannot be used to risk weight other entities within the same group.

6.4.2.3 Mapping Process

6.4.2.3.1 The ratings issued by the eligible ECAIs have been mapped to the appropriate risk weights applicable as per the Standardised Approach under the Revised Framework. The rating risk weight - mapping furnished in the tables below shall be adopted by all banks:

<table>
<thead>
<tr>
<th>Fitch Ratings Lanka</th>
<th>Lanka Rating Agency</th>
<th>Rating Scale of CAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>AA(sri)</td>
<td>AAA</td>
<td>AAA</td>
</tr>
<tr>
<td>AA+(sri)</td>
<td>AA1</td>
<td>AA+</td>
</tr>
<tr>
<td>AA(sri)</td>
<td>AA2</td>
<td>AA</td>
</tr>
<tr>
<td>AA-(sri)</td>
<td>AA3</td>
<td>AA-</td>
</tr>
<tr>
<td>A+(sri)</td>
<td>A1</td>
<td>A+</td>
</tr>
<tr>
<td>A(sri)</td>
<td>A2</td>
<td>A</td>
</tr>
<tr>
<td>A-(sri)</td>
<td>A3</td>
<td>A-</td>
</tr>
<tr>
<td>BBB+(sri)</td>
<td>BBB1</td>
<td>BBB+</td>
</tr>
</tbody>
</table>
Table 2
Mapping of Notations of the International Credit Rating Agencies

<table>
<thead>
<tr>
<th>Standard and Poor’s</th>
<th>Moody’s</th>
<th>Fitch Ratings</th>
<th>Rating Scale of CAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Aaa</td>
<td>AAA</td>
<td>AAA</td>
</tr>
<tr>
<td>AA+</td>
<td>Aa1</td>
<td>AA+</td>
<td>AA+</td>
</tr>
<tr>
<td>AA</td>
<td>Aa2</td>
<td>AA</td>
<td>AA</td>
</tr>
<tr>
<td>AA-</td>
<td>Aa3</td>
<td>AA-</td>
<td>AA-</td>
</tr>
<tr>
<td>A+</td>
<td>A1</td>
<td>A+</td>
<td>A+</td>
</tr>
<tr>
<td>A</td>
<td>A2</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>A-</td>
<td>A3</td>
<td>A-</td>
<td>A-</td>
</tr>
<tr>
<td>BBB+</td>
<td>Baa1</td>
<td>BBB+</td>
<td>BBB+</td>
</tr>
<tr>
<td>BBB</td>
<td>Baa2</td>
<td>BBB</td>
<td>BBB</td>
</tr>
<tr>
<td>BBB-</td>
<td>Baa3</td>
<td>BBB-</td>
<td>BBB-</td>
</tr>
<tr>
<td>BB+</td>
<td>Ba1</td>
<td>BB+</td>
<td>BB+</td>
</tr>
<tr>
<td>BB</td>
<td>Ba2</td>
<td>BB</td>
<td>BB</td>
</tr>
<tr>
<td>BB-</td>
<td>Ba3</td>
<td>BB-</td>
<td>BB-</td>
</tr>
<tr>
<td>B+</td>
<td>B1</td>
<td>B+</td>
<td>B+</td>
</tr>
<tr>
<td>B</td>
<td>B2</td>
<td>B</td>
<td>B</td>
</tr>
<tr>
<td>B- &amp; Lower</td>
<td>B3 &amp; Lower</td>
<td>B- &amp; Lower</td>
<td>B- &amp; Lower</td>
</tr>
</tbody>
</table>
6.4.2.4 Short-Term Ratings

6.4.2.4.1 Short-term assessments may only be used for short-term claims against banks and corporates.

6.4.2.4.2 For risk-weighting purposes, short-term ratings are deemed to be issue specific. They can only be used to derive risk weights for claims arising from the rated facility. They cannot be generalised to other short-term claims. In no event can a short-term rating be used to support a risk weight for an unrated long-term claim.

6.4.2.4.3 If a short-term rated facility attracts a 50% risk weight, unrated short-term claims cannot attract a risk weight lower than 100%. If an issuer has a short-term facility with an assessment that warrants a risk weight of 150%, all unrated claims, whether long term or short term, should also receive a 150% risk weight, unless the bank uses recognized CRM techniques for such claims.

6.4.2.4.4 The above risk weight mapping of both long term and short-term ratings of the chosen domestic rating agencies would be reviewed annually by CBSL.

6.4.2.5 Use of Unsolicited Ratings

A rating would be treated as solicited only if the issuer of the instrument has requested the credit rating agency for the rating and has accepted the rating assigned by the agency. As a general rule, banks should use only solicited rating from the chosen ECAIs. No ratings issued by the credit rating agencies on an unsolicited basis should be considered for risk weight Computation as per the Standardised Approach.

Table 3
Mapping of Short Term Ratings

<table>
<thead>
<tr>
<th>Lanka Rating Agency</th>
<th>Standard and Poor’s</th>
<th>Moody’s</th>
<th>Fitch Ratings</th>
<th>Risk weights</th>
</tr>
</thead>
<tbody>
<tr>
<td>L - 1</td>
<td>A - 1+/A - 1</td>
<td>P - 1</td>
<td>F1+/ F1</td>
<td>20%</td>
</tr>
<tr>
<td>L - 2</td>
<td>A - 2+/A - 2</td>
<td>P - 2</td>
<td>F2</td>
<td>50%</td>
</tr>
<tr>
<td>L - 3</td>
<td>A - 3+/A - 3</td>
<td>P - 3</td>
<td>F3</td>
<td>100%</td>
</tr>
<tr>
<td>NP</td>
<td>Below A - 3</td>
<td>NP</td>
<td>Below F3</td>
<td>150%</td>
</tr>
</tbody>
</table>
6.4.2.6 Issuer versus Issues Assessment
Where a bank’s exposure is to a particular issue that has an issue-specific assessment, the risk weight of the claim will be based on this assessment.

6.4.2.7 Use of Multiple Rating Assessments
Banks shall be guided by the following in respect of exposures/obligors having multiple ratings from the eligible ECAIs chosen by the bank for the purpose of risk weight computation:

6.4.2.7.1 If there is only one rating by an eligible credit rating agency for a particular claim, that rating would be used to determine the risk weight of the claim.

6.4.2.7.2 If there are two ratings accorded by eligible credit rating agencies, which map into different risk weights, the higher risk weight should be applied.

6.4.2.7.3 If there are three or more ratings accorded by eligible credit rating agencies with different risk weights, the ratings corresponding to the two lowest risk weights should be referred to and the higher of those two risk weights should be applied, i.e., the second lowest risk weight.

6.4.3 Specific Rules for Measuring Credit Risk Based on the Standardised Approach (SA)

6.4.3.1 Total Risk-weighted amount for Credit Risk
(BRC 11.3.1.0.0.0)
The amount must agree to sum of total amount of on-balance sheet items and total amount of credit equivalent items (from 6.4.3.1.1 to 6.4.3.1.14) after applying the specific risk weight assigned.
(WBRC 11.3.1.1.0.0 to 11.3.1.14.0.0)

6.4.3.1.1 Claims on Government of Sri Lanka and Central Bank of Sri Lanka
(WBRC 11.3.1.1.0.0)
All claims on Government of Sri Lanka and Central Bank of Sri Lanka are risk-weighted at 0%. The amount must agree to sum of items (i) and (ii)
(WBRC 11.3.1.1.1.0 to 11.3.1.1.2.0)

(i) Claims on Government of Sri Lanka
(WBRC 11.3.1.1.1.0)
All claims on Government of Sri Lanka are risk-weighted at 0%.
(ii) **Claims on Central Bank of Sri Lanka**  
(WBRC 11.3.1.1.2.0)  
All claims on Central Bank of Sri Lanka are risk-weighted at 0%.

