

GUIDELINE ON CAPITAL ADEQUACY CBK/PG/03

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PART I: PRELIMINARY

1.1 Title – Guideline on Capital Adequacy

1.2 Authorization – This Guideline is issued under section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.

Section 18 of the Banking Act empowers the Central Bank of Kenya to prescribe the minimum ratios that shall be maintained by institutions as between their core capital and total capital on the one hand and their risk weighted assets and off-balance sheet items on the other, and for that purpose, may also determine the method of classifying and evaluating assets.

1.3 Application – This Guideline is applicable to institutions including banks and mortgage finance companies licensed to conduct banking business in Kenya under the Banking Act (CAP 488) and to Non-Operating Holding Companies.

Institutions are required to maintain the minimum capital and capital buffer requirements as laid out in this Guideline at all times at both stand-alone (solo) and consolidated (group) basis.

1.4 Definitions - Terms used within this guideline are as defined in the Banking Act and as further defined below, or as reasonably implied by contextual usage:

1.4.1 “Additional Tier 1” has the meaning ascribed to it in Clause 4.3 of this Guideline.

1.4.2 "Bilateral netting" means the consolidation of agreements between a financial organization and a counterparty, which results in a single legally enforceable arrangement between a financial organization and a counterparty covering all, included individual contracts including master netting agreements.

1.4.3 “Capital Conservation Buffer” - is a ratio of extra capital to risk weighted assets over and above the set minimum capital ratios, required to be maintained by institutions as a buffer for losses during periods of financial and economic stress.

1.4.4 "Central counterparty (CCP)" is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the future performance of open contracts. A CCP becomes counterparty to trades with market participants through novation, an open offer system, or another legally

binding arrangement. For the purposes of the capital framework, a CCP is a financial institution.

- 1.4.5 “Clearing member”** is a member of, or a direct participant in, a CCP that is entitled to enter into a transaction with the CCP, regardless of whether it enters into trades with a CCP for its own hedging, investment or speculative purposes or whether it also enters into trades as a financial intermediary between the CCP and other market participants.
- 1.4.6 “Clearing relationship”** means a service arrangement that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement systems to final recipients. Such services are limited to the following activities: transmission, reconciliation and confirmation of payment orders, daylight overdraft, overnight financing and maintenance of post-settlement balances, and determination of intra-day and final settlement positions.
- 1.4.7 “Commitment”** means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes. It includes any such arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor. It also includes any such arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility documentation, including conditions that must be met by the obligor prior to any initial or subsequent drawdown under the arrangement
- 1.4.8 “Commodity risk”** is the risk that on- or off-balance sheet positions will be adversely affected by movements in commodity prices. Commodities include agricultural products, minerals (including oil) and precious metals (excluding Gold). Commodity risk only has a general market risk component because commodity prices are not influenced by specific market risk. Commodity risk comprises of directional risk, the most important risk, basis risk, interest rate risk and forward gap risk. Directional risk is the exposure to changes in spot prices arising from net open positions. Basis risk is the risk that the relationship between the prices of similar commodities changes over time. Forward gap and interest rate risk is the exposure to changes in forward prices arising from maturity mismatches.
- 1.4.9 “Common Equity Tier 1”** has the meaning ascribed to it in Clause 4.2 of this Guideline.

- 1.4.10 “Countercyclical Capital buffer”** - is an additional layer of Common Equity Tier 1 (CET1) capital that banks must hold during periods of excessive credit growth to protect the banking system against systemic risk.
- 1.4.11 “Counterparty credit risk (CCR)”** is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default. Unlike a firm's exposure to credit risk through a loan, where the exposure to credit risk is unilateral and only the lending bank faces the risk of loss, CCR creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.
- 1.4.12 “Credit Risk”** - is the current or prospective risk to earnings and capital arising from an obligor’s failure to meet the terms of any contract with the bank or if an obligor otherwise fails to perform as agreed.
- 1.4.13 “Defaulted exposures”** – is defined for risk weighting purposes as one that is past due for more than 90 days or is an exposure to a defaulted borrower. A defaulted borrower is a borrower in respect of whom any of the following events have occurred:
- 1) Any material credit obligation that is past due for more than 90 days. Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current outstandings;
 - 2) Any material credit obligation is on non-accrued status (e.g. the lending bank no longer recognises accrued interest as income or, if recognised, makes an equivalent amount of provisions);
 - 3) A write-off or account-specific provision is made as a result of a significant perceived decline in credit quality subsequent to the bank taking on any credit exposure to the borrower;
 - 4) Any credit obligation is sold at a material credit-related economic loss;
 - 5) A distressed restructuring of any credit obligation (i.e. a restructuring that may result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees) is agreed by the bank;
 - 6) The borrower’s bankruptcy or a similar order in respect of any of the borrower’s credit obligations to the banking group has been filed;
 - 7) The borrower has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of any of the credit obligations to the banking group; or

8) Any other situation where the bank considers that the borrower is unlikely to pay its credit obligations in full without recourse by the bank to actions such as realising security.

- 1.4.14 “Domestic Systemically Important Banks”** – are financial institutions whose failure or distress could cause significant **disruption** to the domestic financial system and the wider economy.
- 1.4.15 “Financial Institution”** means a company, other than a bank, which carries on, or proposes to carry on, financial business and includes any other company which the Cabinet Secretary may, by **notice** in the Gazette, declare to be a financial institution for the purposes of this Act;
- 1.4.16 “Financial Instrument”** - is any contract that gives to both parties a financial asset of one entity and a financial liability of another entity. Financial instruments include both primary financial instruments (and cash instruments) and derivative financial instruments. A financial asset is any asset that is cash, the right to receive cash or another financial asset; or the contractual right to exchange financial assets on potentially favourable terms. A financial liability is the contractual obligations to deliver cash or another financial asset or to exchange financial liabilities under conditions that are potentially unfavourable.
- 1.4.17 “Foreign Exchange Risk”** refers to the risk that the value of on or off-balance sheet positions will be adversely affected by movements in exchange rates. Positions denoted in foreign currency may decline in value due to movements in exchange rates. Foreign currency is any currency other than the bank's reporting currency. Foreign exchange risk only has a general market risk component because movements in exchange rates are not affected by issuer- or issuance-specific factors.
- 1.4.18 “General Market Risk”** refers to the risk of loss arising from changes in the general market behaviour. It is the risk of a price change in the underlying instrument owing (in the case of a traded loan-**stock** instrument or loan-stock derivative), to a change in the level of interest rates or (in the case of a security or security derivative), to a broad market movement unrelated to any specific attributes of the individual securities. In the case of a fixed income instrument, general market risk is driven by a change in the yield curve.
- 1.4.19 “Initial margin”** means a clearing member's or client's funded collateral posted to the CCP to mitigate the potential future **exposure** (PFE) of the CCP to the clearing member arising from the possible future change in the value of their transactions. Initial margin includes collateral deposited by a clearing member or

client in excess of the minimum amount required, provided the CCP or clearing member may, in appropriate cases, prevent the clearing member or client from withdrawing such excess collateral.

- 1.4.20 “Interest Rate Risk”** is the potential for losses in on- or off-balance sheet positions from adverse changes in interest rates. Interest rate-dependent instruments can be affected by both general and specific market risk.
- 1.4.21 “Long settlement transactions”** are transactions where a counterparty undertakes to deliver a security, a commodity, or a foreign exchange amount against cash, other financial instruments, or commodities, or vice versa, at a settlement or delivery date that is contractually specified as more than the lower of the market standard for this particular instrument and five business days after the date on which the bank enters into the transaction.
- 1.4.22 “Margin lending transactions”** are transactions in which a bank extends credit in connection with the purchase, sale, carrying or trading of securities. Margin lending transactions do not include other loans that happen to be secured by securities collateral. Generally, in margin lending transactions, the loan amount is collateralised by securities whose value is greater than the amount of the loan.
- 1.4.23 “Market Risk”** is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices. These risks pertain to interest rate related instruments in the trading book, commodities risk though out the bank, equities risk and foreign exchange risk both in the trading and banking book of financial institutions.
- 1.4.24 “Market risk Qualifying Assets”** includes interest rate risk assets in the trading book and foreign currency and commodities risk assets throughout the bank.
- 1.4.25 “Market Risk Weighted Equivalents”** Capital charge emanating from the market risk calculation to a risk weighted equivalent.
- 1.4.26 “Multilateral Development Bank (MDB)”** is an institution created by a group of countries that provides financing and professional advice for economic and social development projects. MDBs have large sovereign memberships and may include both developed and/or developing countries. Each MDB has its own independent legal and operational status, but with a similar mandate and a considerable number of joint owners.
- 1.4.27 “Netting set”** is a group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement and for which

netting is recognised for regulatory capital purposes that are applicable to the group of transactions. Each transaction that is not subject to a legally enforceable bilateral netting arrangement that is recognised for regulatory capital purposes should be interpreted as its own netting set for the purpose of these rules.

- 1.4.28 “Operational Risk”** is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
- 1.4.29 “Positions Held with Trading Intent”** - are those held intentionally for short-term resale and/or with the intent of benefiting from actual or expected short-term price movements or to lock in arbitrage profits, and may include for example proprietary positions, positions arising from client servicing (e.g. matched principal broking) and market making.
- 1.4.30 “Qualifying central counterparty (QCCP)”** is an entity that is licensed to operate as a CCP (including a license granted by way of confirming an exemption), and is permitted by the appropriate regulator/overseer to operate as such with respect to the products offered. This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the Principles for Financial Market Infrastructures issued by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions.
- 1.4.31 “Real estate”**, for purposes of this Guideline, is immovable property that is land, including agricultural land and forest, or anything treated as attached to land, in particular buildings, in contrast to being treated as movable/personal property.
- 1.4.32 “Security financing transaction (SFT)”** are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.
- 1.4.33 “Specific Risk”** - Refers to potentially adverse movement in the price of an individual loan/debt owing to factors related to the individual issuers. Specific risk does not affect foreign exchange- and commodities-related instruments. This is because changes in FX rates and commodities prices are completely dependent on general market movements.
- 1.4.34 “Subordinated Debt”** - includes issued and paid-in unsecured subordinated debt instruments (debt equity, lines of credit, bonds, commercial paper or loan capital)

having an original maturity of at least five years. Principal should be repayable after at least five (5) years. It also includes issued and paid-in limited life redeemable preference shares and loan loss reserves held against future, presently unidentified losses. During the last 5 years to maturity, a cumulative discount (amortization) factor of 20% per annum will be applied to reflect the diminishing value of these instruments as a continuing source of strength. Since subordinated debt is not normally available to participate in losses, the amount included for capital adequacy calculations is limited to 50% of core capital.

1.4.35 “Tier 1 capital” is defined as the sum of Common Equity Tier 1 and Additional Tier 1 capital, net of the regulatory adjustments applied to those categories.

1.4.36 “Tier 2 capital” has the meaning ascribed to it in Clause 4.4 of this Guideline.

1.4.37 “Trading Book” Consists of positions in financial instruments which are held with trading intent or in order to hedge other elements of the trading book and are free of any restrictive covenants on their tradability, frequently and accurately valued and are actively managed.

1.4.38 “Total regulatory capital” is the sum of Common Equity Tier 1, Additional Tier 1 and Tier 2 capital, net of regulatory adjustments.

1.4.39 “Variation margin” means a clearing member's or client's funded collateral posted on a daily or intraday basis to a CCP based upon price movements of their transactions.

PART II: STATEMENT OF POLICY

2.1 Purpose

This Guideline is intended to ensure that each institution maintains a level of capital that is adequate to reduce the likelihood of insolvency during economic downturns, reduce systemic risk by making banks more robust and limiting excessive leverage, protect depositors and creditors, commensurate with the risk associated with activities and profile of the institution, and promote public confidence in the institution.

2.2 Responsibility

The Board of directors of each institution shall be responsible for establishing and maintaining, at all times, an adequate level of capital. The capital standards herein are the minimum acceptable for institutions that are fundamentally sound, well-managed, and which have no material financial or operational weaknesses. Higher capital ratios may be

required for individual institutions based on circumstances listed under Clause 10.3 of this Guideline.

PART III: SCOPE OF THE CAPITAL FRAMEWORK AND TREATMENT OF BANKING, SECURITIES AND OTHER FINANCIAL SUBSIDIARIES

The scope of application of the framework will include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group. The scope of the framework will include approved Non-Operating Holding Companies. The framework will also apply to all internationally active banks at every tier within a banking group, also on a fully consolidated basis

Further, to supplement consolidated supervision, it is essential to ensure that capital recognised in capital adequacy measures is adequately distributed amongst legal entities of a banking group. Accordingly, banks should be adequately capitalised on a stand-alone basis.

To the greatest extent possible, all banking and other relevant financial activities (both regulated and unregulated) conducted within a group containing an internationally active bank will be captured through consolidation. Thus, majority owned or -controlled banking entities, securities entities (where subject to broadly similar regulation or where securities activities are deemed banking activities) and other financial entities should generally be fully consolidated.

If any majority-owned securities and other financial subsidiaries are not consolidated for capital purposes, all equity and other regulatory capital investments in those entities attributable to the group will be deducted, and the assets and liabilities, as well as third-party capital investments in the subsidiary will be removed from the bank's balance sheet.

Significant minority investments in banking, securities and other financial entities, where control does not exist, will be excluded from the banking group's capital by deduction of the equity and other regulatory investments. Alternatively, such investments might be, under certain conditions, consolidated on a pro rata basis.

Insurance subsidiaries:

A bank that owns an insurance subsidiary bears the full entrepreneurial risks of the subsidiary and should recognise on a group-wide basis the risks included in the whole group. When measuring regulatory capital for banks, it is, in principle, appropriate to deduct banks' equity and other regulatory capital investments in insurance subsidiaries and significant minority investments in insurance entities.

The capital invested in a majority-owned or controlled insurance entity may exceed the amount of regulatory capital required for such an entity (surplus capital). Such surplus capital will be recognised in calculating a bank's capital adequacy, under limited circumstances and subject to disclosure.

Majority-owned or controlled insurance subsidiaries, which are not consolidated and for which capital investments are deducted or subject to an alternative group-wide approach, must be adequately capitalised to reduce the possibility of future potential losses to the bank. If actions taken by the subsidiary are ineffective to correct any capital shortfall in a timely manner, the shortfall will also be deducted from the parent bank's capital.

PART IV: DEFINITION OF CAPITAL

4.1 Components of Capital

4.1.1 Regulatory capital consists of three categories, each governed by a single set of criteria that instruments are required to meet before inclusion in the relevant category.

(1) Common Equity Tier 1 (going-concern capital)

(2) Additional Tier 1 (going-concern capital)

(3) Tier 2 Capital (gone-concern capital)

4.1.2 Total regulatory capital is the sum of Common Equity Tier 1 (CET1), Additional Tier 1 (AT1) and Tier 2 capital, net of regulatory adjustments described in Clause 4.6.5 below.

4.1.3 Tier 1 capital is the sum of Common Equity Tier 1 and Additional Tier 1 capital, net of the regulatory adjustments in Clause 4.6.5 applied to those categories.

4.1.4 A bank shall compute its regulatory Capital Adequacy Ratios (CAR) as follows:

$$(a) \text{ CET1 Capital Ratio} = \frac{\text{CET1 Capital}}{\text{Total Risk Weighted Assets (TRWA)}} \times 100\%$$

$$(b) \text{ Tier 1 Capital Ratio} = \frac{\text{CET1 Capital} + \text{AT1 Capital}}{\text{Total Risk Weighted Assets (TRWA)}} \times 100\%$$

$$(c) \text{ Total Capital Ratio} = \frac{\text{Tier 1 Capital} + \text{Tier 2 Capital}}{\text{Total Risk Weighted Assets (TRWA)}} \times 100\%$$

Where Total Risk Weighted Assets (TRWA) is calculated as the sum of:

- (a) Credit Risk Weighted Assets (RWAs) as defined in Part IV of this guideline on the Calculation of Capital Requirement for Credit Risk;
- (b) Market RWAs as defined in Part V of this guideline on the Calculation of Capital Requirement for Market Risk;
- (c) Operational RWAs as defined in Part VIII of this guideline on the Calculation of Capital Requirement for Operational Risk.

4.2 Common Equity Tier 1 Capital

Common Equity Tier 1 capital consists of the sum of the following elements:

- (1) Ordinary shares issued by the bank that meet the criteria for classification as common shares for regulatory purposes set out on clause 4.2.1 (or the equivalent for non-joint stock companies);
- (2) Stock surplus (share premium) resulting from the issue of instruments included Common Equity Tier 1;
- (3) Retained earnings less foreseeable dividends.

Retained earnings and other comprehensive income include interim profit or loss. Current year to date profits or loss will be considered as below:

- (i) Fifty percent of the current year-to-date profits less foreseeable dividends where accounts are unaudited; or
 - (ii) One hundred percent of the current year-to-date profits, less foreseeable dividends, where accounts have been audited, subject to submission of the signed accounts to the Central Bank of Kenya.
 - (iii) In case of a loss, full amount should be included.
- (4) Accumulated other comprehensive income and other disclosed reserves, as may be determined by CBK;
 - (5) Common shares issued by consolidated subsidiaries of the bank and held by third parties (i.e. minority interest) that meet the criteria for inclusion in Common Equity Tier 1 capital. See Clause 4.5 for the relevant criteria; and
 - (6) Regulatory adjustments applied in the calculation of Common Equity Tier 1, in line with Clause 4.6.5 of this Guideline.

4.2.1 An ordinary share shall qualify as a CET1 capital if it meets, at a minimum, all the following criteria:

- (1) Represents the most subordinated claim in liquidation of the bank;
- (2) 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 liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim);
- (3) Principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law);
- (4) The bank 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;
- (5) Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items);
- (6) There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default. Among other things, this requirement prohibits features that require the bank to make payments in kind;
- (7) Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital;
- (8) 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;
- (9) The paid-in amount is recognised as equity capital (i.e. not recognised as a liability) for determining balance sheet insolvency;
- (10) The paid-in amount is classified as equity under the International Financial Reporting Standards;
- (11) It is directly issued and paid-in and the bank cannot directly or indirectly have funded the instrument or the purchase of the instrument;
- (12) The paid-in amount is neither secured nor covered by a guarantee of the issuer or related entity⁴ or subject to any other arrangement that legally or economically enhances the seniority of the claim;
- (13) It is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners and;
- (14) It is clearly and separately disclosed on the bank's balance sheet.

