

CENTRAL BANK OF NIGERIA



REVISED GUIDELINES ON REGULATORY CAPITAL FOR NON-INTEREST BANKS IN NIGERIA

JUNE 2023

Table of Contents

1. INTRODUCTION	2
2. SCOPE OF APPLICATION AND REPORTING REQUIREMENTS	2
2.1 Capital Adequacy at Stand-Alone Level	3
2.3 Capital Adequacy at Group or Consolidated Level	3
3. MINIMUM CAPITAL REQUIREMENTS AND BUFFERS	4
3.1 Components of capital	4
3.2 Limits and Minimum Requirements	6
4. REQUIREMENTS FOR INCLUSION IN REGULATORY CAPITAL	7
4.1 Common Equity Tier 1	7
4.2 Additional Tier 1 capital	9
4.3 Tier 2 capital	10
4.4 Minority interest and other capital issued out of consolidated subsidiaries	14
4.5 Regulatory Adjustments	16
5. TRANSITIONAL ARRANGEMENTS FOR ECL ACCOUNTING	Error! Bookmark not defined.
6. BUFFERS ABOVE THE REGULATORY MINIMUM	19
6.1 Capital Conservation Buffer	20
6.2 Countercyclical Buffer	20
6.3 Higher Loss Absorbency for D-SIBs	Error! Bookmark not defined.
6.4 Minimum Capital Adequacy and Buffer Levels	21
7. DETERMINATION OF MAXIMUM DISTRIBUTION PAYMENT IN NIGERIA	21
8. DISCLOSURE REQUIREMENTS	23
9. APPENDIX 1: REQUIREMENT AT SOLO AND CONSOLIDATED LEVEL	Error! Bookmark not defined.
10. APPENDIX 2: MAXIMUM DIVIDEND PAY-OUT RATIO	24

DRAFT

1. Introduction

1. The Central Bank of Nigeria (CBN), as part of its efforts to enhance the resilience of Non-Interest banks (NIBs) and the Nigerian Banking System, has developed this Revised Guideline on Regulatory Capital for NIBs in Nigeria. This Guidelines sets out the criteria that NIBs' capital instruments must meet to be eligible for regulatory purposes as per the Islamic Financial Services Board capital standards.¹
2. This Guideline also sets out the supervisory requirements for NIBs operating in Nigeria in relation to: minimum regulatory capital, adjustments to the components of regulatory capital, transitional arrangements, disclosure requirements and the additional capital buffers above the minimum requirements.
3. The major changes brought by this revision are in the following areas:
 - a) Introduction of Mudarabah Sukuk for Additional Tier Capital as against Musharakah Sukuk as prescribed by the earlier Guidelines;
 - b) Introduction of Debt-based instruments for Tier 2 capital;
 - c) Enhanced the eligibility criteria for regulatory capital instruments and provides detailed guidelines on the trigger events for conversion of the AT1 and Tier 2 capital instruments
 - d) Introduction of capital buffers: i) Capital Conservation Buffer (CCB1); and ii) Countercyclical Capital Buffer (CCB2).

2. Scope of Application and Reporting Requirements

4. All NIBs are required to maintain the minimum capital and capital buffer requirements as laid out in this Guideline at all times or as may be determined by the CBN from time to time at both stand-alone (solo) and consolidated (group) levels (if any).
5. All NIBs are required to submit an electronic copy of their respective returns of capital adequacy position to the CBN using the prescribed reporting templates. The frequency of reporting shall be as follows:
 - a) Monthly basis for the capital adequacy position on a stand-alone basis; and

¹ This Guidelines combines the requirements of IFSB-15: Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services and the recently published IFSB-23: Revised Capital Adequacy Standard for Institutions Offering Islamic Banking Services.

- b) Quarterly basis for the capital adequacy position at the consolidated level (where applicable).
6. Notwithstanding the prescribed frequency of submission of returns of capital adequacy to the CBN specified in **Paragraph 5** above, the CBN may at any time require an NIB to calculate and report its capital adequacy ratios for any financial period or as at any specified date on a:
- a) stand-alone basis; and/or
 - b) consolidated basis in respect of the NIB and all its subsidiaries;

2.1 Capital Adequacy at Stand-Alone Level

- 7. Capital adequacy position of an NIB on a stand-alone (solo) level measures its capital strength and risk profile. It takes into consideration a NIB's global operations including its foreign subsidiaries and overseas branch operations, on a stand-alone basis.
- 8. In the assessment of capital adequacy at the stand-alone level, NIBs are required to incorporate all regulatory adjustments set out in this Guideline.
- 9. Investments in the capital instruments of subsidiaries, which are consolidated in the consolidated financial statements of the banking group, should be deducted from the corresponding capital instruments issued.

2.3 Capital Adequacy at Group or Consolidated Level

- 10. The capital adequacy at the consolidated ("Group²") level measures the capital strength and risk profile of an NIB HoldCo after consolidating the assets and liabilities of its subsidiaries, joint ventures, associates etc., excluding the entities or subsidiaries which are predominantly engaged in non-financial sector activities.
- 11. Investments in subsidiaries, joint ventures, associates et,c shall be subject to the CBN's Regulations, 2 and 3.
- 12. The adopted consolidation technique should be consistent with the requirements of International Financial Reporting Standard (IFRS) and Accounting and Auditing Organizations for Islamic Financial Institutions (AAOIFI) taking into consideration the necessary adjustments specified in this Guideline.