### 6.4.3.1.2 Claims on Foreign Sovereigns and their Central Banks  
(WBRC 11.3.1.2.0.0)  
Exposures on foreign sovereigns and their central banks will attract risk weights as per the rating assigned to those sovereigns/sovereign exposures by international rating agencies as given in the table below. **The amount must agree to sum of following items from (i) to (vi).**  
(WBRC 11.3.1.2.1.0 to 11.3.1.2.6.0)

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.2.1.0</td>
<td>AAA to AA-</td>
<td>0%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.2.2.0</td>
<td>A+ to A-</td>
<td>20%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.2.3.0</td>
<td>BBB+ to BBB-</td>
<td>50%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.2.4.0</td>
<td>BB+ to B</td>
<td>100%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.2.5.0</td>
<td>Below B-</td>
<td>150%</td>
</tr>
<tr>
<td>(vi)</td>
<td>11.3.1.2.6.0</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

### Table 4

### 6.4.3.1.3 Claims on Public Sector Entities (PSEs)  
(WBRC 11.3.1.3.0.0)  
**All performing claims** on domestic public sector entities (including public corporations, statutory boards, provincial authorities, local government bodies, etc.) and claims on foreign PSEs will be risk weighted in a manner **similar to claims on corporates** as given in the table below. The amount must agree to sum of following items from (i) to (v).  
(WBRC 11.3.1.3.1.0 to 11.3.1.2.5.0)

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.3.1.0</td>
<td>AAA to AA</td>
<td>20%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.3.2.0</td>
<td>A+ to A-</td>
<td>50%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.3.3.0</td>
<td>BBB+ to BB-</td>
<td>100%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.3.4.0</td>
<td>Below BB-</td>
<td>150%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.3.5.0</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

### Table 5
6.4.3.1.4 Claims on Official Entities and Multilateral Development Banks (MDBs)

(WBRC 11.3.1.4.0.0)

The amount must agree with the sum of the following items from (i) to (iii).

(WBRC 11.3.1.4.1.0 to 11.3.1.4.6.0)

(i) **Exposures on following official entities will be assigned zero risk weight:**
   a. Bank for International Settlements (BIS)
   b. International Monetary Fund (IMF)
   c. European Central Bank (ECB)
   d. European Community (EC)

(ii) **The following Eligible MDBs will be assigned a zero risk weight:**
   (a) The World Bank Group comprising of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC)
   (b) The Asian Development Bank (ADB)
   (c) The African Development Bank (AFDB)
   (d) The European Bank for Reconstruction and Development (EBRD)
   (e) The Inter-American Development Bank (IADB)
   (f) The European Investment Bank (EIB)
   (g) The European Investment Fund (EIF)
   (h) The Nordic Investment Bank (NIB)
   (i) The Caribbean Development Bank (CDB)
   (j) The Islamic Development Bank (IDB)
   (k) The Council of Europe Development Bank (CEDB)
   (l) The International Finance Facility for Immunization (IFFIm)

(iii) The risk weight applicable to claims on other MDBs will depend on the **external rating** assigned for each MDBs as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.4.1.0</td>
<td>BIS, IMF and MDBs</td>
<td>0%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.4.2.0</td>
<td>AAA to AA-</td>
<td>20%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.4.3.0</td>
<td>A+ to BBB-</td>
<td>50%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.4.4.0</td>
<td>BB+ to B-</td>
<td>100%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.4.5.0</td>
<td>Below B-</td>
<td>150%</td>
</tr>
<tr>
<td>(vi)</td>
<td>11.3.1.4.6.0</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>
6.4.3.1.5 Claims on Banks
(WBRC 11.3.1.5.0.0)
Total performing claims on banks denominated in LKR and foreign currency. The amount must agree to sum of total rupee claims and foreign currency claims.
(WBRC 11.3.1.5.1.0+11.3.1.5.2.0+11.3.1.5.3.0)

Short-Term Claims: In order to qualify for the preferential treatment for short-term claims, they should have an original contractual maturity of 3 months or less, and should not be rolled over.

Branches of banks incorporated abroad: The rating applicable to the Head Office may be used as the rating applicable to the particular branch, if the branch is not rated locally.

(i) Claims on Banks: Rupee Exposures less than 3 months
(WBRC 11.3.1.5.1.0)
All performing claims on all banks (short-term) including LCBs and LSBs, excluding investment in equity shares and other instruments eligible for capital status, denominated in LKR would be risk weighted based on their external credit assessment as follows:
The amount must agree with the sum of the following items from (i) to (iv).
(WBRC 11.3.1.5.1.1 to 11.3.1.5.1.4)

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.5.1.1</td>
<td>AAA to BBB-</td>
<td>20%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.5.1.2</td>
<td>BB+ to B-</td>
<td>50%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.5.1.3</td>
<td>Below B-</td>
<td>150%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.5.1.4</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

(ii) Claims on Banks: Foreign Currency Exposures less than 3 months
(WBRC 11.3.1.5.2.0)
All performing claims denominated in foreign currency on banks (short-term) will be risk weighted based on their external credit assessment as given in the table below.
The amount must agree with the sum of the following items from (i) to (v).
(WBRC 11.3.1.5.2.1 to 11.3.1.5.2.5)
Table 8

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.5.2.1</td>
<td>AAA to A-</td>
<td>20%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.5.2.2</td>
<td>BBB+ to BBB-</td>
<td>50%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.5.2.3</td>
<td>BB+ to B-</td>
<td>100%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.5.2.4</td>
<td>Below B-</td>
<td>150%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.5.2.5</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

(iii) Claims on Banks: Rupee and Foreign Currency Exposures more than 3 months (WBRC 11.3.1.5.3.0)
All performing claims denominated in rupees and foreign currency on banks (more than 3 months) will be risk weighted based on their external credit assessment as given in the table below.
The amount must agree with the sum of the following items from (i) to (v).
(WBRC 11.3.1.5.3.1 to 11.3.1.5.3.5)

Table 9

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.5.3.1</td>
<td>AAA to AA-</td>
<td>20%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.5.3.2</td>
<td>A+ to BBB-</td>
<td>50%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.5.3.3</td>
<td>BB+ to B-</td>
<td>100%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.5.3.4</td>
<td>Below B-</td>
<td>150%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.5.3.5</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

6.4.3.1.6 Claims on Financial Institutions (WBRC 11.3.1.6.0.0)
Total performing claims on non-bank financial institutions. However, investment in equity shares and other instruments eligible for capital status in the financial institutions are stated in paragraph 6.2.3 and 6.2.4 should be excluded from here.
(WBRC 11.3.1.6.1.0+11.3.1.6.2.0)

(i) Claims on Primary Dealers/Finance Companies/Specialised Leasing Companies (WBRC 11.3.1.6.1.0)
All performing claims on following institutions.
Primary Dealers: Registered under the Local Treasury Bills Ordinance (Primary Dealers) Regulations No. 1 of 2002.
Finance Companies: Registered under the Finance Companies Act No.78 of 1988, as amended.
Specialised Leasing Companies: Registered under the Finance Leasing Act No. 56 of 2000.
The amount must agree with the sum of the following items from (i) to (v).
(WBRC 11.3.1.6.1.1 to 11.3.1.6.1.5)

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.6.1.1</td>
<td>AAA to AA-</td>
<td>20%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.6.1.2</td>
<td>A+ to BBB-</td>
<td>50%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.6.1.3</td>
<td>BB+ to B-</td>
<td>100%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.6.1.4</td>
<td>Below B-</td>
<td>150%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.6.1.5</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

(ii) Claims on Other Financial Institutions (WBRC 11.3.1.6.2.0)
All performing claims on other financial institutions.
The amount must agree with the sum of the following items from (i) to (v).
(WBRC 11.3.1.6.2.1 to 11.3.1.6.2.5)

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
</tr>
</thead>
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<td>AAA to AA-</td>
<td>20%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.6.2.2</td>
<td>A+ to A-</td>
<td>50%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.6.2.3</td>
<td>BBB+ to BB-</td>
<td>100%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.6.2.4</td>
<td>Below BB-</td>
<td>150%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.6.2.5</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

6.4.3.1.7 Claims on Corporates (WBRC 11.3.1.7.0.0)
All performing claims on corporates shall be risk weighted as per the ratings assigned.
Banks can, with prior approval of CBSL, exercise the option to rate all corporate customers at 100%. Once decided and approved by CBSL the banks should apply a single consistent approach.
The amount must agree with the sum of the following items from (i) to (v).
(WBRC 11.3.1.7.1.0 to 11.3.1.7.5.0)
Table 12

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Credit Assessment</th>
<th>Risk Weight</th>
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<tbody>
<tr>
<td>(i)</td>
<td>11.3.1.7.1.0</td>
<td>AAA to AA-</td>
<td>20%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.1.7.2.0</td>
<td>A+ to A-</td>
<td>50%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.1.7.3.0</td>
<td>BBB+ to BB-</td>
<td>100%</td>
</tr>
<tr>
<td>(iv)</td>
<td>11.3.1.7.4.0</td>
<td>Below BB-</td>
<td>150%</td>
</tr>
<tr>
<td>(v)</td>
<td>11.3.1.7.5.0</td>
<td>Unrated</td>
<td>100%</td>
</tr>
</tbody>
</table>

6.4.3.1.8 Retail Claims
(WBRC 11.3.1.8.0.0)

All performing retail claims include: Retail claims that qualify for regulatory capital purposes and retail claims that do not qualify for regulatory capital purposes

However, the following shall be excluded from the retail portfolio:

(a) Investments in securities such as bonds and equities (to be treated as investments).