4.3 Additional Tier 1 Capital

Additional Tier 1 capital consists of the sum of the following elements:

- (1) Instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital (and are not included in Common Equity Tier 1); These include non-cumulative irredeemable preference shares when they meet AT1 eligibility criteria.
- (2) Stock surplus (share premium) resulting from the issue of instruments included in Additional Tier 1 capital;
- (3) Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Additional Tier 1 capital and are not included in Common Equity Tier 1 capital. See Clause 4.5 for the relevant criteria; and
- (4) Regulatory adjustments applied in the calculation of Additional Tier 1 Capital.

The following criteria must be met or exceeded for an instrument issued by the bank to be included in Additional Tier 1 capital

- (1) Issued and paid in;
- (2) Subordinated to depositors, general creditors and subordinated debt of the bank. In the case of an issue by a holding company, the instrument must be subordinated to all general creditors;
- (3) Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors;
- (4) Is perpetual, i.e. there is no maturity date and there are no step-ups or other incentives to redeem;
- (5) May be callable at the initiative of the issuer only after a minimum of five years:
 - (a) To exercise a call option a bank must receive prior approval by the Central Bank of Kenya; and
 - (b) A bank must not do anything which creates an expectation that the call will be exercised; and
 - (c) Banks must not exercise a call unless:
 - (i) They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or
 - (ii) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.
 - (d) The use of tax event and regulatory event calls are permitted within the first five years of a capital instrument. The Central Bank of Kenya permits banks to exercise such a call if in their view the bank was not in a position to anticipate the event at issuance.

- (6) Any repayment of principal (e.g. through repurchase or redemption) must be with prior supervisory approval and banks should not assume or create market expectations that supervisory approval will be given;
- (7) Dividend/coupon discretion:
 - (a) the bank must have full discretion at all times to cancel distributions /payments.
 - (b) cancellation of discretionary payments must not be an event of default.
 - (c) banks must have full access to cancelled payments to meet obligations as they fall due.
 - (d) cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stockholders.
- (8) Dividends/coupons must be paid out of distributable items;
- (9) The instrument cannot have a credit-sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing;
- (10) The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law;
- (11) Instruments classified as liabilities for accounting purposes must have a principal loss-absorption mechanism. This must generate Common Equity Tier 1 under the relevant accounting standards, and the instrument will only receive recognition in Additional Tier 1 up to the minimum level of Common Equity Tier 1 generated by the loss-absorption mechanism. The mechanism must operate through either:
 - (a) conversion to common shares at an objective pre-specified trigger point of at least 10.25% Common Equity Tier 1; or
 - (b) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point of at least 10.25% Common Equity Tier 1. The write-down will have the following effects:
 - (i) Reduce the claim of the instrument in liquidation;
 - (ii) Reduce the amount repaid when a call is exercised; and
 - (iii) Partially or fully reduce coupon/dividend payments on the instrument.
- (12) The aggregate amount to be written down/converted for all instruments classified as liabilities for accounting purposes on breaching the trigger level must be at least the amount needed to immediately return the bank's Common Equity Tier 1 ratio to the trigger level or, if this is not possible, the full principal value of the instruments;
- (13) Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly fund the instrument or the purchase of the instrument;
- (14) The instrument cannot have any features that hinder recapitalisation, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame;
- (15) If the instrument is not issued out of an operating entity or the holding company in the consolidated group (e.g. a special purpose vehicle - "SPV"), proceeds must be

immediately available without limitation to a single operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 capital and;

- (16) The terms and conditions must have a provision that requires, at the option of the Central Bank of Kenya, the instrument to either be written off or converted into common equity upon the occurrence of a trigger event. Any compensation paid to instrument holders as a result of a write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies) of either the issuing bank or the parent company of the consolidated group (including any successor in resolution) and must be paid prior to any public sector injection of capital (so that the capital provided by the public sector is not diluted). The issuing bank must maintain at all times all prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur. The trigger event:
- (a) is the earlier of:
 - (i) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the Central Bank of Kenya; and
 - (ii) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the Central Bank of Kenya; and
 - (b) is determined by the jurisdiction in which the capital is being given recognition for regulatory purposes. Therefore, where an issuing bank is part of a wider banking group and the issuing bank 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 a write-off, without which the firm would become non-viable, is necessary, as determined by the Central Bank of Kenya, in the jurisdiction of Kenya; 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 firm receiving the support would have become non-viable, as determined by the Central Bank of Kenya in Kenya jurisdiction.

4.3.1 Stock surplus (share premium) that is not eligible for inclusion in CET1, will only be permitted to be included in AT1 capital if the shares giving rise to the stock surplus are permitted to be included in AT1 capital.

4.3.2 CBK approval should be obtained for recognition of AT1 instruments.

4.4 Tier 2 Capital

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

- (1) Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital);
- (2) stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital;
- (3) instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital. See Clause 4.5 for the relevant criteria;
- (4) certain loan-loss provisions such as prudential general provisions/general loan-loss reserve up to a maximum of 1.25 percent of credit risk weighted assets calculated in line with CBK Prudential Guidelines and;
- (5) regulatory adjustments applied in the calculation of Tier 2 capital.

The objective of Tier 2 is to provide loss absorption on a gone-concern basis. Based on this objective, the following criteria must be met or exceeded for an instrument to be included in Tier 2 capital

- (1) Issued and paid-in
- (2) Subordinated to depositors and general creditors of the bank. In the case of an issue by a holding company, the instrument must be subordinated to all general creditors.
- (3) Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general bank creditors
- (4) Maturity:
 - (a) Minimum original maturity of at least five years.
 - (b) Recognition in regulatory capital in the remaining five years before maturity will be amortised on a straight-line basis.
 - (c) There are no step-ups or other incentives to redeem.
- (5) May be callable at the initiative of the issuer only after a minimum of five years:
 - (a) To exercise a call option a bank must receive prior approval by the Central Bank of Kenya;
 - (b) A bank must not do anything that creates an expectation that the call will be exercised; and
 - (c) Banks must not exercise a call unless:
 - (i) they replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or
 - (ii) the bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

- (d) The use of tax event and regulatory event calls are permitted within the first five years of a capital instrument, but supervisors will only permit the bank to exercise such a call if in their view the bank was not in a position to anticipate the event at issuance.
- (6) The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation.
- (7) The instrument cannot have a credit-sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.
- (8) Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the instrument or the purchase of the instrument.
- (9) If the instrument is not issued out of an operating entity or the holding company in the consolidated group (e.g. an SPV), proceeds must be immediately available without limitation to a single operating entity 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.
- (10) The terms and conditions of the instrument shall have a provision that requires, at the instruction of the Central Bank of Kenya, to be able to either write off or convert the instrument into common equity upon the occurrence of a trigger event. Any compensation paid to instrument holders as a result of such a write-off shall be paid immediately in the form of common stock, or its equivalent in the case of non-joint stock companies, of either the issuing bank or the parent company of the consolidated group, including any successor in resolution, and shall be paid prior to any public sector injection of capital.

4.4.1 Stock surplus (i.e. share premium) that is not eligible for inclusion in Tier 1 will only be permitted to be included in Tier 2 capital if the shares giving rise to the stock surplus are permitted to be included in Tier 2 capital.

4.4.2 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 risk-weighted assets (RWA) calculated under the standardised approach.

4.4.3 CBK approval should be obtained for recognition of Tier 2 instruments.

4.5 Minority Interest and Other Capital Issued out of Consolidated Subsidiaries Held by Third Parties

- 4.5.3 Minority interest (non-controlling interest) arising from the issue of common shares by a fully consolidated subsidiary of the bank or a Non-Operating Holding Company (NOHC) may receive recognition in Common Equity Tier 1 only if:
- (1) the instrument giving rise to the minority interest would, if issued by the bank/NOHC, meet all of the criteria for classification as common shares for regulatory capital purposes; and
 - (2) the subsidiary that issued the instrument is itself a bank/NOHC.
- 4.5.4 Minority interest in a subsidiary that is a bank is strictly excluded from the parent bank'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.
- 4.5.5 The amount of minority interest meeting the criteria above that will be recognised in consolidated Common Equity Tier 1 will be calculated as follows:
- (1) Total minority interest meeting the two criteria above minus the amount of the surplus Common Equity Tier 1 of the subsidiary attributable to the minority shareholders.
 - (2) Surplus Common Equity Tier 1 of the subsidiary is calculated as the Common Equity Tier 1 of the subsidiary minus the lower of:
 - (a) the minimum Common Equity Tier 1 requirement of the subsidiary plus the capital conservation buffer (i.e. 10.5 percent of consolidated RWA); and
 - (b) the portion of the consolidated minimum Common Equity Tier 1 requirement plus the capital conservation buffer (i.e. 10.5 percent of consolidated RWA) that relates to the subsidiary.
 - (3) The amount of the surplus Common Equity Tier 1 that is attributable to the minority shareholders is calculated by multiplying the surplus Common Equity Tier 1 by the percentage of Common Equity Tier 1 that is held by minority shareholders.
- 4.5.6 Tier 1 capital instruments issued by a fully consolidated subsidiary of the bank, whether wholly or partly owned, to third-party investors (including amounts under 4.5.5) may receive recognition in Tier 1 capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 capital.
- 4.5.7 The amount of this capital that will be recognised in Tier 1 will be calculated as follows:

- (1) Total Tier 1 of the subsidiary issued to third parties minus the amount of the surplus Tier 1 of the subsidiary attributable to the third-party investors.
- (2) Surplus Tier 1 of the subsidiary is calculated as the Tier 1 of the subsidiary minus the lower of:
 - (a) the minimum Tier 1 requirement of the subsidiary plus the capital conservation buffer (i.e. 12.5 percent of RWA); and
 - (b) the portion of the consolidated minimum Tier 1 requirement plus the capital conservation buffer (i.e. 12.5 percent of consolidated RWA) that relates to the subsidiary.
- (3) 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.
- (4) The amount of this Tier 1 capital that will be recognised in Additional Tier 1 will exclude amounts recognised in Common Equity Tier 1 under 4.5.5.

4.5.8 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 4.5.5 to 4.5.7) 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.

4.5.9 The amount of this capital that will be recognised in consolidated Total Capital will be calculated as follows:

- (1) 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.
- (2) Surplus Total Capital of the subsidiary is calculated as the Total Capital of the subsidiary minus the lower of:
 - (a) the minimum Total Capital requirement of the subsidiary plus the capital conservation buffer (i.e. 14.5 percent of RWA); and
 - (b) the portion of the consolidated minimum Total Capital requirement plus the capital conservation buffer (i.e. 14.5 percent of consolidated RWA) that relates to the subsidiary.
- (3) 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.
- (4) The amount of this Total Capital that will be recognised in Tier 2 will exclude amounts recognised in Common Equity Tier 1 under 4.5.5 and amounts recognised in Additional Tier 1 under 4.5.7.

4.6 Regulatory Adjustments

- 4.6.1** Regulatory adjustments must be made to the components of regulatory capital in order to calculate the amount of a bank's capital resources that may be used to meet prudential requirements.
- 4.6.2** Regulatory adjustments shall be made from CET1 except investments in capital instruments that are treated as per a corresponding deduction approach in that it applies to the same tier of capital the investment would qualify if it was capital issued by the bank.
- 4.6.3** Assets that are deducted from regulatory capital should be excluded from RWA in calculating the CAR.
- 4.6.4** 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.
- 4.6.5** Notwithstanding the provisions provided from Clauses 4.6.1 to 4.6.4 of this Guideline, a bank shall make the regulatory adjustments from Clauses 4.6.5.1.

4.6.5.1 Goodwill and Other Intangibles

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.

With the exception of mortgage servicing rights, 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. The amount to be deducted in respect of mortgage servicing rights is set out in the threshold deductions set out in clause 4.6.6.

Banks may use the IFRS definition of intangible assets to determine which assets are classified as intangible and are thus required to be deducted.

4.6.5.2 Deferred Tax Assets

Deferred tax assets that rely on the future profitability of the bank shall be deducted in the calculation of CET1 capital. DTA may be netted with associated deferred tax liabilities only if the DTAs and DTLs relate to taxes levied by the

same taxation authority and offsetting is permitted by the relevant taxation authority.

Where these DTAs relate to temporary differences (e.g. allowance for credit losses) the amount to be deducted is set out in clause 4.6.6.

All other such assets, for example, those relating to operating losses such as the carry forward of unused tax losses, or unused tax credits, shall be deducted in full, net of deferred tax liabilities as described above. The DTLs permitted to be netted against DTAs shall exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets, and must be allocated on a pro rata basis between DTAs subject to the threshold deduction treatment and DTAs that are to be deducted in full.

DTAs arising from any other source shall be deducted from CET1 capital as a prudent measure. An over-installment of tax, or current year tax losses carried back to prior years may give rise to a claim or receivable from the government or local tax authority. Such amounts are generally classified as current tax assets for accounting purposes. The recovery of such a claim or receivable shall not rely on the future profitability of a bank and shall be assigned the relevant sovereign risk weighting.

4.6.5.3 Cash Flow Hedge Reserve

The amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet, including projected cashflows, shall be derecognized in the calculation of CET1 capital. In this regard, positive amounts shall be deducted and negative amounts shall be added back.

4.6.5.4 Gain on sale Related to Securitisation Transactions

Banks must deduct from Common Equity Tier 1 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.

4.6.5.5 Cumulative Gains and Losses Due to Changes in Own Credit Risk on Fair Valued Financial Liabilities

- a) All unrealized gains and losses that have resulted from changes in the fair value of liabilities that are due to changes in the bank's own credit risk shall be derecognized in the calculation of CET1 capital.

- b) In addition, all accounting valuation adjustments on derivative liabilities that are due to changes in the bank's own credit risk shall be derecognized in the calculation of CET1 capital. The offsetting between valuation adjustments that are due to changes in the bank's own credit risk and those arising from its counterparties' credit risk shall not be allowed.

4.6.5.6 Defined Benefit Pension Fund Assets and Liabilities

- a) Defined benefit pension fund liabilities, as included on the balance sheet, must be fully recognised in the calculation of Common Equity Tier 1 (i.e. Common Equity Tier 1 cannot be increased through derecognising these liabilities).
- b) For each defined benefit pension fund that is an asset on the balance sheet of a bank, the asset shall be deducted in the calculation of CET1 capital, net of any associated deferred tax liability, which would be extinguished if the asset becomes impaired or derecognized under IFRS.
- c) A bank shall seek a prior written approval of the Central Bank of Kenya before the assets in the fund, to which the bank has unrestricted and unfettered access, can be used to offset the deduction. Such offsetting assets should be given the risk weight they would receive if they were owned directly by the bank.

4.6.5.7 Investment in Own Shares

All of a bank's investments in its own common shares, whether held directly or indirectly, will be deducted in the calculation of Common Equity Tier 1 (unless already derecognised under IFRS). In addition, any own stock which the bank could be contractually obliged to purchase should be deducted in the calculation of Common Equity Tier 1. The treatment described will apply irrespective of the location of the exposure in the banking book or the trading book.

In addition:

- (1) Gross long positions may be deducted net of short positions in the same underlying exposure only if the short positions involve no counterparty risk.
- (2) Banks should look through holdings of index securities to deduct exposures to own shares. However, gross long positions in own shares resulting from holdings of index securities may be netted against short position in own shares resulting from short positions in the same underlying index. In such cases the short positions may involve counterparty risk (which will be subject to the relevant counterparty credit risk charge).

- (3) Subject to supervisory approval, a bank may use a conservative estimate of investments in its own shares where the exposure results from holdings of index securities and the bank finds it operationally burdensome to look through and monitor its exact exposure.

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.

4.6.5.8 Reciprocal Cross Holdings in the Capital of Banking, Financial Institutions and Other Financial Entities

Reciprocal cross-holdings of capital that are designed to artificially inflate the capital position of banks will be deducted in full. Banks must apply a “corresponding deduction approach” to such investments in the capital of other banks, other financial institutions and insurance 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.

4.6.5.9 Investments in the Capital of Banking, Financial Institutions and Other Financial Entities that are Outside the Scope of Regulatory Consolidation and where the bank does not own more than 10% of the issued common share capital of the entity

The following regulatory adjustments apply to investments in the capital of banking, financial institutions and other financial entities that are outside the scope of regulatory consolidation. These investments shall be deducted from regulatory capital subject to a threshold. For the purpose of this regulatory adjustment:

- a. direct, indirect and synthetic holdings of capital instruments. A bank, for instance, shall look through holdings of index securities to determine its underlying holdings of capital;
- b. holdings in both the banking book and trading book. Capital includes common stock and all other types of cash and synthetic capital instruments such as subordinated debt;
- c. for the capital instruments, it is the net long position that is to be included, which means 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;
- d. Underwriting positions in capital instruments held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included.

- e. consideration of whether the capital instrument of the entity in which the bank has invested meets the criteria for CET1, AT1, or Tier 2 capital of the bank, and if it does not meet, it shall be considered as common shares for the purposes of this regulatory adjustment.

With the prior written approval of the Central Bank of Kenya and subject to conditions that CBK may specify, including the period of exclusion, a bank may exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganize a distressed institution

If the total of all holdings of capital instruments in aggregate and on a net long basis exceed 10 percent of the bank's common equity (after applying all other regulatory adjustments in full listed before) then the amount above 10 percent is required to be deducted.

In the case of capital instruments, deduction should be made applying a corresponding deduction approach. 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. Accordingly, the amount to be deducted from common equity should be calculated as the total of all holdings of capital instruments which in aggregate exceed 10 percent of the bank's common equity (as per above) multiplied by the common equity holdings as a percentage of the total holdings of capital instruments. This would result in a common equity deduction which corresponds to the proportion of the holdings held in common equity.

Similarly, the amount to be deducted from AT 1 capital should be calculated as the total of all holdings of capital instruments which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by the AT 1 capital holdings as a percentage of the total. The amount to be deducted from Tier 2 capital should be calculated as the total of all holdings of capital instruments which in aggregate exceed 10 percent of the bank's common equity (as per above) multiplied by holdings of the Tier 2 capital as a percentage of the total.

If a bank 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 (e.g. if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1).

Amounts that are not deducted will continue to be risk weighted. Thus, instruments in the trading book will be treated as per the market risk rules and instruments in the banking book should be treated as per the standardised

approach. For the application of risk weighting the amount of the holdings must be allocated on a pro rata basis between those below and those above the threshold.