² There are two group structures under the focus of this Guidance Notes i.e. Banking Group and Holding Company Group (HoldCo Group)

13. For the purpose of this guidelines, financial sector activities shall mean activities undertaken by NIBs in one or more of the following businesses or activities, whether by itself or through any of its subsidiaries: (i) banking, (ii) securities business, (iii) Takaful business, (iv) financial leasing, (v) portfolio management, (vi) investment advisory services, (vii) custodial services, (viii) central clearing services, and (ix) activities ancillary to banking
14. In computing capital adequacy ratio on a consolidated basis, a banking group shall aggregate its consolidated group's risk weighted assets for credit risk, market risk and operational risk. The calculation of the risk weighted assets shall be as per the risk-weight of the CBN Guidance Notes on Credit, Market and Operational Risk for NIFIs.
15. All regulatory adjustments set out in this Guideline are required to be made to the consolidated CET1 capital of the banking group or HoldCo group.
16. Minority interest (i.e. non-controlling interest) and other capital issued out of consolidated subsidiaries held by third parties will be recognized in the consolidated regulatory capital of the group subject to certain conditions as stipulated in **Paragraph 48 to 52** of this Guideline.
17. Where a reporting entity determines that consolidation of a subsidiary is not feasible, the entity shall seek the approval of the CBN to:
 - a) In the case of a subsidiary engaged in financial sector activities, deduct such investments from capital; and
 - b) In the case of a non-financial subsidiary, apply a risk weight of 1,250%
18. All NIBs and financial holding companies (HoldCos) shall comply with the capital adequacy requirements specified in this Guideline (at the consolidated level).

3.0 Minimum capital requirements and buffers

3.1 Components of capital

19. Total Regulatory Capital (TRC) is the sum of Common Equity Tier 1 (CET1), Additional Tier 1 Capital (AT1) and Tier 2 Capital (T2), net of regulatory adjustments.
20. Tier 1 capital is the sum of CET1 and AT1 capital, net of the regulatory adjustments applied to those categories.

21. CET1 and AT1 capital are going-concern capital³ while Tier 2 capital is gone concern capital⁴.

22. An NIB shall compute its regulatory capital adequacy ratios (CAR) using The Supervisory Discretion Formula as detailed below:

The supervisory discretion formula, in which NIBs shall hold Regulatory Capital in respect of Displaced Commercial Risk (DCR). In this approach, commercial risks of assets financed by Unrestricted PSIA (UPSIA) are considered to be borne proportionately by both the Unrestricted Investment Account Holders (UIAH) and the NIBs. Hence, a proportion of the (risk-weighted) assets funded by UPSIA, symbolized as "alpha" is required to be included in the denominator of the CAR, the permissible value of alpha being subject to CBN discretion. The CBN may also decide to extend this treatment to restricted investment accounts.

Eligible Capital

$$\frac{\{\text{Total Risk-Weighted Assets (Credit + Market Risks) Plus Operational Risk} \\ \text{Less} \\ \text{Risk-Weighted Assets Funded by Restricted PSIA (Credit and Market Risks)} \\ \text{Less} \\ (1 - \alpha) [\text{Risk-Weighted Assets Funded by Unrestricted PSIA (Credit and Market} \\ \text{Risks)}] \text{ Less} \\ \alpha[\text{Risk-Weighted Assets funded by PER and IRR of Unrestricted PSIA (Credit and} \\ \text{Market Risks)}]\}}{\text{Eligible Capital}}$$

23. In applying the Supervisory Discretion Formula Approach, the following should be noted:

- a) Total RWAs include those financed by both restricted and unrestricted PSIA.
- b) Credit and market risks for on- and off-balance sheet exposures.
- c) Where the funds are co-mingled, the RWAs funded by PSIA are calculated based on their pro-rata share of the relevant assets. PSIA balances include PER and IRR, or equivalent reserves.
- d) "Alpha (α)" refers to the proportion of assets funded by unrestricted PSIA which shall be determined by the CBN.
- e) The relevant proportion of RWAs funded by the PSIA's share of PER and by IRR is deducted from the denominator. The PER has the effect of reducing the displaced commercial risk, and the IRR has the effect of reducing any future losses on the investment financed by the PSIA.

³ This component is able to absorb losses without constituting an event of default on the holders of the instrument.

⁴ This component can absorb losses only when Tier 1 capital has been eroded and a bank is in liquidation.

3.2 Non-Interest Banking Windows

24. All conventional banks with non-interest windows shall allocate a notional capital fund (not Share capital) for the operations of the Window. The banks shall establish a separate and self-accounting non-interest banking department, with designated management as contained in the CBN Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria.
25. A Window's minimum level of capital fund requirement at any point in time shall be determined by the level of its RWAs.

3.3 Limits and Minimum Requirements

26. A minimum Pillar 1 regulatory Capital Adequacy Ratio (CAR) of 10% will be applicable to all NIBs.
27. With respect to a holding company, its minimum capital adequacy ratio shall not be less than the capital ratio requirement of any banking subsidiary within the group. In this regard, the reference subsidiary shall be that with the highest minimum capital requirement.
28. The CBN may require any NIB to maintain a higher minimum level of capital than those stated in **Paragraph 26** and **Table 1** after taking into consideration the outcome of the supervisory review of its Internal Capital Adequacy Assessment Process (ICAAP) under Pillar 2. The aim will be to ensure that the level of an NIB's minimum capital requirement reflects its risk profile, business strategy and risk management capacity.

Table 1: Minimum Regulatory Capital Requirements

Regulatory Capital Ratio	As a percentage of TRWA
	NIBs
CET1 Capital Ratio	7.0%
Tier 1 Capital Ratio	7.5%
Capital Adequacy Ratio	10.0%

29. The minimum requirements set out in Table 1 do not take into consideration the additional capital buffers which the CBN may require NIBs in Nigeria to maintain from

time to time depending on, amongst others, the prevailing macroeconomic conditions and the systemic importance of the individual NIBs.

30. The inclusion of eligible Tier 2 Capital would only be permitted subject to the minimum thresholds set out in Table 1 being met. In the absence of AT1 capital, the minimum Tier 1 capital ratio should be met from CET1 capital.
31. The minimum CAR for the NIBs that have been designated as D-SIBs should be further enhanced with the Higher Loss Absorbency (HLA) requirement of 1.0% consisting wholly of CET1 capital.
32. In addition to the minimum CET 1 capital ratios specified in Table 1, NIBs are also required to maintain minimum capital conservation and countercyclical buffers specified in **Paragraph 76**. The buffers should be met with CET1 capital only.