(b) Residential housing loans secured by mortgages over the residential property that qualify for inclusion as claims secured by residential property (refer WBRC 1.3.1.9.0.0).

The amount must agree with the sum of the retail claims that qualify for regulatory capital purposes and retail claims that do not qualify for regulatory capital purposes.

(WBRC 11.3.1.8.1.0 to 11.3.1.8.2.0)

(i) Retail claims that qualify for regulatory capital purposes
(WBRC 11.3.1.8.1.0)

Performing claims that meet the criteria given below qualify for inclusion in the regulatory retail portfolio. All such exposures qualify for a 75% risk weight.

The qualifying criteria for the Regulatory Retail Portfolio (applicable to both the retail and SME portfolios):

(a) **Orientation Criterion** – The exposure should be to an individual person or persons or to a SME.

(b) **Product Criterion** – The exposure should be of one of the following product types. Both fund based and non-fund based facilities to be included:

• Revolving credit and lines of credit including overdrafts and credit cards
• Personal term loans and leases (e.g. installment loans, vehicle loans and leases, student and educational loans, personal finance)
• SME facilities.

(c) **Granularity Criterion** – The regulatory retail portfolio must be sufficiently diversified to a degree that reduces the risks in the portfolio. In order to meet this criterion,
• No aggregate exposure without considering CRM, to one counterpart should exceed 0.2% of the overall retail portfolio (excluding any non-performing retail/SME claims).
• “To one counterpart” means one or several entities that constitute a single beneficiary, eg: in the case of a small business affiliated to another small business, the limit would apply to the bank’s aggregate exposure on both businesses.

(d) **Low value of Individual Exposures** –
• **Individual Exposures**: The maximum aggregate retail exposure (not taking any CRM into account) to one counterpart cannot exceed:
  – the lower of 0.4% of capital base (as included in the computation as at the reporting date) or Rs.10 million at the time of first granting.
  – This criterion will be applicable for a period of 3 years from adoption.
  – From 01.01.2011, the criterion would be the lower of 0.2% or Rs. 10 million.
• **SME Exposures**:
  – The maximum exposure in the case of SME loans would be Rs. 35 million at the time of first granting.
  – In order to qualify as an SME, the firm’s annual turnover should not be more than Rs. 140 million.
  – The annual turnover should be based on the latest available audited financial statements at the time of granting the facilities.
  – If audited financial statements are not available, the draft accounts may be used.
However, the audited financial statements should be obtained during the year.

- The qualifying criteria is given above should be reviewed in respect of each financial year.

(ii) Retail claims that do not qualify for regulatory capital purposes
(WBRC 11.3.1.8.2.0)

Claims that not qualify for inclusion in the regulatory retail portfolio:
Performing claims that do not meet the criteria given above do not qualify for inclusion in the regulatory retail portfolio. All such exposures qualify for a 100% risk weight.

6.4.3.1.9 Claims Secured by Residential Property
(WBRC 11.3.1.9.0.0)

All performing claims secured by residential property include: Claims that qualify for regulatory capital purposes and claims that do not qualify for regulatory capital purposes. However, the exposures secured by mortgages on commercial real estates shall be excluded from here. The amount must agree with the sum of the claims secured by residential property that qualify for regulatory capital purposes and claims secured by residential property that do not qualify for regulatory capital purposes.
(WBRC 11.3.1.9.1.0 to 11.3.1.9.2.0)

(i) Claims that qualify for regulatory capital purposes
(WBRC 11.3.1.9.1.0)

(a) Subject to conditions below, residential housing loans fully secured by a primary mortgage over such residential property that is or will be occupied by the borrower, or rented, qualify for a risk weight of 50%.

The claims should strictly meet the following qualifying criteria to be able to use the preferential risk weight

- A margin of at least 25% on the value of the property based on the latest valuation report

- Valuation of property: valuation of property is carried out by an external independent valuer or current internal assessment of the value of the properties subject to the conditions stated in the
Directions on Classification of Advances and Specific Provisions issued under Banking Act.

(b) Mortgages other than primary mortgages will qualify for the same risk weight, subject to the above conditions, if:
   - The mortgage is with the same bank
   - The purpose of the loan is for residential purposes.

(ii) Claims that do not qualify for regulatory capital purposes
    (WBRC 11.3.1.9.2.0)
    Performing claims that do not meet the criteria given above do not qualify for inclusion in the regulatory residential portfolio. All such exposures qualify for a 100% risk weight.

6.4.3.10 Claims Secured by Commercial Real Estate
    (WBRC 11.3.1.10.0.0)
    Commercial real estate exposure is defined as exposures secured by mortgages on commercial real estate (office buildings, multi-purpose or multi-tenanted commercial premises, multi-family residential buildings, industrial or warehouse space, hotels, land acquisition, land development and construction).
    Commercial real estate exposures, as defined above will attract a risk weight of 100%.

6.4.3.11 Non-Performing Assets (NPAs)
    (WBRC 11.3.1.11.0.0)
    The unsecured portion of NPAs, other than a qualifying residential mortgage loan which is addressed in item 6.4.2.1.12, net of specific provision will be risk weighted as items (i) and (ii) below.
    For the purpose of computing the level of specific provisions of NPAs for deciding the risk-weighting, all funded NPA exposures of a single counterparty (without netting the value of the eligible collateral under CRM) should be reckoned in the denominator.
    For the purpose of defining the secured portion of the NPA, eligible collateral will be the same as recognised for credit risk mitigation purposes. Hence, other forms of collateral like land, buildings, plant, machinery, current assets, etc. will not be reckoned while computing the secured portion of NPAs for capital adequacy purposes.
The amount must agree with the sum of the following items (i) and (ii).
(WBRC 11.3.1.11.1.0 + 11.3.1.11.2.0)

(i) **Specific provisions are equal or more than 20%**
(WBRC 11.3.1.11.1.0)
**100% risk weight** when specific provisions are equal or more than 20% of the outstanding amount of the NPA.

(ii) **Specific provisions are less than 20%**
(WBRC 11.3.1.11.2.0)
**150% risk weight** when specific provisions are less than 20% of the outstanding amount of the NPA.

**6.4.3.1.12 Non-Performing Assets Secured by Residential property**
(WBRC 11.3.1.12.0.0)

The unsecured portion NPAs (without netting the value of property mortgage), *net of specific provision* will be risk weighted as items (i) and (ii):

*For the purpose of computing the level of specific provisions* in NPAs for deciding the risk-weighting, all funded NPA exposures of a single counterparty (without netting the value of property mortgage) should be reckoned in the denominator.

The amount must agree with the sum of the following items (i) and (ii).
(WBRC 11.3.1.12.1.0 + 11.3.1.12.2.0)

(i) **Specific provisions are equal or more than 20%**
(WBRC 11.3.1.12.1.0)
**50% risk weight** when specific provisions equal or more than 20% of the outstanding amount of the NPA.

(ii) **Specific provisions are less than 20%**
(WBRC 11.3.1.12.2.0)
**100% risk weight** when specific provisions are less than 20% of the outstanding amount of the NPA.