4.6.5.10 Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation

The regulatory adjustment described in this clause 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 percent 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. For example, banks should look through holdings of index securities to determine their underlying holdings of capital.
- b. Holdings in both the banking book and trading book are to be included. Capital includes common stock and all other types of cash and synthetic capital instruments (e.g. subordinated debt). 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). Banks are also permitted to net gross long positions arising through holdings of index securities against short positions in the same underlying index, as long as the maturity of the short position matches the maturity of the long position or has residual maturity of at least a year.
- c. Underwriting positions in capital instruments held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included.
- d. If the capital instrument of the entity in which the bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank, the capital is to be considered common shares for the purposes of this regulatory adjustment.

With the prior written approval of the Central Bank of Kenya and subject to conditions that CBK may specify, including the period of exclusion, a bank may exclude temporarily certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

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. If the bank 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 (e.g. if a bank does not have enough AT 1 capital to satisfy the deduction, the shortfall will be deducted from CET 1).

4.6.6 Threshold deductions

Instead of a full deduction, the following items may each receive limited recognition when calculating Common Equity Tier 1, with recognition capped at 10% of the bank's common equity (after the application of all regulatory adjustments set out in clause 4.6.5:

- (1) significant investments in the common shares of unconsolidated financial institutions (banks, insurance and other financial entities) as referred to in Clause 4.6.5.10;
- (2) mortgage servicing rights, and
- (3) DTAs that arise from temporary differences.

The amount of the three items above that remains recognised after the application of all regulatory adjustments must not exceed 15 percent of the Common Equity Tier 1 capital, calculated after all regulatory adjustments.

The amount of the three items that are not deducted in the calculation of Common Equity Tier 1 will be risk weighted at 250%.

4.6.7 Other Adjustments

A bank shall make any other adjustments as may be required by the Central Bank of Kenya.

PART V: MINIMUM CAPITAL ADEQUACY REQUIREMENT AND BUFFERS ABOVE THE REGULATORY MINIMUM

5.1 A bank shall, at all times, maintain the following minimum capital adequacy ratio for each component of tier of capital and the total regulatory capital:

- (1) CET1 ratio: eight percent (8.0%) of risk-weighted assets;
- (2) Tier 1 capital ratio: ten percent (10%) of risk-weighted assets; and

- (3) Total capital (Tier 1 Capital plus Tier 2 Capital) ratio: twelve percent (12%) of risk-weighted assets.

5.2 Buffers Above the Regulatory Minimum

In addition to the above minimum capital adequacy ratios, all institutions will be required to hold a capital conservation buffer (see Clause 5.2.1) and for those banks deemed systemically important an additional loss absorbency cushion (see Clause 5.2.3).

5.2.1 Capital Conservation Buffer

A capital conservation buffer of 2.5 percent, comprised of CET1, is established above the regulatory minimum capital requirement. Capital distribution constraints will be imposed on a bank when capital levels fall within this range. Banks will be able to conduct business as normal when their capital levels fall into the conservation range as they experience losses. The constraints imposed only relate to distributions, not the operation of the bank. Capital distribution constraints will be imposed on a bank when capital levels fall within this range, as shown in Table 1 below.

Table 1: Capital Conservation Ratios

CET1 ratio	Minimum Capital Conservation Ratios (as a % of earnings)
8.0% - 8.625%	100%
>8.625% - 9.250%	80%
>9.250% - 9.875%	60%
>9.875% - 10.50%	40%
> 10.50%	0%

The applicable conservation standards must be recalculated at each distribution date. For example, a bank with a CET1 capital ratio in the range of 8.625% to 9.250% is required to conserve 80% of its earnings in the subsequent payment period (i.e. pay out no more than 20% in terms of dividends, share buybacks and discretionary bonus payments). If the bank wants to make payments in excess of the constraints imposed by this regime, it would have the option of raising capital in the private sector equal to the amount above the constraint which it wishes to distribute. This would be approved by CBK as part of the capital planning process.

The CET1 ratio includes amounts used to meet the 8% minimum CET1 requirement, but excludes any additional CET1 needed to meet the 10% Tier 1 and 12% Total capital requirements.

Set out below are a number of other key aspects of the requirements:

- (1) Elements subject to the restriction on distributions: Items considered to be distributions include dividends and share buybacks, discretionary payments on other Tier 1 capital instruments and discretionary bonus payments to staff. Payments that do not result in a depletion of CET1, which may for example include certain scrip dividends, are not considered distributions. The distribution restrictions do not apply to dividends which satisfy all three of the following conditions:
 - i) the dividends cannot legally be cancelled by the bank;
 - ii) the dividends have already been removed from CET1; and
 - iii) the dividends were declared in line with the applicable capital conservation standards at the time of declaration.
- (2) Earnings are defined as distributable profits calculated prior to the deduction of elements subject to the restriction on distributions. Earnings are calculated after the tax which would have been reported had none of the distributable items been paid. As such, any tax impact of making such distributions are reversed out. Where a bank does not have positive earnings and has a CET1 ratio less than 7% (or higher if the capital conservation buffer has been expanded by other buffers), it would be restricted from making positive net distributions.
- (3) The framework should be applied at the consolidated level, i.e. restrictions will be imposed on distributions out of the consolidated group.
- (4) The Central Bank may require a bank operating within the capital conservation buffer to restore its capital buffers within such period as the Central Bank may determine, on a case-by-case basis.

5.2.2 Countercyclical Capital Buffer

In addition to CCB, institutions will be required to maintain a Countercyclical Capital Buffer (CCyB) where the Central Bank of Kenya determines that there is a build-up of credit risk which could lead to system-wide stress. The CCyB is to be met with CET1 capital and shall range from 0% to 2.5% of TRWA.

The CCyB and shall be determined by CBK from time to time taking into consideration, amongst others, the prevailing economic and industry circumstances. CBK shall apply its macro prudential tools and supervisory judgement in determining the level of CCyB to be maintained by institutions. The supervisory judgement shall be informed by, amongst others, the assessment of developments in the macroeconomic and financial conditions including the underlying drivers.

CBK shall announce the required CCyB 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, CBK may require banks to build up a CCyB2 at a much shorter notice.

Institutions shall be required to maintain, if necessary, CCyB for a minimum period to be determined by the CBK after the expectation for system wide risk has been alleviated.

5.2.3 Higher Loss Absorbency Requirements for Domestic Systemically Important Banks

CBK may impose a surcharge on designated D-SIBs, implemented as an extension of the CCB known as Higher Loss Absorbency (HLA). HLA is implemented as a capital "add-on" or an extension to the existing Capital Conservation Buffer (CCB). This supplementary buffer must be met exclusively using Common Equity Tier 1 capital. CBK will categorize D-SIBs based on their systemic importance with surcharges ranging from 0.5 percent to 2.5 percent of RWA.

The aim of HLA requirement is to reduce the probability of failure of D-SIBs given the relatively higher impact that their failure is expected to have on the domestic financial system and real economy.

5.3 Pillar II Specific Capital Requirements

As Pillar I capital requirements do not capture other risks that bank are exposed, the CBK will impose specific capital requirements (called Pillar II capital requirements) on an individual basis for each bank based on the findings of an ongoing supervisory review and assessment (see Part X).

5.4 In summary, the capital requirements will be determined as shown in Table 2.

Table 2: Summary Capital Requirements

Item	Minimum Requirement(%)	Composition / Notes
CET 1 ratio	8.0	
Tier 1 ratio	10.0	CET1 + AT1 capital
Total Pillar 1 Capital ratio	12.0	Tier 1 + Tier 2 capital
Capital Conservation Buffer (CCB)	2.5	Must be met with CET1 capital; applies above the minimum requirements.
Domestic systemic important bank (DSIB) buffer	0 - 2.5	Must be met with CET1 capital; only for systemically important institutions
Pillar 2 specific capital requirement	Determined by supervisor	Institution-specific additional capital based on risks not considered or not fully captured under Pillar 1.

5.5 Minimum Absolute Common Equity Tier 1 Requirement

Minimum core capital for banks, mortgage finance companies and financial institutions is as stated below:

- a) Banks and Mortgage Finance Companies: Kshs.10 billion by 2029.
- b) Financial Institutions: Kshs.200 million.

Institutions' minimum core capital levels will be monitored on a continuous basis by the Central Bank of Kenya. These levels will apply to all institutions and may be reviewed from time to time.

PART VI: CALCULATION OF RISK WEIGHTED ASSETS FOR CREDIT RISK

6.1 General Principles

Credit risk arises from the possibility of losses associated with reduction in the credit quality of borrowers or counterparties. In institutions' portfolio, losses arise from outright default due to inability or unwillingness of an obligor to meet commitments in relation to lending, trading settlements, or any other financial transaction. Alternatively, losses occur from reduction in portfolio value due to deterioration in credit quality.

This section addresses determination of minimum capital requirements for credit risk in accordance with the standardised approach defined in the Basel III framework.

- 6.1.1 In determining risk-weighted assets for credit risk under the standardised approach, banks and financial institutions shall multiply on-balance sheet exposures by the appropriate risk weights, while off-balance sheet exposures shall be multiplied by the appropriate credit conversion factor before applying the respective risk weights. Exposures should be risk-weighted net of specific provisions.
- 6.1.2 Under the Standardised approach for credit risk, banks and financial institutions exposures shall be risk weighted based on the following hierarchy:
- (a) External Credit Risk Assessment Approach (ECRA) – for exposures with external ratings that are allowable for regulatory purposes; and
 - (b) Standardised Credit Risk Assessment Approach (SCRA) – for unrated exposures to banks and financial institutions incorporated in jurisdictions that allow the use of external ratings for regulatory purposes.
- 6.1.3 Banks and financial institutions shall use external ratings issued by recognised External Credit Assessment Institutions (ECAIs) in determining the risk weights as provided in this Guideline (**See Appendix I**). The list of ECAIs recognised by the Central Bank for purposes of determining regulatory capital is set out in **Appendix II**.
- 6.1.4 External ratings are not used for determining the risk weights for residential mortgages, regulatory retail portfolios, non-performing loans and high risk exposures, instead specific risk weights prescribed by Basel Committee on Banking Supervision (BCBS) as provided in this guideline shall be applied.
- 6.1.5 Banks and financial institutions must perform due diligence to ensure that they have an adequate understanding, at origination and thereafter on a regular basis (at least annually), of the risk profile and characteristics of their counterparties. In cases where ratings are used, due diligence is necessary to assess the risk of the exposure for risk management purposes and whether the risk weight applied is appropriate and prudent. The sophistication of the due diligence should be appropriate to the size and complexity of bank's or financial institution's activities. Banks must take reasonable and adequate steps to assess the operating and financial performance levels and trends through internal credit analysis and/or other analytics outsourced to a third party, as appropriate for each counterparty.
- 6.1.6 Banks and financial institutions are expected to maintain a credit risk framework that allows for adequate analysis for any asset or group of assets with exposure to credit risk. The use of external ratings does not preclude the banks and financial institutions from performing due diligence on the risk of an exposure. Where the due diligence analysis reflects higher risk characteristics, the bank or financial institution is required to assign a risk weight that is consistent with the outcome of the due diligence and at least one bucket higher than the "Base" risk weight determined by the recognized external rating.

However, due diligence analysis shall never result in the application of a lower risk weight than that determined by the external rating;

6.1.7 Multiple external ratings;

- (1) If there is only one rating by an ECAI chosen by a bank for a particular exposure, that rating should be used to determine the risk weight of the exposure.
- (2) If there are two ratings by ECAIs chosen by a bank that map into different risk weights, the higher risk weight will be applied.
- (3) If there are three or more ratings with different risk weights, the two ratings that correspond to the lowest risk weights should be referred to. If these give rise to the same risk weight, that risk weight should be applied. If different, the higher risk weight should be applied.

6.1.8 The capital requirements for credit risk shall apply on solo and consolidated basis.

6.1.9 Bank and financial institutions shall manage and measure capital requirement for credit risk in the following three parts:

- (a) on-balance sheet exposures;
- (b) off-balance sheet exposures; and
- (c) credit risk mitigation.

6.2 On-Balance Sheet Credit Exposures

The following part defines the various categories of exposures and their corresponding risk weights under the standardized approach. On-balance sheet exposures shall be multiplied by the appropriate risk weight to determine the risk-weighted asset amount. Specifically, all exposures subject to the standardized approach should be risk-weighted net of specific provisions.

6.2.1 Exposures to Sovereigns and Central Banks

Exposures to the Government of Kenya and the Central Bank of Kenya, denominated and funded in Kenya Shillings shall be accorded a risk weight of zero percent. Any exposures where there is an explicit guarantee provided by the Government of Kenya and the Central Bank of Kenya and such exposure is denominated and funded in Kenya Shillings shall also be accorded a zero percent risk weight. For such exposures denominated in foreign currency, Table 3 will apply.

Exposures to other sovereigns and their central banks shall be risk-weighted as follows:

Table 3: Risk weight table for sovereigns and central banks

External rating	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk weight	0%	20%	50%	100%	150%	100%

6.2.2 Exposures to Non-Central Government Public Sector Entities (PSEs)

Exposures to domestic PSEs shall be risk-weighted as follows:

Table 4: Risk weight table for PSEs based on External Rating of PSE

External rating of the PSE	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk weight under Option 2	20%	50%	50%	100%	150%	100%

Exposure to County Governments shall be included in this category.

6.2.3 Exposures to Multilateral Development Banks (MDBs)

A zero percent risk weight will be applied to exposures to MDBs that fulfil the eligibility criteria provided below.

- (1) very high-quality long-term issuer ratings, i.e. a majority of an MDB's external ratings must be AAA.
- (2) either the shareholder structure comprises a significant proportion of sovereigns with long-term issuer external ratings of AA– or better, or the majority of the MDB's fund-raising is in the form of paid-in equity/capital and there is little or no leverage;
- (3) strong shareholder support demonstrated by the amount of paid-in capital contributed by the shareholders; the amount of further capital the MDBs have the right to call, if required, to repay their liabilities; and continued capital contributions and new pledges from sovereign shareholders;
- (4) adequate level of capital and liquidity (a case-by-case approach is necessary in order to assess whether each MDB's capital and liquidity are adequate); and,
- (5) strict statutory lending requirements and conservative financial policies, which would include among other conditions a structured approval process, internal creditworthiness and risk concentration limits (per country, sector, and individual exposure and credit category), large exposures approval by the board or a committee of the board, fixed repayment schedules, effective monitoring of use of proceeds, status review process, and rigorous assessment of risk and provisioning to loan loss reserve.

MDBs currently eligible for a 0% risk weight are:

- (1) The World Bank Group comprising:
 - (a) International Bank for Reconstruction and Development
 - (b) International Finance Corporation
 - (c) the Multilateral Investment Guarantee Agency
 - (d) International Development Association
- (2) Asian Development Bank
- (3) African Development Bank
- (4) European Bank for Reconstruction and Development
- (5) Inter-American Development Bank
- (6) European Investment Bank
- (7) European Investment Fund
- (8) Nordic Investment Bank
- (9) Caribbean Development Bank
- (10) Islamic Development Bank,
- (11) Council of Europe Development Bank
- (12) International Finance Facility for Immunization
- (13) Asian Infrastructure Investment Bank.
- (14) Any other MDB that may be specified by CBK, subject to fulfilling above criteria.

Banks and financial institutions shall risk weight exposures to all other MDBs as follows.

Table 5: Risk weight table for MDB exposures

External rating of counterparty	AAA to AA-	A+ to A-	BBB+ to BBB	BB+ to B	Below B-	Unrated
"Base" risk weight	20%	30%	50%	100%	150%	50%

6.2.4 Exposures to Banks

For the purposes of calculating capital requirements, a bank exposure is defined as a claim (including loans and senior debt instruments, unless considered as subordinated debt) on any financial institution that is licensed to take deposits from the public and is subject to appropriate prudential standards and level of supervision.

Bank exposures will be risk-weighted based on the following hierarchy:

- (1) ECRA - It applies to all their rated exposures to banks.

Banks and financial institutions shall apply the following risk weights for externally rated exposures to banks and financial institutions:

Table 6: Risk weight table for bank exposures - External Credit Risk Assessment Approach

External rating of counterparty	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-
"Base" risk weight	20%	30%	50%	100%	150%
Risk weight for short-term exposures	20%	20%	20%	50%	150%

Exposures to banks with an original maturity of three months or less, as well as exposures to banks that arise from the movement of goods across national borders with an original maturity of six months or less can be assigned a risk weight that correspond to the risk weights for short term exposures.

(2) SCRA - For exposures to banks that are unrated.

Unrated exposures to banks and financial institutions shall be risk-weighted based on the SCRA and shall apply the following risk weights.

Table 7: Risk weight table for bank exposures - Standardised Credit Risk Assessment Approach

Credit risk assessment of counterparty	Grade A	Grade B	Grade C
"Base" risk weight	40%	75%	150%
Risk weight for short-term exposures	20%	50%	150%

Grade A refers to exposures to banks, where the counterparty bank has adequate capacity to meet their financial commitments (including repayments of principal and interest) in a timely manner, for the projected life of the assets or exposures and irrespective of the economic cycles and business conditions.

A counterparty bank classified into Grade A must meet or exceed the published minimum regulatory requirements and buffers established by its national supervisor as implemented in the jurisdiction where it is incorporated, except for bank-specific minimum regulatory requirements or buffers that may be imposed through supervisory actions and not made public. If such minimum regulatory requirements and buffers are not publicly disclosed or otherwise made available by the counterparty bank, then the counterparty bank must be assessed as Grade B or lower.

Grade B refers to exposures to banks, where the counterparty bank is subject to substantial credit risk, such as repayment capacities that are dependent on stable or favourable economic or business conditions.

A counterparty bank classified into Grade B must meet or exceed the published minimum regulatory requirements (excluding buffers) established by its national supervisor as implemented in the jurisdiction where it is incorporated, except for bank-specific minimum regulatory requirements that may be imposed through supervisory actions and not made public. If such minimum regulatory requirements are not publicly disclosed or otherwise made available by the counterparty bank then the counterparty bank must be assessed as Grade C.

Grade C refers to higher credit risk exposures to banks, where the counterparty bank has material default risks and limited margins of safety. For these counterparties, adverse business, financial, or economic conditions are very likely to lead, or have led, to an inability to meet their financial commitments.