4.0 Requirements for Inclusion in Regulatory Capital

4.1 Common Equity Tier 1

33. CET1 capital forms the highest quality of capital for NIB. This section of the Standard lays out the eligibility criteria for a component to qualify to be included in the CET1 capital in terms of its permanence and loss absorbency.
34. CET1 capital comprises the sum of the following elements:
 - a Common equity shares issued by the NIB:

These shares should be fully paid up and should meet the criteria of being classified as common shares forming part of the shareholders' equity of the NIB.
 - b Stock surplus:
 - c Share premium from the issue of common shares is eligible to form part of CET1 capital.
 - d Retained earnings: The amount of net earnings carried forward from previous financial periods shall be recognised and included in the calculation of CET1 capital.
 - e Other reserves and accumulated other comprehensive income, as defined in IFRS: Dividends are removed from CET1 capital in accordance with applicable accounting standards.
 - f Such common equity shares that are issued by NIB's consolidated subsidiaries of the bank and held by third parties (i.e. minority interest) that meet the criteria for inclusion in CET 1 capital. Please see Paragraph 44 to 48 for the relevant criteria;
 - g Other reserves as may be determined by the CBN; and

h Regulatory adjustments/deductions applicable to CET1 capital

35. For an instrument to be included as part of CET1 capital, it must meet all of the criteria set out below. The criteria shall be met solely with common shares:

- a) Represents the most subordinated claim in liquidation of the NIB;
- b) Entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation⁵;
- c) Principal is perpetual and never repaid outside of liquidation;
- d) The NIB does nothing to create an expectation at issuance that the instrument will be bought back, redeemed, or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation;
- e) Distributions are paid out of distributable items (retained earnings included). The level of distributions should not in any way be tied or linked to the amount paid in at issuance and should not be subject to a contractual cap;
- f) There are no circumstances under which the distributions are obligatory and therefore non-payment is not a default event⁶;
- g) Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made;
- h) It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and pari passu with all the others;
- i) The paid-in amount is recognised as equity capital (not as liability) for determining balance sheet insolvency;
- j) The paid-in amount is classified as equity under IFRS;
- k) Recognized as directly issued and paid-in and the bank cannot directly or indirectly have funded the instrument or the purchase of the instrument;
- l) The paid-in amount is neither secured nor covered by a guarantee of the issuer or related entity ⁷ or subject to any other arrangement that legally or economically enhances the seniority of the claim;
- m) It is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, where permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners;

⁵ That is, has an unlimited and variable claim, not a fixed or capped claim.

⁶ Amongst other things, this requirement prohibits features that require the bank to make payment in kind.

⁷ A related entity can include a parent company, a sister company, a subsidiary, or any other affiliate. A holding company is a related entity irrespective of whether it forms part of the consolidated banking group.

- n) It is clearly and separately disclosed on the bank's balance sheet published in the bank's annual report.

36. There is no limit on the inclusion of Tier 1 capital for the purpose of calculating total regulatory capital.

4.2 Additional Tier 1 capital

37. Additional Tier 1 capital includes, but is not limited to, the sum of the following elements:

- a) Sukūk that are issued by the NIBs meeting the criteria to be an AT1 capital mentioned below;
- b) Sukūk that are issued by consolidated subsidiaries of the NIBs to third-party investors that meet the criteria to be an AT1 capital and are not included in CET1 capital. Please see **Paragraph 38** for the relevant criteria; and
- c) Regulatory adjustments applied in the calculation of AT1.

38. The criteria that must be met by sukūk issuances to be included in AT1 are described below.

a) Loss absorbency

An NIB may issue muḍārabah sukūk⁸ the proceeds of which are invested in the general asset pool of the NIB after commingling with CET1 capital so that sukūk holders participate in the whole business of the NIB, including all its financial entitlements and liabilities as per the terms of the muḍārabah sukūk agreement.⁹ These sukūk must therefore absorb losses that the NIB is liable for on a going concern basis notwithstanding the sukūk holders' right to recourse thereafter to the NIB in its original capital should these losses be due to negligence, misconduct, or otherwise violation of contractual terms by the NIB.

b) Distribution of profits

Parties to the AT1 muḍārabah sukūk contract agree that the distribution of muḍārabah sukūk profits is discretionary and non-distribution would not constitute a default event. Distributions should not be linked to the credit rating of the NIB, either wholly or in part.¹⁰ Nonetheless, non-distribution of profits

⁸ The suggestion to use muḍārabah sukūk in this standard, instead of mushārahah sukūk (as in IFSB-15), is made in order to comply with the eligibility criterion that profit distribution for AT1 must be discretionary, and that non-payment of the profits should not constitute a default event for the NIB. This, from a Sharī'ah perspective, would be possible to operationalise using a muḍārabah contract where the mudarib could keep all profits, whereas in mushārahah the NIB as a partner would not be allowed to keep the partnership profits to itself.

⁹ Since muḍārabah sukūk holders and shareholders would, in this case, share the same risks and rewards of the NIB's businesses, the main differences between these sukūk and shares would be in the legal contract and administrative rights available for shareholders but not for sukūk holders, such as voting rights and membership of the NIB's board of directors.