**6.4.3.1.13 Higher-Risk Categories**
(WBRC 11.3.1.13.0.0)

Exposures to the following segments, which are considered as high-risk exposures, will attract a higher **risk weight of 150%**:

(i) Venture capital funds/companies
(ii) Private equity investments

**6.4.3.1.14 Cash Items and Other Assets**
(WBRC 11.3.1.14.0.0)

The amount must agree with the sum of cash items (i) and Other Assets (ii)
(WBRC 11.3.1.14.1.0 to 11.3.1.14.2.0)
(i) **Cash Items**  
(WBRC 11.3.1.14.1.0)  
Total of cash items from (a) to (c)  
(a) **Notes and Coins**  
(WBRC 11.3.1.14.1.1)  
Local currency notes and coins held by tellers, in ATMs, in vault and petty cash.  
Risk weight is 0%  
(b) **Gold and Bullion held in own vault**  
(WBRC 11.3.1.14.1.2)  
Gold and bullion held in the bank’s vaults. Gold items held in safe custody should be excluded.  
Risk weight is 0%  
(c) **Cash Items in the process of Collection**  
(WBRC 11.3.1.14.1.3)  
Cheques, drafts and other cash items, such as money orders, postal orders drawn on banks and other authorized institutions and paid immediately on presentation. Trade bills, such as import bills and export bills, in the process of collection should be excluded from this item and considered as loans and advances.  
Risk weight is 20%  

(ii) **Other Assets**  
(WBRC 11.3.1.14.2.0)  
Total of items (a) and (b) below.  
(a) **Fixed Assets**  
(WBRC 11.3.1.14.2.1)  
The item includes bank premises, immovable property, machinery and equipment, motor vehicles, furniture and fittings and other fixed assets, reported at cost or at revalued amount, net of accumulated depreciation will attract a risk weight of 100%.  
(b) **Other Assets/Exposures**  
(WBRC 11.3.1.14.2.2)  
All other assets/exposures which are not specified elsewhere will attract a uniform risk weight of 100%.  

35
6.5 Part III (b) - Computation of Credit Equivalent Amount of Off-Balance Sheet Items

6.5.1 General Instructions

6.5.1.1 The risk-weighted amount of an off-balance sheet item that gives rise to credit exposure is generally calculated by means of a two-step process:

6.5.1.1.1 The notional amount of the transaction is converted into a credit equivalent amount, by multiplying the amount by the specified credit conversion factor or by applying the current exposure method, and

6.5.1.1.2 The resulting credit equivalent amount is multiplied by the risk weight applicable to the counterpart or type of asset.

6.5.1.2 Where the off-balance sheet item is secured by eligible collateral or guarantee, the CRM guidelines detailed in paragraph 6.6 may be applied.

6.5.2 The credit conversion factors to be used will be as follows:

6.5.2.1 Off-balance Sheet Items:

6.5.2.1.1 Direct Credit Substitutes

6.5.2.1.1.1 Total direct credit substitutes of the following items from (i) to (iv).

Conversion Factor 100%

6.5.2.1.1.2 (WBRC 11.3.2.1.0.0 to 11.3.2.1.4.0)
(i) **General Guarantees of Indebtedness**  
(WBRC 11.3.2.1.1.0)  
General guarantees of indebtedness where the risk of loss in the transaction may crystallise into a direct liability and become a direct claim on the counterparty. These include Guarantees in respect of counterparties like insurance agents, sales agents, etc. to cover any non-payment by them of premium, sales proceeds, etc. to their beneficiaries. Bank Guarantees in favor of customs would cover any non-payment of customs duties by their counterparties.

(ii) **Stand-by LCs serving as Financial Guarantees**  
(WBRC 11.3.2.1.2.0)  
Stand-by Letters of Credit, which are direct, credit substitutes where the risk of loss in the transaction is equivalent to that of a direct claim on the counterparty. This includes stand-by Letters of Credit serving as financial guarantees for loans, securities and other financial liabilities.

(iii) **Bank Acceptances**  
(WBRC 11.3.2.1.3.0)  
Liabilities arising from acceptances on accommodation of bills but excludes bills that have been discounted by the bank itself. Risk participation and other similar commitments undertaken to repay the financial obligation of a customer, on his failure to do so, should be included.

(iv) **Others**  
(WBRC 11.3.2.1.4.0)  
Any other obligation which carries the same risk of loss in the transaction and is equivalent to that of a direct claim on the counterparty.

6.5.2.1.2 **Transaction - related Contingencies**  
(WBRC 11.3.2.2.0.0)  
Total transaction-related contingencies of following items from (i) to (iii).  
Conversion Factor 50%  
(WBRC 11.3.2.2.1.0 to 11.3.2.2.3.0)

(i) **Performance Bonds, Bid Bonds & Warranties**  
(WBRC 11.3.2.2.1.0)  
Transaction-related contingent items such as Performance Bonds, Bid Bonds and Warranties, where the risk of loss arises from an irrevocable obligation to pay a third party,
the non-financial obligation of the customer upon his failure to fulfill obligations under a contract or a transaction. Such contingencies would crystallise into actual liabilities dependent upon the occurrence or non-occurrence of an event other than that of a default in payment by the counterparty.

(ii) **Stand-by LCs related to particular transactions**  
(WBRC 11.3.2.2.2.0)  
Contingent liabilities relating to particular transactions. Here too, there is a likelihood of the contingencies crystallizing into actual liabilities depending upon the occurrence or non-occurrence of an event other than that of a default in payment by a counterparty.

(iii) **Others**  
(WBRC 11.3.2.2.3.0)  
Other contingent liabilities arising from an irrevocable obligation to pay a third party, the non-financial obligation of a customer upon his failure to fulfill such obligation or terms under contract or transaction.

### 6.5.2.1.3 Short-Term Self Liquidating Trade - related Contingencies  
(WBRC 11.3.2.3.0.0)  
Total short-term self liquidating trade-related contingencies of following items from (i) to (iv).  
Conversion Factor 20%  
(WBRC 11.3.2.3.1.0 to 11.3.2.3.4.0)

(i) **Shipping Guarantees**  
(WBRC 11.3.2.3.1.0)  
Guarantees issued by the reporting institution to customers where the reporting institution agrees to indemnify fully, to a named shipping agent, against all liabilities arising from the release of goods without production of Bills of Lading and/or other shipping documents by the receiving party.

(ii) **Documentary Letters of Credit**  
(WBRC 11.3.2.3.2.0)  
Documentary credits collateralised by the underlying shipments which are short-term self-liquidating and trade-related transactions.
(iii) **Trade-related Acceptances**  
*(WBRC 11.3.2.3.3.0)*  
Liabilities arising from acceptances that are based on a specific trade transaction either domestic or foreign e.g. Letters of Credit.

(iv) **Others**  
*(WBRC 11.3.2.3.4.0)*  
Contingent liabilities arising from short-term self-liquidating trade related obligations.

6.5.2.1.4 **Sale and Repurchase agreements and Assets sale with recourse where the credit risk remains with the bank**  
*(WBRC 11.3.2.4.0.0)*  
Total of following items from (i) to (vi).  
Conversion Factor 100%  
*(WBRC 11.3.2.4.1.0 to 11.3.2.4.6.0)*

(i) **Sale and Repurchase Agreements**  
*(WBRC 11.3.2.4.1.0)*  
Sale and Repurchase Agreement (REPO) is an agreement whereby a bank sells an asset to a third party with a commitment to repurchase it at an agreed price on an agreed future date. Purchase and Resale Agreements (Reverse REPOS) should be considered as collateralised loans. The risk is to be measured as an exposure to the counterparty unless the underlying asset has been reported as an on-balance sheet item where the risk weight appropriate to the underlying asset should be used.

(ii) **Housing Loans Sold with Recourse**  
*(WBRC 11.3.2.4.2.0)*  
The amount of housing loans sold to a counterparty with recourse where the credit risk remains with the Bank.

(iii) **Other Assets Sold with Recourse**  
*(WBRC 11.3.2.4.3.0)*  
Assets sold with recourse where the credit risk remains with the reporting institution. The holder of the asset is entitled to put the assets back to the reporting institution within an agreed period or under certain prescribed circumstances – e.g. deterioration in the value or credit quality of the asset concerned.
(iv) **Forward Assets Purchases**  
(WBRC 11.3.2.4.4.0)  
Commitment to purchase, at a specified future date and/or on pre-arranged terms, a loan, security or other asset from another party.

(v) **Partly-Paid Shares/Securities**  
(WBRC 11.3.2.4.5.0)  
Unpaid amounts on partly-paid shares and securities where the issuer may call upon the bank to pay at a pre-determined or unspecified date in the future.

(vi) **Others**  
(WBRC 11.3.2.4.6.0)  
Placements of forward deposits and other commitments with certain drawdown. A forward deposit is an agreement between two parties whereby one will place and the other will receive, at a pre-determined future date, a deposit, at an agreed rate of interest. A commitment to place a forward deposit should be reported under this item and weighted according to the risk-weight appropriate to the counterparty.