At a minimum, if any of the following triggers is breached, a bank must classify the exposure into Grade C:

- (1) The counterparty bank does not meet the criteria for being classified as Grade B with respect to its published minimum regulatory requirements.
- (2) Where audited financial statements are required, the external auditor has issued an adverse audit opinion or has expressed substantial doubt about the counterparty bank's ability to continue as a going concern in its financial statements or audited reports within the previous 12 months.
- (3) Even if the triggers set out in (1) and (2) above are not breached, a bank may assess that the counterparty bank meets the definition of Grade C above. In that case, the exposure to such counterparty bank must be classified into Grade C.

Exposures to banks with an original maturity of three months or less, as well as exposures to banks that arise from the movement of goods across national borders with an original maturity of six months or less, can be assigned a risk weight that correspond to the risk weights for short term exposures in Table 7.

To reflect transfer and convertibility risk under the SCRA, a risk-weight floor based on the risk weight applicable to exposures to the sovereign of the country where the bank counterparty is incorporated will be applied to the risk weight assigned to bank exposures. The sovereign floor applies when:

- (1) the exposure is not in the local currency of the jurisdiction of incorporation of the debtor bank;

- (2) for a borrowing booked in a branch of the debtor bank in a foreign jurisdiction, when the exposure is not in the local currency of the jurisdiction in which the branch operates. The sovereign floor will not apply to short-term (i.e. with a maturity below one year) self-liquidating, trade-related contingent items that arise from the movement of goods.

6.2.5 Exposures to Securities Firms and Other Financial Institutions

Exposures to other financial institutions covered under the Banking Act shall be treated as exposures to banks.

Exposures to all other securities firms and other financial institutions will be treated as exposures to corporates.

6.2.6 Exposures to Corporates

For the purposes of calculating capital requirements, exposures to corporates include exposures (loans, bonds, receivables, etc.) to incorporated entities, associations, partnerships, proprietorships, trusts funds and other entities with similar characteristics, except those which qualify for one of the other exposure classes. The corporate exposure class does not include exposures to individuals.

The corporate exposure class differentiates between the following subcategories:

- (a) General corporate exposures;
- (b) Specialised lending exposures,

6.2.6.1 General corporate exposures

Banks and financial institutions shall apply the following “base” risk weights for exposures to corporates:

Table 8: Risk weight table for corporate exposures

Credit assessment	AAA to AA-	A+ to A-	BBB+ to BB-	Below BB-	Unrated
Risk weight	20%	50%	100%	150%	100%

Corporate SMEs are defined as corporate exposures where the reported annual sales for the consolidated group of which the corporate counterparty is a part is less than or equal to Ksh.100 million for the most recent financial year. For unrated exposures to corporate SMEs in jurisdictions that allow the use of external ratings for regulatory purposes an 85% risk weight will be applied.

6.2.6.2 Specialised lending

A corporate exposure will be treated as a specialised lending exposure if such lending possesses some or all of the following characteristics, either in legal form or economic substance:

- (1) The exposure is not related to real estate and is within the definitions of object finance, project finance or commodities finance.
- (2) The exposure is typically to an entity (often a special purpose vehicle (SPV)) that was created specifically to finance and/or operate physical assets;
- (3) The borrowing entity has few or no other material assets or activities, and therefore little or no independent capacity to repay the obligation, apart from the income that it receives from the asset(s) being financed. The primary source of repayment of the obligation is the income generated by the asset(s), rather than the independent capacity of the borrowing entity; and
- (4) The terms of the obligation give the lender a substantial degree of control over the asset(s) and the income that it generates.

Specialised lending exposures will be classified in one of the following three subcategories of specialised lending:

- (1) Project finance refers to the method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the loan. This type of financing is usually for large, complex and expensive installations such as power plants, chemical processing plants, mines, transportation infrastructure, environment, media, and telecoms. Project finance may take the form of financing the construction of a new capital installation, or refinancing of an existing installation, with or without improvements.
- (2) Object finance refers to the method of funding the acquisition of equipment (e.g. ships, aircraft, satellites, railcars, and fleets) where the repayment of the loan is dependent on the cash flows generated by the specific assets that have been financed and pledged or assigned to the lender.
- (3) Commodities finance refers to short-term lending to finance reserves, inventories, or receivables of exchange-traded commodities (e.g. crude oil, metals, or crops), where the loan will be repaid from the proceeds of the sale of the commodity and the borrower has no independent capacity to repay the loan.

Banks will assign to their specialised lending exposures the risk weights determined by the issue-specific external ratings, if these are available, according to Table 8. Issuer ratings must not be used.

For specialised lending exposures for which an issue-specific external rating is not available, the following risk weights will apply:

- (1) Object and commodities finance exposures will be risk-weighted at 100%;
- (2) Project finance exposures will be risk-weighted at 130% during the preoperational phase and 100% during the operational phase. Project finance exposures in the operational phase which are deemed to be high quality, as described below, will be risk weighted at 80%. For this purpose, operational phase is defined as the phase in which the entity that was specifically created to finance the project has:
 - (a) a positive net cash flow that is sufficient to cover any remaining contractual obligation, and
 - (b) declining long-term debt.

A high quality project finance exposure refers to an exposure to a project finance entity that is able to meet its financial commitments in a timely manner and its ability to do so is assessed to be robust against adverse changes in the economic cycle and business conditions. The following conditions must also be met:

- (1) The project finance entity is restricted from acting to the detriment of the creditors (e.g. by not being able to issue additional debt without the consent of existing creditors);
- (2) The project finance entity has sufficient reserve funds or other financial arrangements to cover the contingency funding and working capital requirements of the project;
- (3) The revenues are availability-based or subject to a rate-of-return regulation or take-or-pay contract;
- (4) The project finance entity's revenue depends on one main counterparty and this main counterparty shall be a central government, PSE or a corporate entity with a risk weight of 80% or lower;
- (5) The contractual provisions governing the exposure to the project finance entity provide for a high degree of protection for creditors in case of a default of the project finance entity;
- (6) The main counterparty or other counterparties which similarly comply with the eligibility criteria for the main counterparty will protect the creditors from the losses resulting from a termination of the project;
- (7) All assets and contracts necessary to operate the project have been pledged to the creditors to the extent permitted by applicable law; and
- (8) Creditors may assume control of the project finance entity in case of its default.

6.2.7 Retail Exposures

- (1) The retail exposure class excludes exposures within the real estate exposure class. The retail exposure class includes exposures to an individual person or persons, and exposures to SMEs that meet the “regulatory retail” criteria set out below. Exposures to SMEs that do

not meet these criteria will be treated as corporate SMEs exposures under the corporate class.

(2) “Regulatory retail” exposures are defined as retail exposures that meet all of the criteria listed below:

- a. Product criterion: the exposure takes the form of any of the following: revolving credits and lines of credit (including credit cards, charge cards and overdrafts), personal term loans and leases (eg instalment loans, auto loans and leases, student and educational loans, personal finance) and small business facilities and commitments. Mortgage loans, derivatives and other securities (such as bonds and equities), whether listed or not, are specifically excluded from this category.
- b. Low value of individual exposures: the maximum aggregated exposure to one counterparty cannot exceed an absolute threshold of Ksh.1 million.
Granularity criterion: no aggregated exposure to one counterparty can exceed 0.2% of the overall regulatory retail portfolio.

Defaulted retail exposures are to be excluded from the overall regulatory retail portfolio when assessing the granularity criterion.

(3) Transactors are obligors in relation to facilities such as credit cards and charge cards where the balance has been repaid in full at each scheduled repayment date for the previous 12 months.

(4) The risk weights that apply to exposures in the retail asset class are as follows:

- (a) Regulatory retail exposures that do not arise from exposures to transactors will be risk weighted at 100%;
- (b) Regulatory retail exposures that meet the criterion that arise from obligors who qualify as “transactors” will be risk-weighted at 45%.
- (c) Other retail exposures will be risk weighted at 100%.

6.2.8 Real Estate Exposures

6.2.8.1 The real estate exposure asset class consists of:

- (1) Exposures secured by real estate that are classified as “regulatory real estate” exposures.
- (2) Exposures secured by real estate that are classified as “other real estate” exposures.
- (3) Exposures that are classified as “land acquisition, development and construction” (ADC) exposures.

6.2.8.2 "Regulatory real estate" exposures consist of:

- (1) "Regulatory residential real estate" exposures that are not "materially dependent on cash flows generated by the property".
- (2) "Regulatory residential real estate" exposures that are "materially dependent on cash flows generated by the property".
- (3) "Regulatory commercial real estate" exposures that are not "materially dependent on cash flows generated by the property".
- (4) "Regulatory commercial real estate" exposures that are "materially dependent on cash flows generated by the property".

6.2.8.3 Regulatory real estate exposures (both residential and commercial) are classified as exposures that are “materially dependent on cash flows generated by the property” when the prospects for servicing the loan materially depend on the cash flows generated by the property securing the loan rather than on the underlying capacity of the borrower to service the debt from other sources.

Regulatory real estate exposures (both residential and commercial) shall be considered materially dependent on cash flows generated by the property where at least 50% of the borrower’s debt servicing capacity is derived from such property-related cash flows, rather than from other independent income or funding sources.

As exceptions, the following types of regulatory real estate exposures are not classified as exposures that are materially dependent on cash flows generated by the property:

- (1) An exposure secured by a property that is the borrower’s primary residence;
- (2) An exposure secured by an income-producing residential housing unit, to an individual who has mortgaged less than a certain number of properties or housing units, as may be specified by the Central Bank of Kenya;
- (3) An exposure secured by residential real estate property to associations or cooperatives of individuals that are regulated under national law and exist with the only purpose of granting its members the use of a primary residence in the property securing the loans; and
- (4) An exposure secured by residential real estate property to public housing companies and not-for-profit associations regulated under national law that exist to serve social purposes and to offer tenants long-term housing.

6.2.8.4 Exposures secured by residential real estate or commercial real estate must meet the following requirements to be classified as regulatory real estate:

- (1) Finished property: the exposure must be secured by a fully completed immovable property. This requirement does not apply to forest and agricultural land. Banks

should ensure that the lending is not, in effect, indirectly financing land acquisition, development and construction exposures.

- (2) Legal enforceability: any claim on the property taken must be legally enforceable in all relevant jurisdictions.
- (3) Claims over the property: the loan is a claim over the property where the lender bank holds a first lien over the property.
- (4) Ability of the borrower to repay: banks should put in place underwriting policies with respect to the granting of mortgage loans that include the assessment of the ability of the borrower to repay.
- (5) Prudent value of property: the property must be valued according to the criteria for determining the value in the loan to value (LTV) ratio. Moreover, the value of the property must not depend materially on the performance of the borrower.

The LTV is the amount of the loan divided by the value of the property. When calculating the LTV, the loan amount will be reduced as the loan amortises. The value of the property will be maintained at the value measured at origination, with the following exceptions:

- (a) Banks to revise the property value downward, If the value has been adjusted downwards, a subsequent upwards adjustment can be made but not to a higher value than the value at origination.
- (b) The value must be adjusted if an extraordinary, idiosyncratic event occurs resulting in a permanent reduction of the property value.
- (c) Modifications made to the property that unequivocally increase its value could also be considered in the LTV.

6.2.8.5 The LTV must be prudently calculated in accordance with the following requirements:

- (a) Amount of the loan: includes the outstanding loan amount and any undrawn committed amount of the mortgage loan. The loan amount must be calculated gross of any provisions and other risk mitigants, except for pledged deposits accounts with the lending bank that meet all requirements for on-balance sheet netting and have been unconditionally and irrevocably pledged for the sole purposes of redemption of the mortgage loan.
- (b) Value of the property: the valuation must be appraised independently using prudently conservative valuation criteria. To ensure that the value of the property is appraised in a prudently conservative manner, the valuation must exclude expectations on price increases and must be adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan. For the purposes of determining the LTV, institutions shall apply a conservative valuation approach by using the forced-sale value of the property.

- (6) Required documentation: all the information required at loan origination and for monitoring purposes shall be properly documented, including information on the ability of the borrower to repay and on the valuation of the property.

6.2.8.6 Exposures secured by residential real estate

A “regulatory residential real estate” exposure is a regulatory real estate exposure that is secured by a property that has the nature of a dwelling and satisfies all applicable laws and regulations enabling the property to be occupied for housing purposes (i.e. residential property).

- (1) Risk weights for regulatory residential real estate exposures that are not materially dependent on cash flows generated by the property

‘For regulatory residential real estate exposures that are not materially dependent on cash flow generated by the property, the risk weight to be assigned to the total exposure amount will be determined based on the exposure’s LTV ratio in the Table 9 below.

Table 9: Whole loan approach risk weights for regulatory residential real estate exposures that are not materially dependent on cash flows generated by the property

	$LTV \leq 50\%$	$50\% < LTV \leq 60\%$	$60\% < LTV \leq 80\%$	$80\% < LTV \leq 90\%$	$90\% < LTV \leq 100\%$	$LTV > 100\%$
Risk weight	20%	25%	30%	40%	50%	70%

- (2) Risk weights for regulatory residential real estate exposures that are materially dependent on cash flows generated by the property

For regulatory residential real estate exposures that are materially dependent on cash flows generated by the property, the risk weight to be assigned to the total exposure amount will be determined based on the exposure’s LTV ratio in the Table 10 below.

Table 10: Risk weights for regulatory residential real estate exposures that are materially dependent on cash flows generated by the property

	$LTV \leq 50\%$	$50\% < LTV \leq 60\%$	$60\% < LTV \leq 80\%$	$80\% < LTV \leq 90\%$	$90\% < LTV \leq 100\%$	$LTV > 100\%$
Risk weight	30%	35%	45%	60%	75%	105%

6.2.8.7 Exposures secured by commercial real estate

A “regulatory commercial real estate” exposure is regulatory real estate exposure that is not a regulatory residential real estate exposure.

- (1) Risk weights for regulatory commercial real estate exposures that are not materially dependent on cash flows generated by the property

For regulatory commercial real estate exposures that are not materially dependent on cash flow generated by the property, the risk weight to be assigned to the total exposure amount will be determined based on the exposure’s LTV in Table 11 below

Table 11: Whole loan approach risk weights for regulatory commercial real estate exposures that are not materially dependent on cash flows generated by the property

	LTV $\leq$ 60%	LTV > 60%
Risk Weight	Min (60%, RW of counterparty)	RW of counterparty

- (2) Regulatory commercial real estate exposures that are materially dependent on cash flows generated by the property

For regulatory commercial real estate exposures that are materially dependent on cash flows generated by the property, the risk weight to be assigned to the total exposure amount will be determined based on the exposure’s LTV in Table 12 below.

Table 12: Whole loan approach risk weights for regulatory commercial real estate exposures that are materially dependent on cash flows generated by the property

	LTV $\leq$ 60%	60% < LTV $\leq$ 80%	LTV > 80%
Risk weight	70%	90%	110%

6.2.8.8 Other Real Estate Exposures

An “other real estate” exposure is an exposure within the real estate asset class that is not a regulatory real estate exposure and is not a land ADC exposure. Other real estate exposures are risk weighted as follows:

- (1) The risk weight of the counterparty is used for other real estate exposures that are not materially dependent on the cash flows generated by the property. Further;
 - a. For exposures to individuals the risk weight applied will be 75%.
 - b. For exposures to SMEs, the risk weight applied will be 85%.

- c. For exposures to other counterparties, the risk weight applied is the risk weight that would be assigned to an unsecured exposure to that counterparty.
- (2) The risk weight of 150% is used for other real estate exposures that are materially dependent on the cash flows generated by the property.

6.2.9 Land Acquisition, Development and Construction Exposures

Land ADC exposures refers to loans to companies or SPVs financing any of the land acquisition for development and construction purposes, or development and construction of any residential or commercial property. ADC exposures will be risk-weighted at 150%, ADC exposures to residential real estate may be risk weighted at 100%, provided that the following criteria are met:

- (1) prudential underwriting standards meet the requirements in Clause 6.2.8.4 (i.e. the requirements that are used to classify regulatory real estate exposures) where applicable; and
- (2) pre-sale or pre-lease contracts amount to a significant portion of total contracts or substantial equity at risk. Pre-sale or pre-lease contracts must be legally binding written contracts and the purchaser/renter must have made a substantial cash deposit which is subject to forfeiture if the contract is terminated. Equity at risk should be determined as an appropriate amount of borrower-contributed equity to the real estate's appraised as-completed value.

Pre-sale or pre-lease contracts shall be considered to constitute a significant portion of total contracts where they account for at least 50% of the total contracted value of the project.

6.2.10 Risk Weight Multiplier to Certain Exposures with Currency Mismatch

For unhedged retail and residential real estate exposures to individuals where the lending currency differs from the currency of the borrower's source of income, banks will apply a 1.5 times multiplier to the applicable risk weight, subject to a maximum risk weight of 150%.

An unhedged exposure refers to an exposure to a borrower that has no natural or financial hedge against the foreign exchange risk resulting from the currency mismatch between the currency of the borrower's income and the currency of the loan.

A natural hedge exists where the borrower, in its normal operating procedures, receives foreign currency income that matches the currency of a given loan (e.g. remittances, rental incomes, salaries). A financial hedge generally includes a legal contract with a financial institution (e.g. forward contract). For the purposes of application of the multiplier, only these natural or

financial hedges are considered sufficient where they cover at least 90% of the loan instalment, regardless of the number of hedges.

6.2.11 Defaulted Exposures

For the purposes of risk-weighting under the Standardised Approach, a defaulted exposure shall have the meaning assigned to it under this Guideline.

For retail exposures, the definition of default can be applied at the level of a particular credit obligation, rather than at the level of the borrower. As such, default by a borrower on one obligation does not require a bank to treat all other obligations to the banking group as defaulted.

With the exception of residential real estate exposures, the unsecured portion of a defaulted exposure shall be risk weighted net of specific provisions and partial write-offs as follows:

- (1) 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan; and
- (2) 100% risk weight when specific provisions are equal to or greater than 20% of the outstanding amount of the loan.

Defaulted residential real estate exposures where repayments do not materially depend on cash flows generated by the property securing the loan shall be risk weighted net of specific provisions and partial write-offs at 100%. Guarantees or financial collateral which are eligible according to the credit risk mitigation framework might be taken into account in the calculation of the exposure.

For the purpose of defining the secured or guaranteed portion of the defaulted exposure, eligible collateral and guarantees will be the same as for credit risk mitigation purposes.

6.2.12 Subordinated Debt, Equity and Other Capital Instruments

Banks will assign a risk weight of 400% to speculative unlisted equity exposures and a risk weight of 250% to all other equity holdings. Banks will assign a risk weight of 150% to subordinated debt and capital instruments other than equities.