¹⁰ In cases of negligence and misconduct by the muḍārib, the appropriate treatment for non-distribution of profits may be determined by courts of law in each jurisdiction.

after they accrue obliges establishing a muḍārabah profit reserve for these ṣukūk. This reserve shall be owned by the ṣukūk holders, can be invested in accordance with ṣukūk investment terms, and shall become part of Additional Tier 1 capital with all its rights and obligations. Profits from this reserve can be paid to ṣukūk holders should the actual profits fall below the expected profit in the distribution period.

c) Issuance process and procedure

The ṣukūk are issued and paid-up, with the issuance proceeds being immediately available to a single operating entity in the consolidated group. Neither the NIB nor a related party over which the NIB exercises control or significant influence can purchase the ṣukūk, or fund its purchase, either directly or indirectly. The information to be disclosed must include, but is not limited to, salient features of the instruments offered, and the use of an SPE that must follow specific requirements.

d) Maturity and Callability

The instrument must be perpetual in nature and must not have any defined maturity date. It must not have step-up features (i.e. periodic increases in the expected rate of return) and must be devoid of any other incentive to the issuing NIB to redeem it.¹¹ If the instrument is callable, the issuing NIB may be allowed to exercise a call option only after five years and subject to certain requirements, such as:

- i) it has prior supervisory approval;
- ii) no call expectation is created by the NIB; and
- iii) it is able to replace the called ṣukūk with the same or better quality of capital, either before or concurrently with the call.

The issuing NIB shall not exercise a call unless it successfully exhibits that its capital position is above the regulatory capital requirement after the call option is exercised. Instruments that qualify for AT1 capital cannot have any features that hinder recapitalisation (provisions that require the NIB to compensate investors if a new instrument is issued at a lower price during a specified time frame).

e) Instruments unsecured in nature

The amount paid at issuance is neither secured nor guaranteed by the NIB or any related entity. In addition, there should not be any arrangement that legally or economically increases the seniority of the sukūk's claim.

4.3 Tier 2 capital

39. T2 capital is considered to be "gone concern"¹² capital with the purpose of absorbing further losses in the case of non-viability of the NIB, and this helps to protect the

¹¹ An example of an "incentive to the issuer to redeem" is a call option held by the issuer combined with an investor right or option to convert the instrument into common shares if the call is not exercised. Such an incentive would conflict with the requirement of permanence.

¹² Capital that is subordinated to depositors' and general creditors' entitlement in the winding-up or insolvency of the bank.

current account holders of the NIB. This component is also crucial in maintaining financial stability by preventing a contagion effect from a failing NIB, as it prevents loss of capital by depositors and creditors of NIB.

40. Tier 2 capital consists of the sum of the following elements:

- a) Sukūk issued by NIB that meet the criteria of paragraph 41 for inclusion in T2 (and are not included in Tier 1 capital);
- b) General provisions or reserves held against future, presently unidentified losses on financing¹³
- c) Sukuk issued by consolidated subsidiaries of the NIB and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital. Please see **Paragraph 41 to 43** for the relevant criteria;
- d) Regulatory adjustments applied in the calculation of Tier 2 capital.

41. Specific criteria for classification of instruments as “Tier 2 capital” are set out below:

a. Loss absorbency

It might be possible, subject to Sharī'ah compliance, for an NIB to issue T2 capital instruments in the form of şukūk that result in indebtedness¹⁴ for the NIB, the repayment of which will be subordinated on a gone concern basis after NIB losses have been absorbed. Şukūk holders will have the right to recourse to Tier 1 capital.

b. Issuance process and procedure

The instrument is issued and paid-up, and neither the NIB nor a related party over which the NIB exercises control or significant influence can purchase the şukūk or fund the purchase of the instrument, either directly or indirectly. Issuance that takes place outside an operating entity of the NIB or the holding company in the consolidated group such as through an SPE must follow specific requirements. For instance, the proceeds of issuance must be made immediately available to an operating entity or holding company in the consolidated group, in a form that meets or exceeds all the other criteria of Tier 2.

c. Maturity and callable option

The original minimum maturity shall be at least five years. The instrument shall not have step-up facilities and be without any incentive to redeem by the issuer. For recognition in regulatory capital, any amortisation of the principal will be on a

¹³ Under the standardised approach to credit risk, provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within Tier 2. Provisions ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded. Furthermore, general provisions/general loan-loss reserves eligible for inclusion in Tier 2, measured gross of tax effects, will be limited to a maximum of 1.25 percentage points of credit RWAs calculated under the standardised approach.

¹⁴ Using muḍārabah or wakālah sukuk for Tier 2 (as suggested in IFSB-15) would mean the T2 sukuk holders would be partners with Tier 1 capital (both CET1 and AT1) and therefore would absorb losses simultaneously with them, which would not be consistent with the “gone concern” role of T2 capital.

straight-line basis in the remaining five years before maturity. If the instrument is callable, the issuer is permitted to exercise a call option only after five years and subject to certain requirements, such as: (i) prior CBN approval; (ii) there is no call expectation created by the NIB; and (iii) ability to replace the called instruments with the same or better quality of capital, either before or concurrently with the call. The NIB shall not exercise a call unless it successfully exhibits that its capital position is above the regulatory capital requirement.

d. Distribution of returns

The distribution of returns to the holders of the sukūk should not be linked to the credit rating of the NIB, either wholly or in part, but shall be linked to actual returns. Investors have no rights to accelerate future scheduled payments, except in the case of liquidation or bankruptcy.

e. Instruments unsecured in nature

The amount paid during issuance and the debt resulting from the instrument is neither secured nor covered by a guarantee by the NIB or any of its related entities. Besides, there should not be any arrangement that legally or economically increases the seniority of claim in the case of liquidation.³⁷

f. Terms of conversion

The sukūk would be convertible (as specified in the contract) into common shares upon the occurrence of a trigger event. It is essential that the terms of conversion, notably the trigger point and the conversion ratio, are clearly specified in the sukūk contract. After conversion of the sukūk in the case of the NIB's non-viability or insolvency, T2 capital would rank pari passu with CET1, along with AT1 capital. The terms and conditions must have a provision that requires, at the option of the relevant authority, the sukūk to be converted into common equity upon the occurrence of a trigger event specified by the RSA or as stated in laws of the governing jurisdiction. The issuing bank must always maintain all prior authorisation necessary to immediately issue the relevant number of shares specified in the sukūk's terms and conditions should the trigger event occur. The trigger event:

- a. is the earlier of:
 - i. a decision that conversion, without which the NIB would become nonviable, is necessary, as determined by the relevant authority without prejudice to sukūk contracts; and
 - ii. the decision to make a public-sector injection of capital, or equivalent support, without which the NIB would have become non-viable, as determined by the relevant authority without prejudice to sukūk contracts; and

- b. is determined by the jurisdiction in which the capital is being given recognition for regulatory purposes. Therefore, where an issuing NIB is part of a wider banking group and it wishes the instrument to be included in the consolidated group's capital in addition to its solo capital, the terms and conditions must specify an additional trigger event. This additional trigger event is the earlier of:
- i. a decision that conversion, without which the NIB would become nonviable, is necessary, as determined by the relevant authority in the home jurisdiction without prejudice to *ṣukūk* contracts; and
 - ii. the decision to make a public-sector injection of capital, or equivalent support, in the jurisdiction of the consolidated supervisor, without which the NIB receiving the support would have become non-viable, as determined by the relevant authority in that jurisdiction without prejudice to *ṣukūk* contracts.

It is paramount that conversion terms – most importantly, trigger events, conversion ratio, conversion value, and the contractual basis of the conversion at implementation – are specified in the *ṣukūk* issuance documents. Also, *ṣukūk* conversion value should not be less than the market or fair value of the underlying assets being converted.

42. In addition to the criteria set out in **Paragraph 41 [(a) to (f)]**, the following criteria must also be met or exceeded for an instrument to be included in Tier 2 capital.

- e) Minimum original maturity of at least five years (recognition in regulatory capital in the remaining five years before maturity **will be amortised on a straight line basis by 20% per annum** and there should be no step-ups or incentives to redeem by the holder);
- f) Subordinated to depositors and general creditors of the NIB;
- g) The Sukuk holders must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation;
- h) If the instrument is not issued out of an operating entity or the holding company in the consolidated group e.g. a Special Purpose Entity (SPE), proceeds must be immediately available without limitation to a single operating entity¹⁵ or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 capital.

43. Other comprehensive income items other than fixed asset revaluation reserves that are created by the adoption of IFRS may be accepted as part of the Tier 2 capital subject to limitations that may be specified by the CBN from time to time.

¹⁵ An operating entity is an entity set up to conduct business with clients with the intention of earning a profit in its own right

4.4 Treatment of Profit-Sharing Investment Account, Profit Equalization Reserve and Investment Risk Reserve

Profit-sharing investment accounts of an NIB are not classified as part of its capital because they do not meet the above-mentioned criteria of core or additional capital. Furthermore, all the investment risk reserve and a portion of the profit equalisation reserve belong to the equity of investment account holders, and thus are not part of the capital of the NIB. As the purpose of a PER is to smooth the profit payouts and not to cover losses, any portion of a PER that is part of the NIB's reserves should also not be treated as part of the regulatory capital of the NIB. It may be noted that the impact of PER and IRR has already been incorporated in the denominator of the supervisory discretion formula for calculation of the CAR, as discussed in Section 4 of this standard.

4.4 Minority interest and other capital issued out of consolidated subsidiaries

44. Minority interest (non-controlling interest) arising from common share equity capital issued by a fully consolidated subsidiary of an NIB or a HoldCo may receive recognition in CET1 capital only if:
- a) the instrument giving rise to the minority interest would, if issued by the NIB/HoldCo, meet all the criteria for classification as CET1 for regulatory capital purposes as stipulated in this Guideline; and
 - b) the subsidiary that issued the instrument is itself an NIB in the case of a banking group or a non-bank financial entity for a HoldCo group.
45. Minority interest in a subsidiary that is an NIB is strictly excluded from the parent NIB's common equity if the parent bank or affiliate has entered into any arrangements to fund directly or indirectly minority investment in the subsidiary whether through an SPE or through another vehicle or arrangement.
46. The amount of minority interest meeting the criteria set out in **Paragraph 48** that will be recognized in consolidated CET1 will be calculated as follows:
- c) Total minority interest meeting the two criteria set out in **Paragraph 48** above minus the amount of the surplus CET1 of the subsidiary attributable to the minority shareholders.
 - d) Surplus CET1 of the subsidiary is calculated as the CET1 of the subsidiary minus the lower of: (i) the minimum CET1 requirement of the subsidiary plus the capital conservation buffer or (ii) the portion of the consolidated minimum CET1 requirement plus the capital conservation buffer that relates to the subsidiary.

- e) The amount of the surplus CET1 that is attributable to the minority shareholders is calculated by multiplying the surplus CET1 by the percentage of CET1 that is held by minority shareholders.

47. Tier 1 capital instruments issued by a fully consolidated subsidiary of the NIB, whether wholly or partly owned, to third party investors (including amounts under **Paragraph 46** above) may receive recognition in Tier 1 capital only if the instruments would, if issued by the bank, meet all of the specified criteria for classification as Tier 1 capital. The amount of this capital that will be recognised in Tier 1 will be calculated as follows:

- f) Total Tier 1 capital of the subsidiary issued to third parties minus the amount of the surplus Tier 1 of the subsidiary attributable to the third-party investors.
- g) Surplus Tier 1 of the subsidiary is calculated as the Tier 1 of the subsidiary minus the lower of: (i) the minimum Tier 1 requirement of the subsidiary plus the capital conservation buffer or (ii) the portion of the consolidated minimum Tier 1 requirement plus the capital conservation buffer that relates to the subsidiary.
- h) The amount of the surplus Tier 1 that is attributable to the third-party investors is calculated by multiplying the surplus Tier 1 by the percentage of Tier 1 that is held by third party investors.
- i) The amount of this Tier 1 capital that will be recognised in AT1 will exclude amounts recognised in CET1 under **Paragraph 46** above

48. Total capital instruments (i.e. Tier 1 and Tier 2 capital instruments) issued by a fully consolidated subsidiary of the bank, whether wholly or partly owned, to third party investors (including amounts under **Paragraph 46** to **Paragraph 47** above) may receive recognition in Total Capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 or Tier 2 capital. The amount of this capital that will be recognised in consolidated Total Capital will be calculated as follows:

- j) Total capital instruments of the subsidiary issued to third parties minus the amount of the surplus Total Capital of the subsidiary attributable to the third-party investors.
- k) Surplus Total Capital of the subsidiary is calculated as the Total Capital of the subsidiary minus the lower of: (i) the minimum Total Capital requirement of the subsidiary plus the capital conservation buffer and (ii) the portion of the consolidated minimum Total Capital requirement plus the capital conservation buffer that relates to the subsidiary.