6.5.2.1.5 **Obligations under an On-going Underwriting Agreement**  
(WBRC 11.3.2.5.0.0)  
Total of following items from (i) to (iii).  
**Conversion Factor 50%**  
(WBRC 11.3.2.5.1.0 to 11.3.2.5.3.0)

(i) **Underwriting of Shares/Securities Issue**  
(WBRC 11.3.2.5.1.0)  
Obligations due to underwriting of shares and securities, net of the amount sub-underwritten by another institution.

(ii) **Note Issuance Facilities and Revolving Underwriting Facilities**  
(WBRC 11.3.2.5.2.0)  
Arrangements where a borrower may draw funds up to a prescribed limit over a pre-defined period through the issue of notes which the reporting bank has committed to underwrite.

(iii) **Others**  
(WBRC 11.3.2.5.3.0)  
Other obligations due to on-going underwriting agreements.
6.5.2.1.6 \textbf{Commitments with an Original maturity of up to one year or which can be unconditionally cancelled at any time} \\
(WBRC 11.3.2.6.0.0) \\
Total of following items from (i) to (iv). \\
Conversion Factor 0\% \\
(WBRC 11.3.2.6.1.0 to 11.3.2.6.4.0)

(i) \textbf{Formal Stand-by Facilities and Credit Lines} \\
(WBRC 11.3.2.6.1.0) \\
Commitments include the undrawn portion of any binding arrangements which obligate the reporting institution to provide funds at some future date. Such commitments would have an original maturity of less than one year or which can be unconditionally cancelled at any time by the reporting bank at its discretion. Formal stand-by facilities and credit lines for Letters of Credit, Trust Receipts, etc; should be included under the item.

(ii) \textbf{Undrawn Term Loans} \\
(WBRC 11.3.2.6.2.0) \\
Undrawn portion of a term loan with an original maturity of less than one year or which can be unconditionally cancelled at any time by the reporting bank.

(iii) \textbf{Undrawn Overdraft Facilities/Unused Credit Card Lines} \\
(WBRC 11.3.2.6.3.0) \\
The undrawn portion of overdraft facilities and credit card lines with an original maturity of less than one year or which can be unconditionally cancelled at any time by the reporting bank.

(iv) \textbf{Others} \\
(WBRC 11.3.2.6.4.0) \\
Any other commitment with an original maturity up to one year or which can be unconditionally cancelled at any time.

6.5.2.1.7 \textbf{Other Commitments with an Original maturity of up to one year} \\
(WBRC 11.3.2.7.0.0) \\
Total of following items from (i) to (iii). \\
Conversion Factor 20\% \\
(WBRC 11.3.2.7.1.0 to 11.3.2.7.3.0)
(i) **Formal Stand-by Facilities and Credit Lines**  
(WBRC 11.3.2.7.1.0)  
The commitments under formal standby facilities and credit lines with an original maturity is up to one year.

(ii) **Undrawn Term Loans**  
(WBRC 11.3.2.7.2.0)  
The undrawn portion of term loans where the original maturity is up to one year.

(iii) **Others**  
(WBRC 11.3.2.7.3.0)  
Any other commitment with an original maturity up to one year.

6.5.2.1.8 **Other Commitments with an Original maturity of over one year**  
(WBRC 11.3.2.8.0.0)  
Total of following items from (i) to (iii).  
Conversion Factor 50%  
(WBRC 11.3.2.8.1.0 to 11.3.2.8.3.0)

(iv) **Formal Stand-by Facilities and Credit Lines**  
(WBRC 11.3.2.8.1.0)  
The commitments under formal standby facilities and credit lines with an original maturity is over one year.

(v) **Undrawn Term Loans**  
(WBRC 11.3.2.8.2.0)  
The undrawn portion of term loans where the original maturity is over one year.

(vi) **Others**  
(WBRC 11.3.2.8.3.0)  
Any other commitment with an original maturity over one year.

6.5.2.1.9 **Exchange Rate Contracts**  
(WBRC 11.3.2.9.0.0)  
Exchange rate contracts shall include the following items (a to e), but exclude exchange rate contracts which have an original maturity of 14 calendar days or less.  
(a) Forward foreign exchange contracts  
(b) Currency futures  
(c) Currency options purchased  
(d) Cross currency FX swaps  
(e) Other similar instruments
To arrive at the credit equivalent amounts of exchange rate contracts, applying the original exposure method, a bank will have to apply one of the conversion factors as given in the table below to the notional principal amounts of each instrument according to the nature of the instrument and its maturity.

**Table 13**

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Original Maturity</th>
<th>Conversion Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.2.9.1.0</td>
<td>Less than one year</td>
<td>2%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.2.9.2.0</td>
<td>One year and less than two years</td>
<td>5%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.2.9.3.0</td>
<td>For each additional year</td>
<td>3%</td>
</tr>
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</table>

### 6.5.2.1.10 Interest Rate Contracts (WBRC 11.3.2.10.0.0)

Interest rate contracts shall include,

(a) Single currency interest rate swaps  
(b) Basis swaps  
(c) Forward rate agreements  
(d) Interest rate futures  
(e) Interest rate options purchased, and  
(f) Other similar instruments  

To arrive at the credit equivalent amounts of interest rate contracts, applying the original exposure method, a bank will have to apply one of the conversion factors as given in the table below to the notional principal amounts of each instrument according to the nature of the instrument and its maturity.

**Table 14**

<table>
<thead>
<tr>
<th>Item</th>
<th>WBRC</th>
<th>Original Maturity</th>
<th>Conversion Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>11.3.2.10.1.0</td>
<td>Less than one year</td>
<td>0.5%</td>
</tr>
<tr>
<td>(ii)</td>
<td>11.3.2.10.2.0</td>
<td>One year and less than two years</td>
<td>1%</td>
</tr>
<tr>
<td>(iii)</td>
<td>11.3.2.10.3.0</td>
<td>For each additional year</td>
<td>1%</td>
</tr>
</tbody>
</table>

Note: In the case of foreign exchange and interest rate contracts above, the netting of contracts subject to novation
would be permitted. Therefore, the net rather than the gross claims arising out of swaps and similar contracts (subject to novation) with the same counterparts will be weighted. In this context, novation is defined as a bilateral contract between two counterparties under which any obligation to each other to deliver a given currency on a given date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single net amount for the previous gross obligations.
6.6 Part III (c) - Exposures Recognized under Credit Risk Mitigation (CRM)

6.6.1 Overview of CRM

6.6.1.1 Banks use a number of techniques to mitigate the credit risks to which they are exposed. For example, exposures may be collateralised by first priority claims, in whole or in part with cash or securities, a loan exposure may be guaranteed by a third party, or a bank may buy a credit derivative to offset various forms of credit risk. Additionally, banks may agree to net loans owed to them against deposits from the same counterpart.

6.6.1.2 The revised approach to credit risk mitigation allows a wider range of credit risk mitigants to be recognised for regulatory capital purposes than is permitted under Basel I, provided that these techniques meet the minimum conditions described below.

6.6.1.3 While the use of CRM techniques reduces or transfers credit risk, it simultaneously may increase other risks (residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, it is imperative that banks employ robust procedures and processes to control these risks, including strategy, consideration of the underlying credit, valuation, policies and procedures, systems, control of roll-off risks and management of concentration risk arising from the bank’s use of CRM techniques and its interaction with the bank’s overall credit risk profile.

6.6.1.4 Legal Certainty: All documentation used in collateralised transactions and guarantees must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review, which should be well documented, to verify this. Such verification should have a well-founded legal basis for reaching the conclusion about the binding nature and enforceability of the documents. Banks should also undertake such further review as necessary to ensure continuing enforceability.

6.6.1.5 Treatment of Pools of CRM Techniques: In case where a bank has multiple CRM techniques covering a single exposure (e.g. a bank has both collateral and guarantee partially covering an exposure), the bank will be required to subdivide the exposure into portions covered by each type of CRM technique (e.g. portion covered by collateral, portion covered by guarantee) and the risk-weighted assets of each portion must be calculated separately. When credit protection provided by a single protection provider has differing maturities, they must be subdivided into separate protection as well.
6.6.2 CRM Techniques

6.6.2.1 Collateralised Transactions: A collateralised transaction is one in which:
- banks have a credit exposure or potential credit exposure; and
- that credit exposure or potential credit exposure is hedged in whole or in part by collateral posted by a counterpart or by a third party on behalf of the counterpart.