The risk weight for investments in significant minority- or majority-owned and – controlled commercial entities depends upon the application of two materiality thresholds:

- (1) for individual investments, 15% of the bank's capital; and
- (2) for the aggregate of such investments, 60% of the bank's capital.

Investments in significant minority- or majority-owned and –controlled commercial entities below the materiality thresholds must be risk weighted as described in the previous paragraph. Investments in excess of the materiality thresholds must be risk-weighted at 1250%.

6.2.13 Securitisation Exposures

The risk-weighted asset amount of a securitisation exposure is computed by multiplying the amount of the position by the appropriate risk weight determined in accordance with tables 13 and 14. For off-balance sheet exposures, banks must apply a CCF and then risk weight the resultant credit equivalent amount. If such an exposure is rated, a CCF of 100% must be applied. For positions with long-term ratings of B+ and below and short-term ratings other than A-1/P-1, A-2/P-2, A-3/P-3, deduction from capital is required. Deduction is also required for unrated positions.

Table 13: Risk weights for securitization exposures – Long term rating category

Credit assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ and below or unrated
Risk weight	20%	50%	100%	350%	Deduction

Table 14: Risk weights for securitization exposures – Short term rating category

Credit assessment	A-1/P-1	A-2/P-2	A-3/P-3	All other ratings or unrated
Risk weight	20%	50%	100%	Deduction

6.2.14 Other Assets

The below exposures are deducted in the calculation of Common Equity Tier 1 if they exceed the certain thresholds. A 250% risk weight applies to the amount of the three “threshold deduction” items listed in that are not deducted.

- (1) Significant investments in the common shares of unconsolidated financial institutions (banks, insurance and other financial entities) as referred to in Clause 4.6.5.10;
- (2) mortgage servicing rights; and
- (3) DTAs that arise from temporary differences.

The standard risk weight for all other assets will be 100%, with the exception of the following exposures:

- (1) A 0% risk weight will apply to:
 - (a) cash owned and held at the bank or in transit; and

- (b) gold bullion held at the bank or held in another bank on an allocated basis, to the extent the gold bullion assets are backed by gold bullion liabilities.

(2) A 20% risk weight will apply to cash items in the process of collection.

6.3 Off Balance Sheet Credit Exposures

6.3.1 Off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCF). In the case of commitments, the committed but undrawn amount of the exposure would be multiplied by the CCF. For these purposes, commitment means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes. It includes any such arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor. It also includes any such arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility documentation, including conditions that must be met by the obligor prior to any initial or subsequent drawdown under the arrangement. Counterparty risk weightings for over-the-counter (OTC) derivative transactions will not be subject to any specific ceiling.

6.3.2 A 100% CCF will be applied to the following items:

- (1) Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).
- (2) Sale and repurchase agreements and asset sales with recourse¹ where the credit risk remains with the bank.
- (3) The lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions). The risk-weighting treatment for counterparty credit risk must be applied in addition to the credit risk charge on the securities or posted collateral, where the credit risk of the securities lent or posted as collateral remains with the bank. This paragraph does not apply to posted collateral related to derivative transactions that is treated in accordance with the counterparty credit risk standards.
- (4) Forward asset purchases, forward deposits and partly paid shares and securities², which represent commitments with certain drawdown.

¹ These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

² These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

(5) Off-balance sheet items that are credit substitutes not explicitly included in any other category.

- 6.3.3 A 50% CCF will be applied to note issuance facilities and revolving underwriting facilities regardless of the maturity of the underlying facility.
- 6.3.4 A 50% CCF will be applied to certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).
- 6.3.5 A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF.
- 6.3.6 A 20% CCF will be applied to both the issuing and confirming banks of shortterm self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment). Short term in this context means with a maturity below one year.
- 6.3.7 A 10% CCF will be applied to commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness.
- 6.3.8 Where there is an undertaking to provide a commitment on an off-balance sheet item, banks are to apply the lower of the two applicable CCFs.

6.4 Exposures that Give Rise to Counterparty Credit Risk

6.4.1 Over-the-Counter Derivatives (OTC)

OTC derivatives transactions expose banks to counterparty risk. The treatment that shall be applied to determine the credit equivalent amount of the OTC derivatives is the so called "current exposure method" (Annex IV of Basel II), whereby banks must calculate the current replacement cost by marking contracts to market/model, thus capturing the current exposure without any need for estimation, and then adding a factor (the "add-on") to reflect the potential future exposure over the remaining life of the contract.

In order to calculate the credit equivalent amount of these instruments under this method, exposures to derivatives are included by means of two components:

- The total replacement cost (RC, obtained by "marking to market") of all its contracts with positive value; and
- An amount for potential future credit exposure (PFE) calculated on the basis of the

total notional principal amount, split by residual maturity as follows:

Table 15: Calculation of PFE

	Interest Rates	FX and Gold	Equities	Precious Metals except Gold	Other commodities
One year or less	0.0%	1.0%	6.0%	7.0%	10.0%
Over one year to five years	0.5%	5.0%	8.0%	7.0%	12.0%
Over five years	1.5%	7.5%	10.0%	8.0%	15.0%

Banks must calculate their exposures associated with all derivative transactions as a scalar multiplier alpha set at 1.4 times the sum of the RC and the PFE³. The exposure measure is calculated according to: **1.4 x (RC+PFE)**. The capital amount is obtained by multiplying this exposure by the risk weight of the counterparty.

Notes:

- For contracts with multiple exchanges of principal (like swaps), the factors are to be multiplied by the number of remaining payments in the contract.
- For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date.
- In the case of interest rate contracts with remaining maturities of more than one year that meet the above criteria, the add-on factor is subject to a floor of 0.5%.
- Other derivative contracts not covered by any of the columns of this matrix are to be treated as "other commodities".
- No potential future credit exposure would be calculated for single currency floating / floating interest rate swaps; the credit exposure on these contracts would be evaluated solely based on their mark-to-market value.

6.4.2 Securities Financing Transactions (SFTs)

SFTs are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements. The credit equivalent amount of SFTs that expose a bank to counterparty credit risk is to be calculated as follows:

³ Or "PFE Add-on" as renamed under the Basel III SA-CCR standard.

$E^* = \max\{0; 1.15 \cdot E - (0.85 - H_{FX}) \cdot C\}$, where
 E^* = credit equivalent (after risk mitigation);
 E = current value of the exposure;
 C = the current value of the collateral received; and
 H_{FX} = 8% when collateral and exposures are denominated in different currencies,
 otherwise 0.

In order to determine the risk weighted assets for OTC derivatives and SFTs, once the bank has calculated the credit equivalent amounts of any off-balance sheet item they are to be weighted according to the category of counterparty in the same way as in the main framework, including concessionary weighting in respect of exposures backed by eligible guarantees and collateral.

6.5 Credit Risk Mitigation

6.5.1 Credit Risk Mitigation (CRM) techniques consist of the use of relevant financial collateral, guarantees, real estate mortgages, lease transactions, and other eligible instruments in relation to banking book exposures and asset classes. These techniques are intended to reduce the credit risk associated with such exposures and, where recognised by the regulatory framework, may be taken into account in the calculation of a bank's capital requirements.

6.5.2 General requirements:

- a. No transaction in which credit risk mitigation (CRM) techniques are used shall receive a higher capital requirement than an otherwise identical transaction where such techniques are not used.
- b. The requirements for recognition and eligibility set out in this Guideline must be fulfilled for banks to obtain capital relief in respect of any CRM techniques.
- c. The effects of CRM must not be double-counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted on exposures for which the risk weight already reflects that CRM.
- d. While the use of CRM techniques reduces or transfers credit risk, it may simultaneously increase other risks (i.e. residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, banks must 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.
- e. In order for CRM techniques to provide protection, the credit quality of the counterparty must not have a material positive correlation with the employed

CRM technique or with the resulting residual risks. For example, securities issued by the counterparty (or by any counterparty-related entity) provide little protection as collateral and are thus ineligible.

- f. In the case where a bank has multiple CRM techniques covering a single exposure (e.g. a bank has both collateral and a guarantee partially covering an exposure), the bank must 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.

6.5.3 Legal requirement:

In order for banks to obtain capital relief for any use of CRM techniques, all documentation used in collateralised transactions, on-balance sheet netting agreements, guarantees and credit derivatives must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review to verify this and have a well-founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

6.5.4 Maturity mismatches:

For the purposes of calculating risk-weighted assets, a maturity mismatch occurs when the residual maturity of a credit protection arrangement (e.g hedge) is less than that of the underlying exposure. In the case of financial collateral, maturity mismatches are not allowed under the simple approach (see collateralized transactions). Under the other approaches, when there is a maturity mismatch the credit protection arrangement may only be recognised if the original maturity of the arrangement is greater than or equal to one year, and its residual maturity is greater than or equal to three months. When there is a maturity mismatch with recognised credit risk mitigants, the following adjustment applies $P_a = P \times (t - 0.25)/(T - 0.25)$, where:

- a. P_a = value of the credit protection adjusted for maturity mismatch
- b. P = credit protection amount (e.g. collateral amount, guarantee amount) adjusted for any haircuts
- c. t = $\min \{T, \text{residual maturity of the credit protection arrangement expressed in years}\}$
- d. T = $\min \{\text{five years, residual maturity of the exposure expressed in years}\}$

6.5.5 Collateralized transactions

A collateralised transaction is one in which:

- (1) banks have a credit exposure or a potential credit exposure; and
- (2) that credit exposure or potential credit exposure is hedged in whole or in part by collateral posted by a counterparty or by a third party on behalf of the counterparty.

6.5.5.1 Where banks take eligible financial collateral, they may reduce their regulatory capital requirements through the application of CRM techniques.

6.5.5.2 A bank shall not be allowed to use credit derivatives even for the purposes of credit risk mitigation.

6.5.5.3 Banks and financial institutions shall use simple approach to mitigate credit risks to which they are exposed.

6.5.5.4 The simple approach replaces the risk weight of the counterparty with the risk weight of the collateral for the collateralised portion of the exposure (generally subject to a 20% floor);

6.5.5.5 For collateral to be recognised in the simple approach, it must be pledged for at least the life of the exposure, and it must be marked to market and revalued with a minimum frequency of six months. Those portions of exposures collateralised by the market value of recognised collateral receive the risk weight applicable to the collateral instrument. The risk weight on the collateralised portion is subject to a floor of 20% except under the conditions specified in 6.5.5.7. The remainder of the exposure must be assigned the risk weight appropriate to the counterparty. Maturity mismatches are not allowed under the simple approach.

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

- (1) Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposit with the bank that is incurring the counterparty exposure.
- (2) Gold.
- (3) In jurisdictions that allow the use of external ratings for regulatory purposes:
 - (a) Debt securities rated by a recognised ECAI where these are either:

- (i) at least BB– when issued by sovereigns or public sector entities (PSEs) that are treated as sovereigns by the Central Bank; or
- (ii) at least BBB– when issued by other entities (including banks and other prudentially regulated financial institutions); or
- (iii) at least A-3/P-3 for short-term debt instruments.

(b) Debt securities not rated by a recognised ECAI where these are:

- (i) issued by a bank; and
- (ii) listed on a recognised exchange; and
- (iii) classified as senior debt; and
- (iv) all rated issues of the same seniority by the issuing bank are rated at least BBB– or A-3/P-3 by a recognised ECAI; and
- (v) the bank holding the securities as collateral has no information to suggest that the issue justifies a rating below BBB– or A-3/P-3 (as applicable); and
- (vi) the supervisor is sufficiently confident that the market liquidity of the security is adequate.

(4) Equities (including convertible bonds) that are included in a main index.

(5) Guarantee of the Government of Kenya.

(6) Unconditional and irrevocable guarantee of an A or higher rated sovereign.

6.5.5.7 Repo-style transactions that fulfil all of the following conditions are exempted from the risk-weight floor under the simple approach:

- (1) Both the exposure and the collateral are cash or a sovereign security qualifying for a 0% risk weight under the standardised approach;
- (2) Both the exposure and the collateral are denominated in the same currency;
- (3) Either the transaction is overnight or both the exposure and the collateral are marked to market daily and are subject to daily remargining;
- (4) Following a counterparty's failure to remargin, the time that is required between the last mark-to-market before the failure to remargin and the liquidation of the collateral is considered to be no more than four business days.
- (5) The transaction is settled across a settlement system proven for that type of transaction;
- (6) The documentation covering the agreement is standard market documentation for repo-style transactions in the securities concerned;

- (7) The transaction is governed by documentation specifying that if the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the transaction is immediately terminable; and
- (8) Upon any default event, regardless of whether the counterparty is insolvent or bankrupt, the bank has the unfettered, legally enforceable right to immediately seize and liquidate the collateral for its benefit.

6.5.5.8 Repo transactions that fulfil the requirement in 6.5.5.7 receive a 10% risk weight. If the counterparty to the transaction is the Government of Kenya, CBK, or another sovereign with credit rating A or higher, banks may apply a risk weight of 0% to the transaction.

6.5.5.9 The 20% floor for the risk weight on a collateralised transaction does not apply and a 0% risk weight may be applied to the collateralised portion of the exposure where the exposure and the collateral are denominated in the same currency, and either:

- (1) the collateral is cash on deposit; or
- (2) the collateral is in the form of sovereign securities eligible for a 0% risk weight, and its market value has been discounted by 20%.

6.5.6 Third-party guarantees

6.5.6.1 If the operational requirements outlined below are met, banks can substitute the RW of the counterparty with the RW of the guarantor:

- a) It represents a direct claim on the protection provider/guarantor;
- b) It is explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible;
- c) Other than non-payment by a protection purchaser of money due in respect of the credit protection contract it is irrevocable;
- d) there is no clause in the contract that would allow the protection provider unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure; and
- e) It must be unconditional; there should be no clause in the protection contract outside the direct control of the bank that could prevent the protection provider/guarantor from being obliged to pay out in a timely manner in the event that the underlying counterparty fails to make the payment(s) due.

6.5.6.2 In addition to the legal certainty requirements, in order for a guarantee to be recognized, the following requirements must be satisfied:

- a) On the qualifying default/non-payment of the counterparty, 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 counterparty covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal action in order to pursue the counterparty for payment.
- b) The guarantee is an explicitly documented obligation assumed by the guarantor.
- c) Except as noted in the following sentence, the guarantee covers all types of payments the underlying counterparty is expected to make under the documentation governing the transaction, for example notional amount, margin payments, etc. The guarantee should cover payment of principal, interests and any other uncovered payments.

6.5.6.3 Range of eligible guarantors (counter-guarantors)/protection providers Credit protection given by the following entities can be recognized when they have a lower RW than the counterparty:

- Sovereign entities, PSEs, banks, securities firms and other prudentially regulated financial institutions with a lower RW than the counterparty;
- Other entities that are externally rated except when credit protection is provided to a securitization exposure. This would include credit protection provided by a parent, subsidiary and affiliate companies when they have a lower RW than the obligor;
- When credit protection is provided to a securitization exposure, other entities that currently are externally rated BBB– or better and that were externally rated A– or better at the time the credit protection was provided. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower RW than the obligor.

6.5.6.4 Risk-weight treatment when credit protection is provided:

The general risk-weight treatment for transactions in which eligible credit protection is provided is as follows:

- (1) 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 counterparty.

- (2) Materiality thresholds on payments below which the protection provider is exempt from payment in the event of loss are equivalent to retained first loss positions. The portion of the exposure that is below a materiality threshold must be assigned a risk weight of 1250% by the bank purchasing the credit protection.

Where losses are shared *pari passu* on a pro rata basis between the bank and the guarantor, capital relief is afforded on a proportional basis, i.e. the protected portion of the exposure receives the treatment applicable to eligible guarantees, with the remainder treated as unsecured.

6.5.7 Currency mismatches

Where the credit protection is denominated in a currency different from that in which the exposure is denominated - that is there is a currency mismatch - the amount of the exposure deemed to be protected (G_A) will be reduced by the application of a haircut (H_{FX}), by using the following formula:

$$G_A = G * (1 - H_{FX}) \quad \text{where:}$$

G = nominal amount of the credit protection

H_{FX} = haircut appropriate for currency mismatch between the credit protection and underlying obligation and will be calculated as $H_{FX} = 8$ percent.

The standard supervisory haircut of 8 percent will be applied where the exposure and collateral are denominated in different currencies based on a 10-business day holding period (assuming daily marking to market).

6.5.8 Sovereign Guarantees and Counter-Guarantees:

Banks will extend the preferential treatment RW, described in section 6.2.1, to portions of exposures guaranteed by the Government or Central Bank, where the guarantee is denominated in the domestic currency and the exposure is funded in that currency. An exposure may be covered by a guarantee that is indirectly counter-guaranteed by a sovereign. Such an exposure may be treated as covered by a sovereign guarantee provided that:

- a) The sovereign counter-guarantee covers all credit risk elements of the exposure;
- b) Both the original guarantee and the counter-guarantee meet all operational requirements for guarantees, except that the counter-guarantee need not be

- direct and explicit to the original exposure; and
- c) The Central Bank is satisfied that the cover is robust and that no historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct sovereign guarantee.

PART VII: CALCULATION OF RISK WEIGHTED ASSETS FOR MARKET RISK

7.1 Introduction

Market risk is defined as the risk of losses arising from movements in market prices. The risks subject to market risk capital requirements include but are not limited to:

- (1) default risk, interest rate risk, and equity risk for trading book instruments⁴; and
- (2) Foreign exchange (FX) risk and commodities risk for both, the trading and banking book instruments.

The purpose of this section is to ensure that institutions which have significant any exposure to market risks maintain adequate capital to support that exposure, in addition to capital requirements for credit and operational risks. The section also sets out the CBK's approach in determining the adequacy of capital to support potential losses arising from market risk. For the purpose of this guideline, all institutions will be required to adopt the Basel III simplified standardised approach in the calculation of the capital charge for market risk.

7.2 Applicability of Market Risk Capital Requirements

- i) The market risk capital requirement applies to all institutions under the supervision of the CBK. Institutions are required to report their market risk exposures on a monthly basis using the Market Risk Reporting templates (**Forms D, D1, D2 & D3**), attached to this guideline. Institutions are required to complete the templates on:
 - A solo basis, covering the market risk exposure positions of the institution on a monthly basis, and
 - A consolidated basis, covering the market risk exposure positions of the institution and its subsidiaries on an annual basis.
- ii) No netting or offsetting requirements is permitted. The subsidiaries of foreign banks operating in Kenya, where the CBK is not the lead/home supervisor, are subject to the market risk capital requirements on a solo basis.