- l) The amount of the surplus Total Capital that is attributable to the third-party investors is calculated by multiplying the surplus Total Capital by the percentage of Total Capital that is held by third party investors.
- m) The amount of Total Capital that will be recognised in Tier 2 will exclude amounts recognised in CET1 under **Paragraph 46** above and amounts recognised in Additional Tier 1 under **Paragraph 47** above.

4.5 Regulatory Adjustments

- 49. This section sets out deductions to be applied to regulatory capital. In most cases, these adjustments are applied in the calculation of CET1 capital.
- 50. The adjustments to regulatory capital are intended to make its quantification more conservative so that it is available at all times to absorb losses.
- 51. All items that are deducted from capital should be excluded from total assets in calculating the CAR.
- 52. If a bank is required to make a deduction from Tier 2 capital and it does not have sufficient capital to make that deduction, the shortfall will be deducted from Tier 1 capital.
- 53. In case of any shortfall in the regulatory capital requirements in any subsidiary entity, the shortfall should be fully deducted from the Common Equity Tier 1 (CET1) capital
- 54. Elements which shall be recognised or adjusted in the calculation of total capital from a regulatory perspective are as follows, subject to the stated conditions:

4.5.1 Goodwill and other intangibles

- 55. Goodwill and all other intangibles must be deducted in the calculation of CET1. This includes any goodwill included in the valuation of significant investments in the capital of other financial entities that are outside the scope of regulatory consolidation.
- 56. The full amount is to be deducted net of any associated Deferred Tax Liability (DTL) which would be extinguished if the intangible assets become impaired or derecognised under the IFRS.

4.5.2 Deferred Tax Assets (DTA)

- 57. Deferred Tax Assets (DTAs) are to be deducted in the calculation of CET1.

4.5.3 Cash Flow Hedge Reserve

- 58. The amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet should be derecognised in the calculation of CET1. This means that positive amounts should be deducted, and negative amounts should be added back.

4.5.4 Gain on Sale Related to Securitisation Transactions

59. NIBs must deduct from CET1 any increase in equity capital resulting from a securitisation transaction, such as that associated with expected future margin income resulting in a gain on sale that is recognised in regulatory capital.

4.5.5 Defined Benefit Pension Fund Assets and Liabilities

60. Defined Benefit (DB) pension fund liabilities, as included on the balance sheet, must be fully recognised in the calculation of CET1. That is, CET1 cannot be increased through derecognising these liabilities.

61. For each DB pension fund that is an asset on the balance sheet, the net asset on the balance sheet in respect of the plan or fund should be deducted in the calculation of CET1 net of any associated deferred tax liability which would be extinguished if the asset should become impaired or derecognised under IFRS.

4.5.6 Investment in Own Shares (Treasury shares) and Own other Capital

62. All of a bank's investments in its own common shares, whether held directly or indirectly, should be deducted in the calculation of CET1. In addition, any own stock which the bank could be contractually obliged to purchase should be deducted in the calculation of CET1¹⁶.

63. Banks must also deduct investments in their own AT1 in the calculation of their AT1 capital and must deduct investments in their own Tier 2 in the calculation of their Tier 2 capital.

4.5.7 Reciprocal cross holdings in the common shares of banking, financial and insurance entities

64. Reciprocal cross-holdings of capital (e.g. Bank A holds capital of Bank B and Bank B in return holds capital of Bank A) should be deducted in full.

65. Banks must apply a "corresponding deduction approach" to such investments in the capital of other banks and financial entities. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the bank itself.

¹⁶ The treatment described will apply irrespective of the location of the exposure in the banking book or the trading book

4.5.8 Investments in the capital of banking and financial entities outside the scope of regulatory consolidation where the bank does not own more than 10% of the issued common shares of the entity

66. An NIB's aggregate investment in all types of eligible capital instruments, issued by NIBs and financial institutions (except its financial subsidiaries) should not exceed 10% of the investing NIB's capital funds (Tier 1 plus Tier 2 before regulatory adjustments). Any investment more than this limit shall be assigned a risk weight of 1250%.
67. An NIB's investment in the following instruments issued by financial institutions will be included in the prudential limit of 10%, referred to in **Paragraph 66** above:
- a) Equity shares;
 - b) Sukuk; and
 - c) Any other instrument approved by the CBN having the nature of capital.
68. Financial institutions whose instruments shall qualify for capital purposes shall be as defined in the Regulation on the Scope of Banking Activities and Ancillary Matters No. 3 and any other extant regulations issued by the CBN.
69. Investment in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation and where the NIB does not own more than 10% of the issued common share capital of the entity should be deducted from capital. For the purpose of this regulatory adjustment:
- d) Investments include direct, indirect¹⁷ and synthetic holdings of capital instruments or other liabilities;
 - e) Holdings in both the banking book and trading book are to be included;
 - f) For capital instruments, it is the net long position that is to be included (i.e. the gross long position net of short positions in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year);
 - g) If the capital instrument of the entity in which the bank has invested does not meet the criteria for CET1, AT1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment;
 - h) NIBs may with prior written approval from the CBN exclude temporarily certain investments where these have been made in the context of resolving a distressed institution.