6.6.2.1.1 The Simple Approach will be Followed in Computing the Effects of CRM
(i) In the simple approach, the portions of claims collateralised by the market value of recognised collateral receive the risk weight applicable to the collateral instrument. The risk weight on the collateralised portion will be subject to a floor of 20%. The remainder of the claim should be assigned to the risk weight appropriate to the counterparty.
(ii) Mismatches in the maturity of the underlying exposure and collateral will not be allowed, i.e. the collateral must be pledged for at least the life of the exposure.

6.6.2.1.2 Risk Weights
(i) The 20% floor for the risk weight on a collateralised transaction will not be applied and 0% risk weight can be applied provided the exposure and the collateral are denominated in the same currency, and either:
   a. the collateral is cash on deposit and gold or
   b. the collateral is in the form of Government securities or
   c. the collateral is in the form provident fund balances.

6.6.2.1.3 Minimum Conditions
(i) Legal Certainty: as described in paragraph 6.6.1.4
(ii) Ability to Liquidate: The bank should have the right to liquidate or take legal possession of it, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the counterparty (and, where applicable, of the custodian holding the collateral). Furthermore banks must take all steps necessary to fulfill those requirements under the law applicable to the bank’s interest in the collateral for obtaining and maintaining an enforceable security interest.
(iii) **Material Correlation:** In order for collateral to provide protection, the credit quality of the counterparty and the value of the collateral must not have a material positive correlation. For example, securities issued by the counterparty or by any related group entity - would provide little protection and so would be ineligible.

(iv) **Recovery Procedures:** Banks must have clear and robust procedures for the timely liquidation of collateral to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral are observed, and that collateral can be liquidated promptly. Where the collateral is held by a custodian, banks must take reasonable steps to ensure that the custodian segregates the collateral from its own assets.

### 6.6.2.1.4 Eligible Financial Collateral

The following collateral instruments are eligible for recognition in the simple approach:

(i) Cash (as well as certificates of deposit or comparable instruments, including fixed deposit receipts, issued by the lending bank) on deposit with the bank, which is incurring the counterparty exposure.

(ii) Gold: Gold would include both bullion and jewellery.

(iii) GOSL securities

(iv) Provident fund balances

(v) Debt securities rated by a recognized ECAI where these are either
   - At least BB- when issued by sovereigns or PSEs that have been recognized, or
   - At least BBB- when issued by other entities (including banks), or
   - At least A-3/P-3 for short-term debt instruments.

(vi) Debt securities not rated by a ECAI where these are:
   - Issued by a bank; and
   - Listed on a recognized exchange, and
   - Classified as senior debt

   - Other securities, specified by the Central Bank.

(vii) Equities those are included in the Milanka index, subject to a discount of 25% on the market value.

### 6.6.2.2 On-Balance Sheet Netting - Where a bank,

6.6.2.2.1 has a well-founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction regardless of whether the counterparty is insolvent or bankrupt;
6.6.2.2 is able at any time to determine those assets (loans) and liabilities (deposits) with the same counter part that are subject to the netting agreement;

6.6.2.3 monitors and controls its roll-off risks; and

6.6.2.4 monitors and controls the relevant exposures on a net basis

6.6.2.5 it may use the net exposure of loans and deposits as the basis for its capital adequacy computation.

6.6.2.3 Guarantees

6.6.2.3.1 Guaranteed Transactions: Where guarantees are direct, explicit, irrevocable and unconditional, banks may take account of such credit protection in calculating capital requirements.

6.6.2.3.2 Minimum Conditions

(i) A guarantee (or counter-guarantee) must represent a direct claim on the protection provider and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible.

(ii) Other than non-payment by a protection purchaser of money due in respect of the credit protection contract it must be irrevocable; there must be no clause in the contract that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure.

(iii) It must also be unconditional; there should be no clause in the protection contract outside the control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterpart fails to make the payment(s) due.

(iv) In addition to the legal certainty requirements above, the following conditions must also be satisfied:

- On the qualifying default or non-payment of the counterpart, the bank may in a timely manner pursue the guarantor for any monies outstanding under the documentation governing the transaction. The guarantor may make one lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counterpart covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counterpart for payment.

- The guarantee is an explicitly documented obligation assumed by the guarantor.
– Except as noted in the following sentence, the guarantee covers all types of payments the underlying obligor is expected to make under the documentation governing the transaction, for example notional amount, margin payments, etc.
– Where a guarantee covers payment of principal only, interests and other uncovered payments should be treated as an unsecured amount.

6.6.2.3.3 Eligible Guarantors (counter-guarantors): Credit protection given by the following entities will be recognised: sovereign entities, PSEs and other entities with a risk weight of 20% or better and a lower risk weight than the counterpart.

6.6.2.3.4 Risk Weights:
The protected portion is assigned the risk weight of the protection provider. The uncovered portion of the exposure is assigned the risk weight of the underlying counterpart.
(i) A zero risk weight will be applied to that portion of loans guaranteed by GOSL and CBSL.
(ii) The portion of exposures guaranteed by the Sri Lanka Export Credit Insurance Corporation (SLECIC) will receive a 50% risk weight.

6.6.3 Specific Instructions for completion Part III (c)

6.6.3.1 Total CRM Exposure
(WBRC 11.3.3.0.0.0)
Total exposure of collateralised transactions and other CRM techniques. All exposures should be reported net of specific provisions and interest in suspense that has been charged to the respective counterparty account. Exposures which are reported in this part under CRM should not be reported in the other parts of the capital adequacy return. The amount is automatically shown on web-based return.
The amount must agree with the sum of items 6.6.3.1.1 and 6.6.3.1.2. (WBRC 11.3.3.1.0.0+11.3.3.2.0.0)

6.6.3.1.1 Collateralised Transactions
(WBRC 11.3.3.1.0.0)
The sum of collateralised retail exposures and collateralised other exposures. The amount must agree to sum of items (i) and (ii). The amount is automatically shown on web-based return. (WBRC 11.3.3.1.1.0+11.3.3.1.2.0)
(i) Retail Exposures (WBRC 11.3.3.1.1.0)
The total amount of retail exposures against the collateral instruments which are eligible for recognition in the simple approach as specified in paragraph 6.6.2.1.4. The amount is automatically shown on web-based return. (WBRC 11.3.3.1.1.1 to 11.3.3.1.1.7)

(ii) Other Exposures
(WBRC 11.3.3.1.2.0)
The total amount of other exposures against the collateral instruments which are eligible for recognition in the simple approach as specified in paragraph 6.6.2.1.4. The amount is automatically shown on web-based return. (WBRC 11.3.3.1.2.1 to 11.3.3.1.2.7)

6.6.3.1.2 Other CRM Techniques
(WBRC 11.3.3.2.0.0)
The total amount of exposures against the other CRM techniques (other than collateralized transactions). The amount is automatically shown on web-based return. (WBRC 11.3.3.2.1.0 + 11.3.3.2.2.0)

(i) On-Balance Sheet Netting
(WBRC 11.3.3.2.1.0)
The total amount of exposures against the on-balance sheet netting should be reported in line with the instructions given in the items under paragraph 6.6.2.2 above.

(ii) Guarantees
(WBRC 11.3.3.2.2.0)
The total amount of exposures against the guarantees should be reported in line with the instructions given in the items under paragraph 6.6.2.3 above.
6.7 Part IV - Computation of Risk-weighted Amount for Market Risk.

6.7.1 Capital Charge for Market Risk - Market risk is defined as the risk of losses in on-balance sheet and off balance sheet positions arising from movements in market prices. The market risk subject to the capital charge requirements are:

6.7.1.1 The risks pertaining to interest rate related instruments in the trading book

6.7.1.2 The risks pertaining to equities in the trading book.

6.7.1.3 The risks pertaining to foreign exchange position (including gold positions) throughout the bank.

6.7.2 Scope and Coverage of Capital Charge for Market Risks

6.7.2.1 This involves computing capital charges for interest rate related instruments in the trading book, equities in the trading book and foreign exchange risk (including gold positions) throughout the bank. For the purpose of this section, the trading book and foreign exchange position will include the following:

6.7.2.1.1 Securities classified in the ‘Trading Account’ in terms of the direction on Prudential Norms for Classification, Valuation and Operation of the Bank’s Investment Portfolio issued by the CBSL dated 01 March 2006.

6.7.2.1.2 Open gold positions

6.7.2.1.3 Open foreign exchange positions.

6.7.3 Measurement of Capital Charge for Interest Rate Risk

6.7.3.1 This section describes the framework for measuring the risk of holding or taking positions in debt securities and other interest rate related instruments denominated in Sri Lanka Rupees as well as foreign currencies in the trading book.