⁴ Market risk also includes credit spread risk, but this will be not included for calculation of capital requirements in the present framework.

- iii) For interest rates, equity prices and commodity prices risks determination for capital charge shall apply to instruments in the trading book, while foreign exchange risk capital charge shall apply to instruments in both trading and banking books.

7.3.1 Although regular reporting will in principle take place only quarterly, banks are expected to manage their market risk in such a way that the capital requirements are being met on a continuous basis, including at the close of each business day. The Central Bank of Kenya will take appropriate measures to prevent banks from window-dress by showing significantly lower market risk positions on reporting dates.

7.3 Boundary Between the Banking Book and the Trading Book

7.3.1 A trading book consists of all instruments that meet the specifications for trading book instruments set out below.

- i) Instruments comprise financial instruments, foreign exchange (FX), and commodities.
- ii) Banks may only include a financial instrument, instruments on FX or commodity in the trading book when there is no legal impediment against selling or fully hedging it.
- iii) Banks must fair value daily any trading book instrument and recognise any valuation change in the profit and loss (P&L) account.
- iv) Any instrument a bank holds for one or more of the following purposes must, when it is first recognised on its books, be designated as a trading book instrument unless specifically otherwise provided for in (iii) above
 - a. short-term resale;
 - b. profiting from short-term price movements
 - c. locking in arbitrage profits; or
 - d. hedging risks that arise from instruments meeting (a), (b) or (c) above.
- v) Any of the following instruments is seen as being held for at least one of the purposes listed in (v) unless specifically otherwise provided for in the banking book and must therefore be included in the trading book.
 - a. instruments in the correlation trading portfolio;
 - b. instruments that would give rise to a net short credit or equity position in the banking book; or
 - c. instruments resulting from underwriting commitments, where underwriting commitments refer only to securities underwriting, and relate only to securities that are expected to be actually purchased by the bank on the settlement date.

- vi) Any instrument which is not held for any of the purposes listed in (iv) at inception, nor seen as being held for these purposes according to be assigned to (v) must be assigned to the banking book.

7.4 Banking Book

- vii) The following instruments must be assigned to the banking book;
- a. unlisted equities;
 - b. instruments designated for securitisation warehousing;
 - c. real estate holdings, where in the context of assigning instrument to the trading book, real estate holdings relate only to direct holdings of real estate as well as derivatives on direct holdings;
 - d. retail and small or medium-sized enterprise (SME) credit;
 - e. equity investments in a fund, unless the bank meets at least one of the following conditions;
 - the bank is able to look through the fund to its individual components and there is sufficient and frequent information, verified by an independent third party, provided to the bank regarding the fund's composition; or
 - the bank obtains daily price quotes for the fund and it has access to the information contained in the fund's mandate or in the national regulations governing such investment funds.
 - f. hedge funds;
 - g. derivative instruments and funds that have the above instrument types as underlying assets; or
 - h. instruments held for the purpose of hedging a particular risk of a position in the types of instrument above.
- viii) There is a general presumption that any of the following instruments are being held for at least one of the purposes listed in (v) are banking book instruments, unless specifically otherwise provided for in (iii) and therefore are trading book;
- a. instruments held as accounting trading assets or liabilities
 - b. instruments resulting from market-making activities
 - c. equity investments in a fund excluding those assigned to the banking book in accordance with (viii)(e)
 - d. listed equities
 - e. trading-related repo-style transaction; or

- f. options including embedded derivatives from instruments that the institution issued out of its own banking book and that relate to credit or equity risk.

7.5 Policies and Procedures

- ix) A bank must have clearly defined policies, procedures and documented practices for determining which instruments to include in or to exclude from the trading book for the purposes of calculating their regulatory capital, ensuring compliance with the criteria set forth in this section, and taking into account the bank's risk management capabilities and practices. A bank's internal control functions must conduct an ongoing evaluation of instruments both in and out of the trading book to assess whether its instruments are being properly designated initially as trading or non-trading instruments in the context of the bank's trading activities.
- x) Compliance with the policies and procedures must be fully documented and subject to periodic (at least yearly) internal audit and the results must be available for supervisory review.

7.6 Prudent Valuation Methodology

This section provides banks with guidance on prudent valuation for positions that are accounted for at fair value, whether they are in the trading book or in the banking book. A bank is required to have a framework for prudent valuation practices. It should, at a minimum, include the following;

- i) Banks must establish and maintain adequate systems and controls sufficient to give management and supervisors the confidence that their valuation estimates are prudent and reliable. These systems must be integrated with other risk management systems within the organisation (such as credit analysis). Such systems must include;
 - a) Documented policies and procedures for the process of valuation. This includes clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the bank's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, end of the month and ad-hoc verification procedures; and

- b) Clear and independent (i.e. independent of front office) reporting lines for the department accountable for the valuation process. The reporting line should ultimately be to a main board executive director.

7.7 Marking to Market

- ii) Banks must mark-to-market as much as possible. The more prudent side of bid /offer should be used unless the institution is a significant market-maker in a particular position type and it can close out at mid-market. Banks should maximise the use of relevant observable inputs and minimise the use of unobservable inputs when estimating fair value using a valuation technique. However, observable inputs or transactions may not be relevant, such as in a forced liquidation or distressed sale, or transactions may not be observable, such as when markets are inactive. In such cases, the observable data should be considered, but may not be determinative.

7.8 Mark-to-Model

- iii) Only where marking-to-market is not possible should banks mark-to-model, but this must be demonstrated to be prudent. Marking-to-model is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. When marking to model, an extra degree of conservatism is appropriate. CBK will consider the following in assessing whether a mark-to-model valuation is prudent;
 - a. Senior management should be aware of the elements of the trading book or other fair-valued positions which are subject to mark to model and should understand the materiality of the uncertainty this creates in the reporting of the risk/performance of the business
 - b. Market inputs should be sourced, to the extent possible, in line with market prices (as discussed above). The appropriateness of the market inputs for the particular position being valued should be reviewed regularly.
 - c. Where available, generally accepted valuation methodologies for particular products should be used as far as possible.
 - d. Where the model is developed by the institution itself, it should be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model should be developed or approved independently of the front office. It should be independently tested. This includes validating the mathematics, the assumptions and the software implementation.

- e. There should be formal change control procedures in place and a secure copy of the model should be held and periodically used to check valuations.
 - f. Risk management should be aware of the weaknesses of the models used and how best to reflect those in the valuation output.
 - g. The model should be subject to periodic review to determine the accuracy of its performance (e.g. assessing continued appropriateness of the assumptions, analysis of profit and loss versus risk factors, comparison of actual close out values to model outputs).
 - h. Valuation adjustments should be made as appropriate, for example, to cover the uncertainty of the model valuation
- iv) **Independent price verification** is distinct from daily mark-to-market. It is the process by which market prices or model inputs are regularly verified for accuracy. While daily marking-to-market may be performed by dealers, verification of market prices or model inputs should be performed by a unit independent of the dealing room, at least monthly. It need not be performed as frequently as daily mark-to-market, since the objective, i.e. independent, marking of positions, should reveal any error or bias in pricing, which should result in the elimination of inaccurate daily marks.
- v) As part of their procedures for marking to market, banks must establish and maintain procedures for considering valuation adjustments. The following valuation adjustments or reserves shall be formally considered:
- a. unearned credit spreads,
 - b. close-out costs,
 - c. operational risks,
 - d. early termination,
 - e. investing and funding costs,
 - f. future administrative costs and,
 - g. where appropriate, model risk.
- vi) Banks must establish and maintain procedures for judging the necessity of and calculating an adjustment to the current valuation of less liquid positions for regulatory capital purposes. This adjustment may be in addition to any changes to the value of the position required for financial reporting purposes and should be designed to reflect the illiquidity of the position.
- vii) CBK expect banks to consider the need for an adjustment to a position's valuation to reflect current illiquidity whether the position is marked to market using market prices or observable inputs, third-party valuations or marked to model.

7.9 Risk measurement framework

For the purpose of this guideline equity risk is not covered since trading in equities by institutions is prohibited in the Banking Act. To determine the level of capital to be held against market risk an institution should calculate capital charge on the following risks:

- Risks pertaining to interest rate related instruments in the trading book,
- Foreign exchange risk and;
- Commodity risk throughout the institution.

(a) Simplified Standardised Approach

All institutions will be required to adopt the simplified standardised approach in calculation of capital charge for market risk. The capital requirement is the weighted sum of the capital requirements arising from each of the three risk classes – namely interest rate risk, foreign exchange risk and commodity risk as detailed in the formula:

$$(CR_{IRR} \times SF_{IRR}) + (CR_{FX} \times SF_{FX}) + (CR_{COMM} \times SF_{COMM})$$

Where;

CR_{IRR} = capital requirement under interest rate risk

SF_{IRR} = Scaling factor of 1.30

CR_{FX} = capital requirement under FX risk

SF_{FX} = Scaling factor of 1.20

CR_{comm} = capital requirement under commodities risks

SF_{comm} = Scaling factor of 1.90

7.10 Interest Rate Risk

- This section sets out the simplified standard approach for measuring the risk of holding or taking positions in debt securities and other interest rate related instruments in the trading book. The use of the simplified standardized approach to calculate interest rate risk uses the “building-block” approach for specific risk and general risk.
- The capital charges for interest rate related instruments will apply to the current market value of items in a banking institution’s trading book(s).

- a. Interest rate related instruments include all fixed-rate and floating-rate debt securities, interest rate derivatives and instruments that behave like them, including non-convertible preference shares and traded mortgage securities.
 - b. Interest rate derivatives include all derivatives contracts and off-balance-sheet instruments which react to changes in interest rates, e.g. interest rate futures, forward rate agreements (FRAs), interest rate and cross currency swaps, interest rate options, forward foreign exchange positions, and mortgage derivative products.
 - c. Convertible bonds, i.e. debt issues or preference shares that are convertible, at a stated price, into common shares of the issuer, will be treated as debt securities.
- iii) Institutions are required to notify the CBK whenever new instruments are introduced.
- iv) The trading portfolio attracts two types of risk capital charges:
- Specific risk charges, and
 - General risk charges.

(a) Specific interest rate risk

- i) The capital requirement 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) In measuring the risk, offsetting will be restricted to matched positions in the identical issue (including positions in derivatives). Even if the issuer is the same, no offsetting will be permitted between different issues since differences in coupon rates, liquidity, call features, etc mean that prices may diverge in the short run.
- iii) The specific risk capital requirements for “government”, “qualifying” and “other” categories will be as shown in Table 16 below:

Table 16: Specific risk capital requirements for “government” and “other” categories

Categories	External credit assessment	Maturity Period	Specific risk capital requirement
Governments*	AAA to AA-	Any	0%
	A+ to BBB-	6 months or less	0.25%
		6 to 24 months	1.00%
		Over 24 months	1.60%
	BB+ to B-	Any	8.00%
	Below B-	Any	12.00%
	Unrated	Any	8.00%
Qualifying		6 months or less	0.25%
		6 to 24 months	1.00%
		Over 24 months	1.60%
Other	BB+ to BB-	Any	8.00%
	Below BB-	Any	12.00%
	Unrated	Any	8.00%

* Exposures to the Government of Kenya and the Central Bank of Kenya, denominated and funded in Kenya Shillings shall be accorded a specific risk capital requirement of zero percent

The *government category* will include all forms of government paper, including bonds, treasury bills and other short-term instruments.

The *qualifying category* includes securities issued by Public Sector Entities and multilateral development banks, plus other securities subject to CBK that are:

- (1) rated investment grade (IG)⁵ by at least two credit rating agencies specified by the national authority; or
- (2) rated IG by one rating agency and not less than investment grade by any other rating agency specified by the national authority (subject to supervisory oversight); or
- (3) subject to supervisory approval, unrated, but deemed to be of comparable investment quality by the reporting bank, and the issuer has securities listed on a recognized stock exchange.

An "investment grade" corporate is a corporate entity that has adequate capacity to meet its financial commitments in a timely manner and its ability to do so is assessed to be robust against adverse changes in the economic cycle and business conditions.

⁵ For example, IG include rated Baa or higher by Moody's and BBB or higher by Standard and Poor's.

The *Other category* includes non-qualifying corporate debt and any other interest rate-related securities not covered in other securities described above.

(b) General interest rate risk

- i) The capital requirements for general market risk are designed to capture the risk of loss arising from changes in market interest rates. Banks and financial institutions shall apply the maturity method in computing the capital charge for general interest rate risk. In each method, the capital requirement is the sum of four components.
 - (1) the net short or long position in the whole trading book;
 - (2) a small proportion of the matched positions in each time band (the “vertical disallowance”)
 - (3) a larger proportion of the matched positions across different time bands (the “horizontal disallowance”); and
 - (4) a net charge for positions in options
- ii) Separate maturity ladders should be used for each currency and capital requirements should be calculated for each currency separately and then summed with no offsetting between positions of the opposite sign. In the case of those currencies in which business is insignificant, separate maturity ladders for each currency are not required. Rather, the bank may construct a single maturity ladder and slot, within each appropriate time band, the net long or short position for each currency. However, these individual net positions are to be summed within each time band, irrespective of whether they are long or short positions, to produce a gross position figure.
- iii) In the maturity method, long or short positions in debt securities and other sources of interest rate exposures including derivative instruments, are slotted into a maturity ladder comprising 13 time bands (or 15 time bands in the case of low coupon instruments). Fixed rate instruments should be allocated according to the residual term to maturity and floating-rate instruments according to the residual term to the next repricing date. Opposite positions of the same amount in the same issues (but not different issues by the same issuer), whether actual or notional, can be omitted from the interest rate maturity framework, as well as closely matched swaps, forwards, futures and forward rate agreements (FRAs) which meet the conditions set out below.
- iv) The first step in the calculation is to weight the positions in each time band by a factor designed to reflect the price sensitivity of those positions to assumed changes in interest rates. The weights for each time band are set out in the table

below. Zero-coupon bonds and deep discount bonds (defined as bonds with a coupon of less than 8%) should be slotted according to the time bands set out in the Table 17 below:

Table 17: Time Bands

Coupon 3% or more	Coupon less than 3%	Risk Weight
≤ 1 month	≤ 1 month	0.00%
1 - 3 months	1- 3 months	0.20%
3 - 6 months	3 - 6 months	0.40%
6 - 12 months	6 - 12 months	0.70%
1 - 2 years	1.0 - 1.9 years	1.25%
2-3 years	1.9 - 2.8 years	1.75%
3 - 4 years	2.8 - 3.6 years	2.25%
4 - 5 years	3.6- 4.3 years	2.75%
5 - 7 years	4.3 - 5.7 years	3.25%
7 - 10 years	5.7 - 7.3 years	3.75%
10 - 15 years	7.3- 9.3 years	4.50%
15 - 20 years	9.3 - 10.6 years	5.25%
Over 20 years	10.6 - 12 years	6.00%
	12 - 20 years	8.00%
	Over 20 years	12.50%

- v) **Vertical disallowances within same time bands.** The next step in the calculation is to offset the weighted longs and shorts in each time band, resulting in a single short or long position for each band. Since, however, each band would include different instruments and different maturities, a 10% capital requirement to reflect basis risk and gap risk will be levied on the smaller of the offsetting positions, be it long or short.

The **result** of the above calculations is to produce two sets of weighted positions, the net long or short positions in each time band and the vertical disallowances, which have no sign;

- vi) **Horizontal Disallowances:** Banks and financial institutions will be allowed to conduct two rounds of horizontal offsetting:
- first between the net positions in each of three zones; and zero to one year, one year to four years and four years and over)
 - subsequently between the net positions in the three different zones.

The offsetting will be subject to a scale of disallowances expressed as a fraction of the matched positions, as set out in Table 18 below. The weighted long and short positions in each of three zones may be offset, subject to the matched portion attracting a disallowance factor that is part of the capital requirement. The residual net position in each zone may be carried over and offset against opposite positions in other zones, subject to a second set of disallowance factors.

Table 18: Scale of Disallowances

Zone	Time band	Within the zone	Between adjacent Zones	Between zones 1 and 3
Zone 1	0 to 1 month	40%	40%	100%
	1 to 3 months			
	3 to 6 months			
	6 to 12 months			
Zone 2	1 to 2 years	30%	40%	
	2 to 3 years			
	3 to 4 years			
	4 to 5 years			
Zone 3	5 to 7 years	30%	40%	
	7 to 10 years			
	10 to 15 years			
	15 to 20 years			
	Over 20 years			

Interest rate derivatives

The measurement system should include all interest-rate derivatives and off-balance sheet instruments in the trading book which react to changes in interest rates (e.g. FRAs, other forward contracts, bond futures, interest rate and cross-currency swaps and forward foreign exchange positions). The derivatives should be converted into positions in the relevant underlying and become subject to specific and general market risk charges as described above. In order to calculate the standard formula described above, the amounts reported should be the market value of the principal amount of the underlying or of the notional underlying resulting from the prudent valuation guidance set out in Clause 7.6,

Futures and forward contracts (including FRAs) are treated as a combination of a long and a short position in a notional government security. The maturity of a future or an FRA will be the period until delivery or exercise of the contract, plus – where applicable – the life of the underlying instrument.

Swaps will be treated as two notional positions in government securities with relevant maturities. For example, an interest rate swap under which a bank is receiving floating rate interest and paying fixed will be treated as a long position in a floating rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument of maturity equivalent to the residual life of the swap.

Banks may exclude from the interest rate maturity framework altogether (for both specific and general market risk) long and short positions (both actual and notional) in identical instruments with exactly the same issuer, coupon, currency and maturity. A matched position in a future or forward and its corresponding underlying may also be fully offset and thus excluded from the calculation.

Interest rate and currency swaps, FRAs, forward FX contracts and interest rate futures will not be subject to a specific risk charge. This exemption also applies to futures on an interest rate index (e.g. SOFR).

General market risk applies to positions in all derivative products in the same manner as for cash positions, subject only to an exemption for fully or very closely matched positions in identical instruments. The various categories of instruments should be slotted into the maturity ladder and treated according to the rules identified earlier.

For the reporting template and computation of interest rate risk capital charge, refer to FORM D1.