¹⁷ Indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the bank substantially equivalent to the loss in value of the direct holding.

70. If an NIB is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital.

71. Amounts that are not deducted will continue to be risk weighted as per the relevant Pillar 1 RWA rules.

4.5.9 Shortfall in impairment

72. Any shortfall in specific and collective impairment is to be deducted from CET1 capital.

4.5.11 Significant Investment in the Capital of Banking, Financial and Insurance Entities that are Outside the Scope of Regulatory Consolidation

73. The regulatory adjustment described in this section applies to investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate of the bank. In addition:

- a) Investments include direct, indirect, and synthetic holdings of capital instruments;
- b) Holdings in both the banking book and trading book are to be included;
- c) If the capital instrument of the entity in which the bank has invested does not meet the criteria for CET1, AT1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment.

74. All investments in capital instruments included above that are not common shares must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the bank itself.

6. Buffers above the Regulatory Minimum

75. All NIBs shall be required to hold and maintain capital buffers above the regulatory minimum, as specified by the CBN from time to time. The capital buffers should be in the form of CET1 and should be above the minimum CET1, Tier 1 and Total Capital Adequacy levels as defined in this Guideline. The capital buffers shall comprise the sum of the following:

- a) a Capital Conservation Buffer (CCB1) of 1.0% of TRWA; and
- b) a Countercyclical Capital Buffer (CCB2), which will be determined by the CBN from time to time taking into consideration the prevailing macroeconomic conditions and developments within the financial sector amongst other factors.

6.1 Capital Conservation Buffer

76. The capital conservation buffer (CCB1) is designed to ensure that NIBs build up capital buffers during business as usual time which can be used to absorb losses during periods of crisis.
77. NIBs are therefore required to maintain a CCB1 of 1.0% of TRWA in the form of CET1 during business as usual periods to withstand future periods of stress.
78. Where buffers have been drawn down, NIBs are required to restrict discretionary capital distributions, including dividend payments, share buybacks, and employee bonuses¹⁵. Discretionary distributions, for the purposes of this Guideline, shall also include payments in respect of intra-group transfer pricing and technical service fees to foreign group members and/or parents.
79. NIBs have the option of raising new capital from the capital market as an alternative to conserving internally generated capital. The approach to be taken by banks shall be subject to prior approval from the CBN.

6.2 Countercyclical Buffer

80. In addition to CCB1, all banks in Nigeria will be required to maintain a Countercyclical Capital Buffer (CCB2)¹⁸ where the CBN determines that there is a build-up of credit risk which could lead to system-wide stress. The CCB2 shall range from 0% to 2.5% of TRWA and shall be determined by the CBN from time to time taking into consideration, amongst others, the prevailing economic and industry circumstances.
81. The CCB2 is to be met with CET1 capital and thus the restrictions on discretionary capital distribution would also take into consideration banks' levels of CCB2.
82. The CBN shall apply its macro prudential tools and supervisory judgement in determining the level of CCB2 to be maintained by Nigerian banks. The supervisory judgement shall be informed by, amongst others, the assessment of developments in the macroeconomic and financial conditions including the underlying drivers.

¹⁸ The objective of countercyclical capital buffer is to support the broader macro-prudential goal and financial system stability

83. The CBN shall announce the required CCB2 twelve (12) months in advance, during which time banks will be expected to take measures aimed at building up their capital buffers to the required level. Where there is an imminent crisis, the CBN may require banks to build up a CCB2 at a much shorter notice.

84. NIBs shall be required to maintain, if necessary, CCB2 for a minimum period to be determined by the CBN after the expectation for system wide risk has been alleviated.

85. The CCB2 buffer for banks with international authorization will be a weighted average of the buffers deployed across all the jurisdictions to which it has credit exposures.

86. Where in place, NIBs must calculate and publicly disclose their CCB2 requirements with at least the same frequency as their minimum capital requirements. The buffer should be based on the most current jurisdictional countercyclical buffers.

87. NIBs must also disclose the geographic breakdown of their exposures used in the calculation of the buffer requirement.

6.4 Minimum Capital Adequacy and Buffer Levels

88. The following table sets out the minimum levels of capital adequacy and capital buffers that are applicable to banks depending on the nature of their authorization and their systemic importance to the Nigerian economy.

Table 2: Minimum Capital Requirements and Buffer Levels

Capital Elements as % of TRWA	National Banks	International Banks	D-SIBs
CET1	7.0	10.5	10.5
T1	7.5	11.25	11.25
CAR	10.0	15.0	15.0
CCB1	1.0	1.0	1.0
CCB2	As determined by CBN from time to time		
HLA	Not applicable	Not applicable	1.0

7. Determination of Maximum Distribution Payment in Nigeria

7.1 Scope of Distribution

89. Distribution payment for the purpose of this Guideline shall refer to:

- a) payment of dividends/coupon in respect of CET1 and AT1 capital;
- b) payment for the purchase of the NIB’s own shares, subject to the existing regulation;

- c) discretionary bonus payment to the directors and employees of the bank as defined in Paragraph 87 ;
- d) technical service fees, management fees, or other agreed or discretionary payments to a group entity or group member/parent; and
- e) any other payment that is in substance a distribution of the bank's CET1 capital

7.2 Conditions for Payment of Bonuses

90. Bonus payment to directors and employees shall only be made in respect of a financial year if the following conditions are jointly met. Specifically, no bonus shall be paid where:

- (i) National bank - Composite Risk Rating (CRR) is Above Average or High, CET 1 is less than 8% (CET 1 of 7% + CCB1%)and has not satisfied the minimum leverage ratio requirement of 4%;
- (ii) International authorization - Composite Risk Rating (CRR) is Above Average or High, CET 1 is less than 11.5% (CET 1 of 10.5% + CCB1%) and has not satisfied the minimum leverage ratio requirement of 4%; and
- (iii) D-SIBs - Composite Risk Rating (CRR) is Above Average or High, CET 1 is less than 12.5% (CET 1 of 10.5% + CCB1% + HLA1%) and has not satisfied the minimum leverage ratio requirement of 5%.