6.7.3.2 The capital charge for interest rate related instruments would apply to the current market value of these items in the bank’s trading book. Since banks are required to maintain capital for market risk on an ongoing basis, they are required to mark-to-market their trading positions on a daily basis. The current market value will be determined according to the Direction on Prudential Norms for
Classification, Valuation and Operation of the bank’s investment portfolio issued by CBSL.

6.7.3.3 The minimum capital requirement is expressed in terms of two separately calculated charges, “specific risk” charge for each security, which is akin to the conventional capital charge for credit risk, both for short and long positions, and “general market risk” charge for interest rate risk in the portfolio, where long and short positions in different securities or instruments can be offset.

6.7.3.3.1 Specific Risk

(i) The capital charge for specific risk is designed to protect against an adverse movement in the price of an individual security owing to factors related to the individual issuer.

(ii) The risk charges to be used in the Computation of specific risk will be as follows:

(iii) Specific risk charge for government securities and central banks:

   a. Government securities issued by the GOSL and securities issued by the CBSL will be subject to a risk charge of 0%.

   b. Securities issued by a foreign government or by a foreign central bank will be subject to a risk charge based on the credit rating as indicated in the following table:

   Table 15

<table>
<thead>
<tr>
<th>Sovereign Rate</th>
<th>Capital Charge for Specific Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA to AA-</td>
<td>0%</td>
</tr>
<tr>
<td>A+ to BBB-</td>
<td>0.25% (residual term to final maturity 6 months or less)</td>
</tr>
<tr>
<td></td>
<td>1% (residual term to final maturity greater than 6 and up to and including 24 months)</td>
</tr>
<tr>
<td></td>
<td>1.60% (residual term to final maturity exceeding 24 months)</td>
</tr>
<tr>
<td>All others</td>
<td>10.00%</td>
</tr>
</tbody>
</table>

(iv) The ‘Qualifying’ category for Corporate entities:

   (a) Corporate entities (Local) will be given a risk charge for specific market risk based on their ratings as indicated in the table below:
Table 16
Specific Risk Charge for Corporates

<table>
<thead>
<tr>
<th>External Rating</th>
<th>Capital Charge for Specific Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA to AA-</td>
<td>0.25%</td>
</tr>
<tr>
<td>A+ to BBB-</td>
<td>1.00% (residual term to final maturity 6 months or less)</td>
</tr>
<tr>
<td></td>
<td>1.60% (residual term to final maturity greater than 6 and up to and including 24 months)</td>
</tr>
<tr>
<td></td>
<td>10.00% (residual term to final maturity exceeding 24 months)</td>
</tr>
<tr>
<td>All others</td>
<td>10.00%</td>
</tr>
</tbody>
</table>

(b) The specific risk charge for foreign corporates would be one notch less favourable than the risk charge applied to the local corporates.

(v) ‘Public sector entities’ should be treated like corporate entities unless they are backed by an explicit Treasury guarantee, which warrants a risk charge of 0%.

(vi) The ‘Other’ category:
A capital charge of 10% will apply to all other types of exposures.

(vii) Banks may rely upon the ratings assigned by the ECAIs recognised by CBSL (See paragraph 6.4.2) for the purpose of ratings referred in the table 15 and 16 above.

6.7.3.3.2 General Market Risk
The capital requirements for general market risk are designed to capture the risk of loss arising from changes in market interest rates. The capital charge is the sum of four components:
(i) the net short or long position in the whole trading book;
(ii) a smaller proportion of the matched positions in each time-band (the “vertical disallowance”);
(iii) a larger proportion of the matched positions across different timebands (the “horizontal disallowance”), and
(iv) a net charge for positions in options, where appropriate.
Note – Components (ii), (iii) and (iv) will not apply at present.

6.7.3.4 It has been decided to allow banks to initially adopt the Standardised Measurement Method, as Sri Lankan banks are still at a nascent stage of developing internal risk management models. There are two principal methods of measuring market risk under the Standardised Measurement Method, i.e. a ‘maturity’ method and a ‘duration’
method. It has been decided to adopt the ‘duration’ method to arrive at the capital charge. Accordingly, banks are required to measure the general market risk charge by calculating the price sensitivity of each instrument in the trading book separately and adding the resulting price sensitivities based on a maturity ladder, subject to disallowances if any.

6.7.3.5 The steps for the computation are as follows:

6.7.3.5.1 Calculate the price sensitivity of each instrument in terms of a change in interest rates between 1.2 and 2.0 percentage points, depending on the maturity of the instrument (see Table 17);

6.7.3.5.2 slot the resulting price sensitivities into a duration based maturity ladder with the fifteen time bands as set out in Table 17;

6.7.3.5.3 subject long and short positions in each time band to a 5% vertical disallowance designed to capture basis risk; and

6.7.3.5.4 carry forward the net positions in each time-band for horizontal offsetting subject to the disallowances set out in Table 18.

Note – Steps (6.7.3.5.2) to (6.7.3.5.4) are not required at present since components ii, iii and iv under paragraph 6.7.3.3.2 above are currently not applicable.

Table 17
Duration Method – Time Bands and Assumed Changes in Yield

<table>
<thead>
<tr>
<th>Time Bands</th>
<th>Assumed Change in Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maturity Zone 1</strong></td>
<td></td>
</tr>
<tr>
<td>1 month or less</td>
<td>2.00</td>
</tr>
<tr>
<td>Over 1 month to 3 months</td>
<td>2.00</td>
</tr>
<tr>
<td>Over 3 months to 6 months</td>
<td>2.00</td>
</tr>
<tr>
<td>Over 6 months to 12 months</td>
<td>2.00</td>
</tr>
<tr>
<td><strong>Maturity Zone 2</strong></td>
<td></td>
</tr>
<tr>
<td>Over 1.0 year to 1.9 years</td>
<td>1.80</td>
</tr>
<tr>
<td>Over 1.9 years to 2.8 years</td>
<td>1.60</td>
</tr>
<tr>
<td>Over 2.8 years to 3.6 years</td>
<td>1.50</td>
</tr>
<tr>
<td><strong>Maturity Zone 3</strong></td>
<td></td>
</tr>
<tr>
<td>Over 3.6 years to 4.3 years</td>
<td>1.50</td>
</tr>
<tr>
<td>Over 4.3 years to 5.7 years</td>
<td>1.40</td>
</tr>
<tr>
<td>Over 5.7 years to 7.3 years</td>
<td>1.30</td>
</tr>
<tr>
<td>Over 7.3 years to 9.3 years</td>
<td>1.20</td>
</tr>
<tr>
<td>Maturity Zones</td>
<td>Time Band</td>
</tr>
<tr>
<td>---------------</td>
<td>-----------</td>
</tr>
<tr>
<td>Maturity Zone 1</td>
<td>1 month or less over 1 month to 3 months over 3 months to 6 months over 6 months to 12 months</td>
</tr>
<tr>
<td>Maturity Zone 2</td>
<td>Over 1.0 year to 1.9 years Over 1.9 years to 2.8 years Over 2.8 years to 3.6 years</td>
</tr>
<tr>
<td>Maturity zone 3</td>
<td>Over 3.6 years to 4.3 years Over 4.3 years to 5.7 years Over 5.7 years to 7.3 years Over 7.3 years to 9.3 years Over 9.3 years to 10.6 years Over 10.6 years to 12 years Over 12 years to 20 years Over 20 years</td>
</tr>
</tbody>
</table>

### 6.7.4 Measurement of Capital Charge for Equities

#### 6.7.4.1 The minimum capital requirement to cover the risk of holding or taking positions in equities in the trading book is set out below. It applies to all instruments that exhibit market behaviour similar to
equities. The instruments covered include equity shares (voting and non-voting), convertible securities that behave like equities (eg. units of unit trusts) and commitments to buy or sell equity securities (eg. warrants, right issues and bonus issues).

6.7.4.2 Specific and General Market Risk

6.7.4.2.1 Specific Equity Risk
Specific risk is defined as the bank’s gross equity positions (i.e. the sum of all long equity positions and of all short equity positions). The capital charge for specific risk for equities on the Milanka Price Index will be 5%, while all other equities will have a specific risk charge of 10%.

6.7.4.2.2 General Equity Risk
General market risk is defined as the overall net position in an equity market (i.e. the difference between the sum of the longs and the sum of the shorts). The general market risk charge will be 10%.