7.11 Foreign Exchange Risk

This section sets out the simplified standardized approach for measuring the risk of holding or taking positions in foreign currencies, including gold. Foreign exchange risk incurs only general market risk. The capital charge requirement for positions held in foreign currencies, including gold, is calculated at 10% of the overall net open position using the 'Shorthand' method. Two processes are needed to calculate the capital requirement for FX risk;

- i) The first is to measure the exposure in a single currency position
- ii) The second is to measure the risks inherent in a bank's mix of long and short positions in different currencies

(a) Measuring the exposure in a single currency

The bank's net open position in each currency should be calculated by summing;

- i) the net spot position (i.e. all asset items less all liability items, including accrued interest, denominated in the currency in question)
- ii) the net forward position (i.e. all amounts to be received less all amounts to be paid under forward FX transactions, including currency futures and the principal on currency swaps not included in the spot position);
- iii) guarantees (and similar instruments) that are certain to be called and are likely to be irrecoverable;
- iv) net future income/expenses not yet accrued but already fully hedged
- v) any other item representing a profit or loss in foreign currencies.
- vi) the net delta-based equivalent of the total book of foreign currency options.

Interest accrued (i.e. earned but not yet received) should be included as a position. Accrued expenses should also be included. Unearned but expected future interest and anticipated expenses may be excluded unless the amounts are certain and banks have taken the opportunity to hedge them. If banks include future income /expenses they should do so on a consistent basis, and not be permitted to select only those expected future flows which reduce their position.

Forward currency and gold positions shall be valued at current spot market exchange rates.

(b) Measuring the foreign exchange risk in a portfolio of foreign currency positions and gold

Banks shall use the shorthand method for measuring the FX risk in a portfolio of foreign currency positions and gold. Under the shorthand method, the nominal amount (or net present value) of the net position in each foreign currency and in gold is converted at spot rates into the Kenya Shillings Currency. 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.

The capital requirement will be 10% of the overall net open position. For the reporting template and computation of foreign exchange risk capital charge, refer to FORM D2.

A bank of which business in foreign currency is insignificant, and which does not take FX positions for its own account is exempted from capital requirements on these positions provided that:

- (1) its foreign currency business, defined as the greater of the sum of its gross long positions and the sum of its gross short positions in all foreign currencies, does not exceed 100% of eligible capital; and
- (2) its overall net open position above does not exceed 2% of its eligible capital.

7.12 Commodities risk

- i) This section sets out the simplified standardised approach for measuring the risk of holding or taking positions in commodities, including precious metals, but excluding gold (which is treated as a foreign currency according to the methodology set out in computation of foreign exchange risk above).
- ii) A commodity is defined as a physical product which is or can be traded on a secondary market, e.g. agricultural products, minerals (including oil) and precious metals.
- iii) The risks associated with commodities include the following risks:
 - a) For spot or physical trading, the directional risk arising from a change in the spot price is the most important risk.
 - b) However, banks using portfolio strategies involving forward and derivative contracts are exposed to a variety of additional risks, which may well be larger than the risk of a change in spot prices. These include:
 - basis risk (the risk that the relationship between the prices of similar commodities alters through time);
 - interest rate risk (the risk of a change in the cost of carry for forward positions and options); and
 - forward gap risk (the risk that the forward price may change for reasons other than a change in interest rates).
 - c) In addition, banks may face counterparty credit risk on over-the-counter derivatives, but this is captured by the methods set out in computation of Credit Risk.
 - d) The funding of commodities positions may well open a bank to interest rate or FX exposure and if that is so the relevant positions should be included in the measures of interest rate and FX risk.
- iv) Banks and financial institutions shall apply the simplified approach in computing the capital charge for commodities risk. Long and short positions in each commodity may be reported on a net basis for the purposes of calculating open positions. However, positions in different commodities will, as a general rule, not be offsetable in this fashion.

- v) In calculating the capital requirements banks will:
 - a) first have to express each commodity position (spot plus forward) in terms of the standard unit of measurement (barrels, kilos, grams etc.).
 - b) The net position in each commodity will then be converted at current spot rates into Kenya Shillings.
- vi) All commodity derivatives and off-balance sheet positions that are affected by changes in commodity prices should be included. The capital requirement will equal 15 percent of the net position, long or short, in each commodity
- vii) In order to protect the bank against basis risk, interest rate risk and forward gap risk under the simplified approach, the capital requirement for each commodity as described above will be subject to an additional capital requirement equivalent to 3 percent of the bank's gross positions, long plus short, in that particular commodity. In valuing the gross positions in commodity derivatives for this purpose, banks should use the current spot price.
- viii) For the reporting template and computation of commodities risk capital charge, refer to FORM D3.

PART VIII: CALCULATION OF RISK WEIGHTED ASSETS FOR OPERATIONAL RISK

8.1 Introduction

- 8.1.1 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 risk and reputational risk. Legal risk⁶ includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.
- 8.1.2 Capital requirement for operational risk shall be calculated according to the Standardized Approach under Basel III. The standardised approach methodology is based on the following components:
 - i) the **Business Indicator (BI)** which is a financial-statement-based proxy for operational risk;
 - ii) the **Business Indicator Component (BIC)**, which is calculated by multiplying the BI by a set of regulatory determined marginal coefficients (α_i); and

⁶ Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

- iii) the **Internal Loss Multiplier (ILM)**, which is a scaling factor that is based on a bank's average historical losses and the BIC.

8.1.3 Operational risk capital requirements (ORC) are calculated by multiplying the BIC and the ILM, as shown in the formula below. Risk-weighted assets (RWA) for operational risk are equal to 12.5 times ORC.

$$ORC = BIC \times ILM$$

8.2 The Business Indicator

A bank shall calculate the BI, which is a financial statement-based proxy for operational risk, as a sum of Interest, Leases & Dividend Component (ILDC), Services Component (SC), and Financial Component (FC), as below:

$$BI = ILDC + SC + FC.$$

8.2.1 Interest, Lease and Dividend Component (ILDC)

ILDC reflects the operational risk associated with interest, leases and dividends, as defined in Table 19. A bank shall calculate the ILDC by the following formula, where the bar above the formula indicates that components are calculated as the average over the last three years: t, t-1 and t-2.

A bank that has been in operation for less than three years may calculate the average values of components based on its available data. The absolute value of the net items such as interest income minus interest expense shall be calculated first year by year. Only after this year-by-year calculation should the average of the three years be calculated. The absolute value of net profit and loss is used instead of the actual value.

$$ILDC = \min\left(\overline{Abs(interest\ income - interest\ expense)}, 2.25\% \times \overline{interest\ earning\ assets}\right) + \overline{dividend\ income}$$

Table 19: ILDC Components

Income statement or balance sheet items	Description	Typical sub-items
Interest income	Interest income from all financial assets and other interest income (includes interest income from financial and operating	Interest income from loans and advances, assets available for sale, assets held to maturity, trading assets, financial leases and operational leases

Income statement or balance sheet items	Description	Typical sub-items
	leases and profits from leased assets)	• Interest income from hedge accounting derivatives • Other interest income • Profits from leased assets
Interest expenses	Interest expenses from all financial liabilities and other interest expenses (includes interest expense from financial and operating leases, depreciation and impairment of, and losses from, operating leased assets)	• Interest expenses from deposits, debt securities issued, financial leases, and operating leases • Interest expenses from hedge accounting derivatives • Other interest expenses • Losses from leased assets • Depreciation and impairment of operating leased assets
Interest earning assets (balance sheet item)	Total gross outstanding loans, advances, interest bearing securities (including government bonds), and lease assets measured at the end of each financial year.	
Dividend income	Dividend income from investments in stocks and funds not consolidated in the bank's financial statements, including dividend income from non-consolidated subsidiaries, associates and joint ventures.	

8.2.2 Service Component (SC)

SC captures the operational risk arising from a bank's service activities, as defined in Table 20, and shall be calculated based on the following formula, where the bar above the formula indicates that components are calculated as the average over the last three years: t, t-1 and t-2.

A bank that has been in operation for less than three years may calculate the average values of components based on its available data.

$$SC = \max(\overline{\text{other operating income}}, \overline{\text{other operating expense}}) + \max(\overline{\text{fee income}}, \overline{\text{fee expense}})$$

Table 20: SC Components

Income statement or balance sheet items	Description	Typical sub-items
Fee and commission income	Income received from providing advice and services. Includes income received by the bank as an outsourcer of finance services.	Fee and commission income from: • Securities (issuance, origination, reception, transmission, execution of orders on behalf of customers) • Clearing and settlement; Asset management; Custody; Fiduciary transactions; Payment services; Structured finance; Servicing of securitisations; Loan commitments and guarantees given; and foreign transactions
Fee and commission expenses	Expenses paid for receiving advice and services. Includes outsourcing fees paid by the bank for the supply of financial services, but not outsourcing fees paid for the supply of nonfinancial services (e.g. logistical, IT, human resources)	• Fee and commission expenses from: Clearing and settlement; Custody; Servicing of securitisations; Loan commitments and guarantees received; and foreign transactions
Other operating income	Expenses and losses from ordinary banking operations not included in other BI items but of similar nature and from operational loss events (expenses from operating leases should be excluded)	• Rental income from investment properties • Gains from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations (IFRS 5.37)
Other operating expenses	Expenses and losses from ordinary banking operations not included in other BI items but of similar nature and from operational loss events (expenses from operating leases should be excluded)	• Losses from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations (IFRS 5.37) • Losses incurred as a consequence of operational loss events (e.g. fines, penalties, settlements, replacement cost of damaged assets), which have not been provisioned/reserved for in previous years

Income statement or balance sheet items	Description	Typical sub-items
		• Expenses related to establishing provisions/reserves for operational loss events

8.2.3 Financial Component (FC)

Financial Component captures the operational risk associated with the bank's trading book and banking book, as defined in Table 21, and shall be calculated based on the following equation, where the bar above the formula indicates that components are calculated as the average over the last three years: t, t-1 and t-2 and the absolute value of net profit and loss is used instead of the actual value.

A bank that has been in operation for less than three years may calculate the average values of components based on its available data.

$$FC = \overline{Abs(Net\ P\ \&\ L_{trading\ book})} + \overline{Abs(Net\ P\ \&\ L_{banking\ book})}$$

Table 21: FC Components

Income statement or balance sheet items	Description	Typical sub-items
Net profit (loss) on the trading book	• Net profit/loss on trading assets and trading liabilities (derivatives, debt securities, equity securities, loans and advances, short positions, other assets and liabilities) • Net profit/loss from hedge accounting • Net profit/loss from exchange differences	
Net profit (loss) on the banking book	• Net profit/loss on financial assets and liabilities measured at fair value through profit and loss • Realised gains/losses on financial assets and liabilities not measured at fair value through profit and loss (loans and advances, assets available for sale, assets held to maturity, financial liabilities measured at amortised cost) • Net profit/loss from hedge accounting • Net profit/loss from exchange differences	

8.2.4 The following profit and loss items do not contribute to any of the items of the BI:

- i) Income and expenses from insurance or reinsurance businesses.
- ii) Premiums paid and reimbursements/payments received from insurance or reinsurance policies purchased.
- iii) Administrative expenses, including staff expenses, outsourcing fees paid for the supply of non-financial services (e.g. logistical, human resources, information technology – IT), and other administrative expenses (e.g. IT, utilities, telephone, travel, office supplies, postage).
- iv) Recovery of administrative expenses including recovery of payments on behalf of customers (e.g. taxes debited to customers).
- v) Expenses of premises and fixed assets (except when these expenses result from operational loss events).
- vi) Depreciation/amortisation of tangible and intangible assets (except depreciation related to operating lease assets, which should be included in financial and operating lease expenses).
- vii) Provisions/reversal of provisions (e.g. on pensions, commitments and guarantees given) except for provisions related to operational loss events.
- viii) Expenses due to share capital repayable on demand.
- ix) Impairment/reversal of impairment (e.g. on financial assets, non-financial assets, investments in subsidiaries, joint ventures and associates).
- x) Changes in goodwill recognised in profit or loss.
- xi) Corporate income tax (tax based on profits including current tax and deferred).

8.3 The Business Indicator Component

To calculate the BIC, the BI is multiplied by the marginal coefficients (α_i). The marginal coefficients increase with the size of the BI as shown in Table 22. For banks in the first bucket (i.e. with a BI less than or equal to Ksh.3bn) the BIC is equal to BI x 12%. The marginal increase in the BIC resulting from a one unit increase in the BI is 12% in bucket 1, 15% in bucket 2 and 18% in bucket 3.

Illustration: If BI = Ksh.20 billion, the BIC = (3 billion x 12%) + (10 billion - 3 billion) x 15% + (20 billion-10 billion) x 18% = Ksh.3.21 billion.

Table 22: BI ranges and marginal coefficients

Bucket	BI range (in Ksh. billion)	BI marginal coefficients (c)
1	≤ 3	12%
2	$3 < BI \leq 10$	15%
3	> 10	18%

8.4 Internal Loss Multiplier

- 8.4.1 The ILM is a risk-sensitive component that captures a bank's internal operational losses. While the BIC is effectively the baseline operational risk capital requirement, the ILM serves as a scaling factor that adjusts the baseline capital depending on the operational loss experience of the bank.
- 8.4.2 A bank's internal operational risk loss experience affects the calculation of operational risk capital through the ILM. The ILM is defined as below, where the Loss Component (*LC*) is equal to 15 times average annual operational risk losses incurred over the previous 10 years:

$$ILM = \ln \left(\exp(1) - 1 + \left(\frac{LC}{BIC} \right)^{0.8} \right)$$

- 8.4.3 The ILM is equal to one where the loss and business indicator components are equal. Where the LC is greater than the BIC, the ILM is greater than one. That is, a bank with losses that are high relative to its BIC is required to hold higher capital due to the incorporation of internal losses into the calculation methodology. Conversely, where the LC is lower than the BIC, the ILM is less than one. That is, a bank with losses that are low relative to its BIC is required to hold lower capital due to the incorporation of internal losses into the calculation methodology.
- 8.4.4 The Standard indicates that at national discretion, supervisors may set the value of ILM equal to 1 for all banks in their jurisdiction. That is, to set the operational risk requirement equal to the BIC for all banks and financial institutions. In this regard, the Central Bank of Kenya has exercised this discretion and accordingly the capital charge for operational risk would be a function of the BIC Component only. Nevertheless, banks and financial institutions shall collect and report historical loss data emanating from the operational risk events.
- 8.4.5 Capital charge for operational risk shall be calculated by multiplying the BI by 12.5 percent.

8.5 Operational Loss Data Identification, Collection and Treatment

- 8.5.1 A bank shall report annual loss data in the ILM calculation to the Central Bank of Kenya. Moreover, loss data is required to be reported on both a gross basis and after recoveries and loss exclusions, on a quarterly basis.

8.5.2 Internal loss data are most relevant when clearly linked to a bank's current business activities, technological processes and risk management procedures. Therefore, a bank shall have documented procedures and processes for the identification, collection and treatment of internal loss data. Such procedures and processes shall be subject to validation before the use of the loss data within the operational risk capital requirement measurement methodology, and to regular independent reviews by internal and/or external audit functions.

8.5.3 For risk management purposes, and to assist in supervisory validation and/or review, the Central Bank of Kenya may request a bank to map its historical internal loss data into the relevant loss event-type categories as defined in Table 23 and to provide this data to Central Bank of Kenya upon request. The bank shall document criteria for allocating losses to the specified event types.

Table 23: Detailed Loss Event Type Classification

Event-type category (Level 1)	Definition	Categories (Level 2)	Activity examples (Level 3)
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party.	Unauthorised activity	• Transactions not reported (intentional) • Transaction type unauthorised (with monetary loss) • Mismarking of position (intentional)
		Theft and fraud	• Fraud / credit fraud / worthless deposits • Theft / extortion / embezzlement / robbery • Misappropriation of assets • Malicious destruction of assets • Forgery • Check kiting • Smuggling • Account takeover / impersonation etc. • Tax non-compliance / evasion (willful) • Bribes / kickbacks • Insider trading (not on firm's account)
External fraud		Theft and fraud	• Theft / robbery

Event-type category (Level 1)	Definition	Categories (Level 2)	Activity examples (Level 3)
	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party		• Forgery • Check kiting
		Systems security	• Hacking damage • Theft of information (with monetary loss)
Employment practices and workplace safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity / discrimination events	Employee relations	• Compensation, benefit, termination issues • Organised labour activity
		Safe environment	• General liability (slip and fall etc.) • Employee health and safety rules events • Workers compensation
		Diversity and discrimination	• All discrimination types
Clients, products and business practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.	Suitability, disclosure and fiduciary	• Fiduciary breaches / guideline violations • Suitability / disclosure issues (know-your-customer etc.) • Retail customer disclosure violations • Breach of privacy • Aggressive sales • Account churning • Misuse of confidential information • Lender liability
		Improper business or market practices	• Antitrust • Improper trade / market practices • Market manipulation

Event-type category (Level 1)	Definition	Categories (Level 2)	Activity examples (Level 3)
			• Insider trading (on firm's account) • Unlicensed activity • Money laundering
		Product flaws	• Product defects (unauthorised etc.) • Model errors
		Selection, sponsorship and exposure	• Failure to investigate client per guidelines • Exceeding client exposure limits
		Advisory activities	• Disputes over performance of advisory activities
Damage to physical assets	Losses arising from loss or damage to physical assets from natural disaster or other events	Disasters and other events	• Natural disaster losses • Human losses from external sources (terrorism, vandalism)
Business disruption and system failures	Losses arising from disruption of business or system failures	Systems	• Hardware • Software • Telecommunications • Utility outage / disruptions
Execution, delivery and process management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors	Transaction capture, execution and maintenance	Miscommunication
			• Data entry, maintenance or loading error • Missed deadline or responsibility • Model / system misoperation • Accounting error / entity attribution error • Other task misperformance • Delivery failure • Collateral management failure • Reference data maintenance
		Monitoring and reporting	• Failed mandatory reporting obligation

Event-type category (Level 1)	Definition	Categories (Level 2)	Activity examples (Level 3)
			• Inaccurate external report (loss incurred)
		Customer intake and documentation	• Client permissions / disclaimers missing • Legal documents missing / incomplete
		Customer / client account management	• Unapproved access given to accounts • Incorrect client records (loss incurred) • Negligent loss or damage of client assets
		Trade counterparties	• Non-client counterparty misperformance • Miscellaneous non-client counterparty disputes
		Vendors and suppliers	• Outsourcing • Vendor disputes

8.5.4 A bank's internal loss data shall be comprehensive and capture all material activities and exposures from all appropriate sub-systems and geographic locations. The minimum threshold for including a loss event in the data collection for the purpose of calculation of average annual losses shall be Ksh.100,000.