91. For failure to meet their leverage ratio buffer requirement, the Table below sets out the criteria that has to be met by each class of banks before bonus payments can be made to directors and employees.

Table 3: Criteria for payment of bonus to directors and employees

Criteria	Banks with Regional and National Authorization
CET1 ¹⁹	Greater than 8.0% of TRWA
Composite Risk Rating (CRR)	Low or Moderate

92. Any bonuses not paid because of failure to meet the criteria set out in **Table 3** above shall be forfeited and shall not be paid in the subsequent years.

7.3 Conditions for Payment of Discretionary Obligations

93. An NIB should be mindful of its capital adequacy and liquidity positions, amongst others, in its decision to fulfill its discretionary obligations to a group entity, parent or member of its group.

¹⁹ This consists of the sum of the minimum CET 1 (as per Table 1), CCB 1 and HLA (where applicable). ¹⁸ e.g., discretionary technical service fees, management fees or other discretionary payments.

94. Where payments in respect of technical service fees, management fees or other agreed or discretionary payments to a group entity or group member/parent have been made, details of such payments shall be provided to the CBN not later than three (3) months after payment.

7.4 Conditions for Payment of dividends in respect of CET1

95. Payments of dividends shall be subject to the provisions of the Banks and Other Financial Institutions Act (BOFIA).

96. The maximum allowable dividend shall be determined taking into consideration the bank's: (i) level of CET 1 capital, (ii) the level of non-performing loans (NPLs), and (iii) Composite Risk Rating (CRR) at the point in time. The bank's maximum dividend for a given financial year shall therefore be restricted to the applicable pay-out ratio contained in **Appendix 1**.

8. Disclosure requirements

97. To help improve transparency of regulatory capital and enhance market discipline, NIBs are required to publicly disclose the following as part of their Pillar 3 disclosures:

- a) A full reconciliation of all regulatory capital elements back to the balance sheet in the audited financial statements;
- b) A description of all limits and minima, identifying the positive and negative elements of capital to which the limits and minima apply;
- c) A description of the main features of capital instruments issued;
- d) Full terms and conditions of all instruments included in regulatory capital;
- d) Where applicable, counter cyclical buffer requirements;
- e) Where applicable, geographic breakdown of exposures used in the calculation of the counter cyclical buffer requirement.

Appendix 1: Maximum Dividend Pay-out Ratio

1. Dividends for the purposes of this Guideline shall be the summation of dividends in respect of CET1 and AT1 capital.
2. Regardless of the type of authorization and the level of CET 1 ratio, **no dividend** shall be paid where:
 - a) The non-performing loans (NPL) ratio is great than 10%, or,
 - b) The Composite Risk Rating (CRR) is High, or
 - c) The leverage ratio is below the minimum threshold
3. In all the other cases (scenarios), the maximum dividend pay-out ratio shall be as follows:

Determination of Maximum Payout Ratio Using CET1, CCB1, CCB2 and HLA

NIBs					
CET1 Scenario 1	CRR	High	Above Average	Moderate	Low
	NPL	NPL > 10%	NPL > 10%	NPL > 10%	NPL > 10%
7% - 7.25%	Minimum Pay-Out Ratio	0%	0%	0%	0%
7.26% - 7.5%		0%	0%	0%	0%
7.51% - 7.75%		0%	0%	0%	0%
7.76% - 8%		0%	0%	0%	0%
> 8		0%	0%	0%	0%

NIBs					
CET1 Scenario 2	CRR	High	Above Average	Moderate	Low
	NPL	NPL > 8% & NPL ≤ 10%	NPL > 8% & NPL ≤ 10%	NPL > 8% & NPL ≤ 10%	NPL > 8% & NPL ≤ 10%
7% - 7.25%	Maximum Pay-Out Ratio	0%	0%	5%	5%
- 7.5%		0%	5%	10%	15%
- 7.75%		0%	5%	20%	25%
7.26%		0%	10%	30%	40%
7.51%		0%	15%	40%	50%
7.76% - 8%		0%	15%	40%	50%

NIBs					
CET1 Scenario 3	CRR	High	Above Average	Moderate	Low
	NPL	NPL > 5% & NPL ≤ 8%	NPL > 5% & NPL ≤ 8%	NPL > 5% & NPL ≤ 8%	NPL > 5% & NPL ≤ 8%
7% - 7.25%	Maximum Pay-Out Ratio	0%	0%	5%	10%
- 7.5%		0%	5%	15%	20%
- 7.75%		0%	10%	30%	40%
7.26%		0%	15%	40%	55%
7.51%		0%	15%	40%	55%

> 8	0%	20%	55%	75%
-----	----	-----	-----	-----

NIBs					
CET1 Scenario 4	CRR	High	Above Average	Moderate	Low
	NPL	NPL ≤ 5%	NPL ≤ 5%	NPL ≤ 5%	NPL ≤ 5%
7.26% 7.51% 7.76% - 8% > 8	Maximum Pay-Out Ratio	0%	5%	10%	10%
		0%	5%	20%	25%
		0%	15%	40%	50%
		0%	20%	55%	75%
		0%	25%	75%	100%
		0%	25%	75%	100%

Computation of Maximum Distributable Profit		
		NGN
Current Year Profit (after tax)	a	XXX
Less: Statutory Reserves Adjustment	b	(xxx)
Less: Regulatory Risk Reserve adjustment ^{xx}	c	(xxx)
Adjusted Profit	d=(a-b-c,0)	xxx
Maximum Dividend Pay-Out Ratio (from the Table above)	e	xx%
Maximum Distributable Profit	f= (d) x (e)	xxx

^{xx}
This precludes transfers or writebacks from Regulatory Risk Reserve