6.7.5 Measurement of the Capital Charge for Foreign Exchange and Gold Open Positions

6.7.5.1 This section sets out the minimum capital requirement to cover the risk of holding or taking positions in foreign currencies, including gold. Gold is treated as a foreign exchange position rather than a commodity because its volatility is more in line with foreign currencies, and banks manage it in a similar manner.

6.7.5.2 The Off-balance sheet position, including forward contracts, will be included in computation of the capital charge for foreign exchange risks.

6.7.5.3 Computing the capital requirement for foreign exchange risk consists of two processes.

6.7.5.3.1 Measuring the Exposure in a Single Currency Position
The bank's net open position in each currency should be calculated by summing the net position of all on balance sheet and off-balance sheet position, including forward contracts denominated in that particular currency.

6.7.5.3.2 Measuring the Risks Inherent in a Bank's Mix of Long and Short Positions in Different Currencies.
Banks are required to adopt the shorthand method of computation. Under the shorthand method, the nominal amount
of the net position in each foreign currency and in gold is converted at spot rates into the reporting currency (i.e. LKR). The overall net open position is measured by aggregating:

(i) the sum of the net short positions or the sum of the net long positions, whichever is the greater, plus
(ii) the net position (short or long) in gold, regardless of sign.

6.7.5.4 The capital charge will be 10% of the overall net open position of foreign currency and gold.

Table 19
Example of the Shorthand Measure of Foreign Exchange Risk

<table>
<thead>
<tr>
<th></th>
<th>YEN</th>
<th>EURO</th>
<th>GB</th>
<th>INR</th>
<th>USS</th>
<th>GOLD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+50</td>
<td>+100</td>
<td>+150</td>
<td>-20</td>
<td>-180</td>
<td>-35</td>
</tr>
<tr>
<td></td>
<td>+300</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In the above example, the capital charge would be 10% of the higher of either the net long currency positions or the net short currency positions (i.e., 300) and of the net position in gold (35) = 335 x 10% = 33.5.

6.7.6 Aggregation of the Capital Charge for Market Risks
The capital charges for specific risk and general market risk are to be computed separately before aggregation.

6.7.7 Capital Charge for Interest Rate Derivatives
The capital charge for interest rate derivatives will be excluded from the capital charge for market risks at present and will be introduced shortly.

6.7.8 Specific Instruction for completion of part IV return (Computation of Risk-weighted amount for Market Risk)

6.7.8.1 Total Capital Charge for Market Risk
(WBRC 11.4.1.0.0.0)
The total amount of capital charge for interest rate risk (6.7.8.1.1), capital charge for equity risk (6.7.8.1.2) and capital charge for foreign exchange risk (6.7.8.1.3). The amount is automatically shown on web-based return.
(WBRC 11.4.1.1.0.0+11.4.1.2.0.0+11.4.1.3.0.0)
6.7.8.1.1 Capital Charge for Interest Rate Risk
(WBRC 11.4.1.1.0.0)
The total amount of capital charge for general interest rate risk and capital charge for specific interest rate risk. The amount is automatically shown on web-based return.
(WBRC 11.4.1.1.0+11.4.1.1.2.0)

(i) General Interest Rate Risk
(WBRC 11.4.1.1.1.0)
Capital charge for general interest rate risk should be calculated in line with the specific instruction given in the paragraph 6.7.3.3.2
(ii) Specific Interest Rate Risk
(WBRC 11.4.1.1.2.0)
Capital charge for specific interest rate risk should be calculated in line with the specific instruction given in the paragraph 6.7.3.3.1

6.7.8.1.2 Capital Charge for Equity Risk
(WBRC 11.4.1.2.0.0)
The total amount of capital charge for general equity risk and capital charge for specific equity risk. The amount is automatically shown on web-based return.
(WBRC 11.4.1.2.1.0+11.4.1.2.2.0)

(i) General Equity Risk
(WBRC 11.4.1.2.1.0)
Capital charge for general equity risk should be calculated in line with the specific instruction given in the paragraph 6.7.4.2.2
(ii) Specific Equity Risk
(WBRC 11.4.1.2.2.0)
Capital charge for specific equity risk should be calculated in line with the specific instruction given in the paragraph 6.7.4.2.1

6.7.8.1.3 Capital Charge for Foreign Exchange & Gold
(WBRC 11.4.1.3.0.0)
Capital charge for Foreign exchange & gold should be calculated in line with the specific instruction given in the paragraph 6.7.5

6.7.8.2 Total Risk-weighted Amount for Market Risk
(WBRC 11.4.2.0.0.0)
The total amount of risk-weighted amount for market risk should be ten times the capital charge for market risk (6.7.8.1*10). The amount is automatically shown on web-based return.
(WBRC 11.4.1.0.0.0*10)
6.8 Part V - Computation of Risk-weighted Amount for Operational Risk.

6.8.1 Capital Charge for Operational Risk

6.8.1.1 Definition of Operational Risk: Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk. Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

6.8.1.2 The Basic Indicator Approach (BIA): To begin with, banks shall compute the capital requirements for operational risk under the BIA. Under the BIA, banks must hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted $\alpha$) of positive annual gross income. Figures for any year in which annual gross income is negative or zero should be excluded from both the numerator and denominator when calculating the average.

6.8.1.3 The charge may be expressed as follows:

$$K_{BIA} = \frac{\sum (GI_{1...n} \times \alpha)}{n}$$

Where;

- $K_{BIA}$ = the capital charge under the Basic Indicator Approach
- GI = annual gross income, where positive, over the previous three audited financial years
- $n$ = number of the previous three financial years for which gross income is positive
- $\alpha$ = 15%, which is set by the BCBS.

6.8.1.4 Gross income is defined as “net interest income” plus “net non-interest income”. It is intended that this measure should:

6.8.1.4.1 be gross of any provisions (e.g. for unpaid interest),
6.8.1.4.2 be gross of operating expenses, including fees paid to outsourcing service providers, in contrast to fees paid for services that are outsourced, fees received by banks that provide outsourcing services shall be included in the definition of gross income,
6.8.1.4.3 exclude realized profits/losses from the sale of securities in the banking book, and
6.8.1.4.4 exclude extraordinary or irregular items.

6.8.1.5 Banks are advised to compute the capital charge for operational risk under the BIA as follows:
6.8.1.5.1 Average of \([\text{Gross Income} \times \alpha]\) for each of the last three financial years, excluding years of negative or zero gross income

6.8.1.5.2 Gross income = Net interest income + non-interest income – items (6.8.1.4.3) and (6.8.1.4.4) of above.

6.8.1.5.3 \(\alpha = 15\%\)

6.8.2 Specific Instruction for completion of part V
(Computation of Risk-weighted amount for Operational Risk)

6.8.2.1 Gross Income
(WBRC 11.5.1.0.0.0)
The total gross income should be total net income (6.8.2.1.1) less total exclude items as specified in the paragraph 6.8.1.4.3 and 6.8.1.4.4. The amount is automatically shown on web-based return.
(WBRC 11.5.1.1.0.0-11.5.1.2.0.0)

6.8.2.1.1 Net Income
(WBRC 11.5.1.1.0.0)
The total net income should be sum of total net interest income and total non-interest income. The amount is automatically shown on web-based return.
(WBRC 11.5.1.1.1.0+11.5.1.1.2.0)

(i) Net Interest Income
(WBRC 11.5.1.1.1.0)
The total net interest income should be the total interest income less total non-interest expenses as reported in the annual audited profit and loss statement.

(ii) Non-interest Income
(WBRC 11.5.1.1.2.0)
The total non-interest income should be the total income other than the interest income.

6.8.2.1.2 Less Amount
(WBRC 11.5.1.2.0.0)
The total aggregate amount of following items, as specified in the paragraph 6.8.1.4.3 and 6.8.1.4.4, which banks are required to deduct from total net income.

6.8.2.2 Total Capital Charge for Operational Risk
(WBRC 11.5.2.0.0.0)
The total capital charge for operational risk should be 15\% of gross income (6.8.2.1.) above. The amount is automatically shown on web-based return.
(WBRC 11.5.1.0.0.0*15\%)
6.8.2.3 Total Risk-weighted Amount for Operational Risk
(WBRC 11.5.3.0.0.0)
The total amount of risk-weighted amount for operational risk should be ten times the capital charge for operational risk (6.8.2.2*10). The amount is automatically shown on web-based return.
(WBRC 11.5.2.0.0.0*10)