8.5.5 Aside from information on gross loss amounts, the bank shall collect information about the reference dates of operational risk events, including the date when the event happened or first began ("date of occurrence"), where available; the date on which the bank became aware of the event ("date of discovery"); and the date (or dates) when a loss event results in a loss, reserve or provision against a loss being recognized in the bank's profit and loss accounts ("date of accounting"). In addition, the bank shall collect information on recoveries of gross loss amounts as well as descriptive information about the drivers or causes of the loss event. The level of detail of any descriptive information shall be commensurate with the size of the gross loss amount.

8.5.6 Operational loss events related to credit risk and that are accounted for in credit risk RWA shall not be included in the loss data set. Operational loss events that

relate to credit risk, but are not accounted for in credit risk RWA shall be included in the loss data set.

8.5.7 Operational risk losses related to market risk are treated as operational risk for the purposes of calculating minimum regulatory capital under this framework and will therefore be subject to the standardised approach for operational risk.

8.5.8 A bank shall have processes to independently review the comprehensiveness and accuracy of loss data.

8.5.9 A bank shall also apply the following specific criteria on loss data identification, collection and treatment:

8.5.9.1 Building an acceptable loss data set from the available internal data requires that the bank develop policies and procedures to address several features, including gross loss definition, reference date and grouped losses.

8.5.9.2 Gross loss is a loss before recoveries of any type. Net loss is defined as the loss after taking into account the impact of recoveries. The recovery is an independent occurrence, related to the original loss event, separate in time, in which funds or inflows of economic benefits are received from a third party.

8.5.9.3 A bank shall identify the gross loss amounts, non-insurance recoveries, and insurance recoveries for all operational loss events. A bank shall use losses net of recoveries, including insurance recoveries, in the loss dataset. However, recoveries can be used to reduce losses only after the bank receives payment. Receivables do not count as recoveries. Verification of payments received to net losses shall be provided to the Central Bank of Kenya upon request.

8.5.9.4 The following items shall be included in the gross loss computation of the loss data set:

- a. Direct charges, including impairments and settlements, to the bank's profit and loss accounts and write-downs due to the operational risk event;
- b. Costs incurred as a consequence of the event including external expenses with a direct link to the operational risk event, such as legal expenses directly related to the event and fees paid to advisors, attorneys or suppliers, and costs of repair or replacement, incurred to

restore the position that was prevailing before the operational risk event;

- c. Provisions or reserves accounted for in the profit and loss against the potential operational loss impact;
- d. Losses stemming from operational risk events with a definitive financial impact, which are temporarily booked in transitory and/or suspense accounts and are not yet reflected in the profit and loss (“pending losses”); and
- e. Negative economic impacts booked in a financial accounting period, due to operational risk events impacting the cash flows or financial statements of previous financial accounting periods (timing losses”). Material “timing losses” shall be included in the loss data set when they are due to operational risk events that span more than one (1) financial accounting period and give rise to legal risk.

8.5.9.5 The following items shall be excluded from the gross loss computation of the loss data set:

- a. costs of general maintenance contracts on property, plant or equipment;
- b. internal or external expenditures to enhance the business after the operational risk losses: upgrades, improvements, risk assessment initiatives and enhancements; and
- c. insurance premiums.

8.5.9.6 A bank shall use the date of accounting for building the loss data set. The bank shall use a date no later than the date of accounting for including losses related to legal events in the loss data set. For legal loss events, the date of accounting is the date when a legal reserve is established for the probable estimated loss in the profit and loss.

8.5.9.7 Losses caused by a common operational risk event or by related operational risk events over time, but posted to the accounts over several years, shall be allocated to the corresponding years of the loss database, in line with their accounting treatment.

PART IX: LEVERAGE RATIO

9.1 Purpose - The Leverage Ratio is a simple, transparent, non-risk-based measure that is calibrated to act as a credible supplementary measure to the risk-based capital requirements. the leverage ratio is intended to achieve the following objectives:

- constrain the build-up of leverage in the banking sector, helping avoid destabilizing deleveraging processes which can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk based “backstop” measure.

9.2 Scope of Application - The Leverage Ratio framework follows the same scope of regulatory consolidation, including consolidation criteria, as is used for the risk-based capital framework. where a banking, financial, insurance or commercial entity is outside the scope of regulatory consolidation, only the investment in the capital of such entities is to be included in the leverage ratio exposure measure. however, investments in the capital of such entities that are deducted from tier 1 capital may be excluded from the leverage ratio exposure measure.

9.3 Calculation

9.3.1 The leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage:

$$\text{Leverage ratio} = \frac{\text{Capital measure}}{\text{Exposure measure}}$$

9.3.2 The capital measure for the leverage- - ratio is core capital (Tier 1 capital) measure’ applicable at that time under the risk-based framework. The exposure measure for the leverage ratio is defined in the next section.

9.3.3 Banks must meet a 4 percent leverage ratio minimum requirement at all times.

9.4 Exposure Measure

9.4.1 A bank's total leverage ratio exposure measure is the sum of the following exposures:

- On-balance sheet exposures (excluding on-balance sheet derivative and SFTs exposures);
- derivative exposures;
- Securities financing transaction exposures; and
- Off-balance sheet items.

9.4.2 The leverage ratio exposure measure generally follows gross accounting values.

- 9.4.3 Unless specified differently below, banks must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the leverage ratio exposure measure, nor may banks net assets and liabilities.
- 9.4.4 To ensure consistency, any item deducted from Tier 1 capital according to the Basel framework and regulatory adjustments other than those related to liabilities may be deducted from the leverage ratio exposure measure. For example, where a banking, financial or insurance entity is not included in the regulatory scope of consolidation, the amount of any investment in the capital of that entity that is totally or partially deducted from Tier 1 capital of the bank may also be deducted from the leverage ratio exposure measure.
- 9.4.5 Liability items must not be deducted from the leverage ratio exposure measure. For example, gains/losses on fair valued liabilities or accounting value adjustments must not be deducted from the leverage ratio exposure measure.

I. On-Balance Sheet Exposures

- 9.4.6 Banks must include all balance sheet assets in their leverage ratio exposure measure, including on-balance sheet derivatives collateral and collateral for SFTs, with the exception of on-balance sheet derivative and SFT assets that are covered under section II. Derivatives exposures.
- 9.4.7 On-balance sheet, non-derivative assets are included in the leverage ratio exposure measure at their accounting values less deductions for associated specific provisions. In addition, general provisions or general loan-loss reserves which have reduced Tier 1 capital may be deducted from the leverage ratio exposure measure.

II. Derivative Exposures

- 9.4.8 For the purpose of the leverage ratio exposure measure, exposures to derivatives are included by means of two components:
- a. replacement cost (RC); and
 - b. potential future exposure (PFE).
- 9.4.9 Banks must calculate their exposures associated with all derivative transactions as a scalar multiplier alpha set at 1.4 times the sum of the RC and the PFE⁷. If the

⁷ Or “PFE Add-on” as renamed under the Basel III SA-CCR standard.

derivative exposure is covered by an eligible bilateral netting contract, a specific treatment may be applied.

- 9.4.10 The amount to be included in the leverage ratio exposure measure is calculated according to:

$$\text{Exposure measure} = 1.4 \cdot (RC + PFE)$$

- 9.4.11 For derivative transactions not covered by an eligible bilateral netting contract, the amount to be included in the leverage ratio exposure measure is determined, for each transaction separately. When an eligible bilateral netting contract is in place, the formula below is applied at the netting set level.

- 9.4.12 When calculating the exposure amount, a bank must not reduce the leverage ratio exposure measure amount by any collateral received from the counterparty. Similarly, with regard to collateral provided, banks must gross up their leverage ratio exposure measure by the amount of any derivatives collateral provided where the provision of that collateral has reduced the value of their balance sheet assets under their operative accounting framework.

- 9.4.13 Where a bank acting as clearing member (CM) offers clearing services to clients, the CM's trade exposures to the CCP that arise when the CM is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults must be captured by applying the same treatment that applies to any other type of derivative transaction. However, if the CM, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered in the event that a QCCP defaults, the CM need not recognize the resulting trade exposures to the QCCP in the leverage ratio exposure measure.

- 9.4.14 For derivative exposures associated with the bank's offering of client clearing services, the RC and the PFE of the exposure to the client may be calculated according to the rules set out in the Capital Adequacy prudential Guidelines for CCR.

- 9.4.15 Where a client enters directly into a derivative transaction with the CCP and the CM guarantees the performance of its client's derivative trade exposures to the CCP, the bank acting as the CM for the client to the CCP must calculate its related leverage ratio exposure resulting from the guarantee as a derivative exposure, as if it had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin.

9.4.16 For the purposes of 9.4.12 and 9.4.14, an entity affiliated to the bank acting as a CM may be considered a client if it is outside the relevant scope of regulatory consolidation at the level at which the leverage ratio is applied. In contrast, if an affiliate entity falls within the regulatory scope of consolidation, the trade between the affiliate entity and the CM is eliminated in the course of consolidation but the CM still has a trade exposure to the CCP. In this case, the transaction with the CCP will be considered proprietary and the exemption in 4.12 will not apply.

9.4.17 In the treatment of derivative exposures for the purpose of the leverage ratio exposure measure, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment if the following conditions are met:

- a. For trades not cleared through a Qualifying Central Counterparty (QCCP) the cash received by the recipient counterparty is not segregated.
- b. Variation margin is calculated and exchanged on at least a daily basis based on mark-to-market valuation of derivative positions.
- c. The variation margin is received in a currency specified in the derivative contract, governing master netting agreement (MNA), credit support annex to the qualifying MNA or as defined by any netting agreement with a CCP.
- d. Variation margin exchanged is the full amount that would be necessary to extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty.
- e. Derivative transactions and variation margins are covered by a single MNA between the legal entities that are the counterparties in the derivative transaction.

9.4.18 If the conditions in 9.4.16 are met, the cash portion of variation margin received may be used to reduce the replacement cost portion of the leverage ratio exposure measure, and the receivables assets from cash variation margin provided may be deducted from the leverage ratio exposure measure.

9.4.19 Banks won't be allowed to use credit derivatives without prior authorization of the CBK.

III. Securities Financing Transaction Exposures

9.4.20 Security Financing Transactions (SFTs) are an important source of leverage and therefore should be included in the exposure measure SFTs are included in the leverage ratio exposure measure according to the treatment described below.

9.4.21 For a bank acting as principal the sum of the amounts in (1) and (2) is to be included in the leverage ratio exposure measure:

(1) Gross SFT assets recognized for accounting purposes⁸, adjusted as follows:

- a. excluding from the leverage ratio exposure measure the value of any securities received under an SFT, where the bank has recognized the securities as an asset on its balance sheet;
- b. cash payables and cash receivables in SFTs with the same counterparty may be measured net if all the following criteria are met:
 - i. Transactions have the same explicit final settlement date;
 - ii. The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of the counterparty's default, insolvency, or bankruptcy; and
 - iii. The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement, that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date.

(2) A measure of CCR calculated as the current exposure without an add-on for PFE calculated as follows. For the purposes of this subparagraph, the term "counterparty" includes not only the counterparty of the bilateral repo transactions but also triparty repo agents that receive collateral in deposit and manage the collateral in the case of triparty repo transactions. Therefore, securities deposited at triparty repo agents are included in "total value of securities and cash lent to a counterparty" (E) up to the amount effectively lent to the counterparty in a repo transaction. However, excess collateral that has been deposited at triparty agents but that has not been lent out may be excluded.

- a. Where a qualifying MNA⁹ is in place, the current exposure (E*) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ($\sum E_i$), less the total fair value of cash and securities received from the counterparty for those transactions ($\sum C_i$). This is illustrated in the following formula: $E^* = \max(0, \sum E_i - \sum C_i)$.

⁸ Gross SFT assets recognized for accounting purposes must not recognize any accounting netting of cash payables against cash receivables (e.g. as currently permitted under the IFRS).

⁹ A qualifying MNA is the one that meets the requirements under 4.21 and 4.22.

- b. Where no qualifying MNA is in place, the current exposure for transactions with a counterparty must be calculated on a transaction-by-transaction basis - that is, each transaction i is treated as its own netting set, as shown in the following formula: $E^* = \max(0, (E_i - C_i))$.
- c. E_i^* may be set to zero if:
 - i. E_i is the cash lent to a counterparty;
 - ii. this transaction is treated as its own netting set; and
 - iii. the associated cash receivable is not eligible for the netting treatment in (1).

9.4.22 The effects of bilateral netting agreements for covering SFTs should be recognized on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

- a) provide the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;
- b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;
- c) allow for the prompt liquidation or setoff of collateral upon the event of default; and
- d) be, together with the rights arising from provisions required in (1) and (3) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default regardless of the counterparty's insolvency or bankruptcy.

9.4.23 Netting across SFT positions held in the banking book and trading book shall only be recognized when the netted transactions fulfil the following conditions:

- a. all transactions are marked to market daily; and
- b. the collateral instruments used in the transactions are recognized as eligible financial collateral in the banking book.

9.4.24 Where a bank acting as agent in an SFT provides an indemnity or guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided, then the bank will be required to calculate its exposure measure by applying only a

measure of CCR calculated as the current exposure without an add-on for PFE. Where a bank acting as an agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the bank is not exposed to the SFT and therefore need not recognize those SFTs in its exposure measure.

IV. Off-Balance-Sheet Exposures

- 9.4.25 Off -Balance Sheet (OBS) items include commitments (including liquidity facilities), whether or not unconditionally cancellable, direct credit substitutes, acceptances, standby letters of credit and trade letters of credit.
- 9.4.26 For the purposes of the leverage ratio, OBS items will be converted into credit exposures by multiplying the committed but undrawn amount by a CCF set out in the prudential guidelines (Capital Adequacy section 4.3.1.3). Commitment means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes. It includes any such arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor. It also includes any such arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility document, including conditions that must be met by the obligor prior to any initial or subsequent drawdown arrangement.
- 9.4.27 Specific and general provisions set aside against OBS exposures that have decreased Tier 1 capital may be deducted from the credit exposure equivalent amount of those exposures (i.e. the exposure amount after the application of the relevant CCF). However, the resulting total off-balance-sheet equivalent amount for OBS exposures cannot be less than zero.

PART X: PILLAR II SPECIFIC CAPITAL REQUIREMENTS

10.1 Minimum Capital Requirements

Capital requirements for a specific institution may increase or decrease depending upon its risk profile. An institution's minimum capital requirement (MCR) will be calculated by dividing its Tier 1, Additional Tier 1 and Total Capital by the sum of the value of its Risk-Weighted Assets for Credit Risk, Market Risk and Operational Risk, to arrive at the minimum Tier One, Additional Tier 1 and Total capital adequacy ratios respectively.

10.2 Minimum Ratios

Unless a higher minimum ratio has been set by the Central Bank of Kenya for an individual institution based on criteria set under Section 10.3 below, every institution shall, at all times, maintain:

- a) CET1 ratio, Tier 1 capital ratio and Total capital (Tier 1 Capital plus Tier 2 Capital) ratio as prescribed in clause 5.1 of this Guideline.
- b) A CET capital of not less than eight per cent of its total deposit liabilities;
- c) A minimum leverage ratio of 4 percent minimum requirement at all times.

10.3 Criteria for Higher Minimum Capital Ratios

The Central Bank may require higher minimum capital ratios for an individual institution based on, but not limited to any one or more of the following criteria:

- a) The ICAAP report submitted by the bank;
- b) The institution has incurred or is expected to incur losses resulting in a capital deficiency;
- c) The institution has significant exposure to risk, whether credit, concentrations of credit, market, interest rate, liquidity, operational, or from other non-traditional activities;
- d) The institution has a high or particularly severe volume of poor quality assets;
- e) The institution is growing rapidly either internally or through acquisitions;
- f) The institution is adversely affected by the activities or condition of its holding company, associates or subsidiaries; or
- g) The institution has deficiencies in ownership or management (i.e. shareholding structure; composition or qualifications of directors or senior officers; risk management policies and procedures).
- h) The institution has been designated as a Domestic Systemically Important Bank (D-SIB) or otherwise poses heightened systemic risk.
- i) Whether the institution has established an appropriate control environment, and/or its risk management framework is not considered commensurate with the size, complexity, or sophistication of the institution.

10.4 Internal Capital Assessment Adequacy Planning (ICAAP)

ICAAP is a system of sound, effective and complete strategies and processes that allow institutions to assess and maintain, on an ongoing basis, the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of risks to which they are or might be exposed.

Institutions are required to ensure that they at all times plan their capital ahead for a minimum of three years and ideally for five years, and to establish and maintain on an ongoing basis an adequate level of capital, which would include an appropriate buffer (Countercyclical Buffer, and any D-SIB surcharge), as determined by the board, above the regulatory required minimum capital. This requires institutions to have in place appropriate and proportionate capital management strategy.

A sound capital assessment process should include the following elements:

- (i) A clear and documented process for evaluating risks and determining whether or not a risk should result in an explicit amount of capital being held.
- (ii) Policies and procedures designed to ensure that the institution identifies, measures and reports all material risks requiring capital.
- (iii) A process that relates capital to current and anticipated future levels of risk in accordance with board approved risk tolerance.
- (iv) A process that states capital adequacy goals with respect to risk, taking account of the institution's strategic focus and business plan.
- (v) A process of internal controls reviews and audits to ensure the integrity of the overall risk management process.

Comprehensive assessment of risks

The ICAAP should address all material risks faced by the institution as they relate to the adequacy of capital, including all risks explicitly captured in minimum regulatory capital requirements as well as risks that are not fully captured under minimum regulatory capital requirements. The techniques used in assessing material risks should be commensurate with the scope and complexity of the institution's risk taking activities.

Stress testing

An institution's capital planning process should incorporate rigorous, forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact the institutions. In their ICAAPs, institutions should examine future capital resources and capital requirements under adverse scenarios. The results of forward-looking stress testing should be considered when evaluating the adequacy of an institution's capital.

For further guidance on stress testing expectations, institutions should refer to Guideline on Stress Testing (CBK/PG/20).

Monitoring and reporting

The institution should establish an adequate system for monitoring and reporting risk exposures and assessing how changes to the institutions risk profile affects the need for capital. The institution's senior management and board of directors should receive regular reports on the institution's risk profile and capital needs.

Internal control review

The institution should conduct periodic reviews of its risk management process to ensure its integrity, accuracy, and reasonableness. Effective control of the capital assessment process includes an independent review and, where appropriate, the involvement of internal and external audits.

PART XI: REPORTING REQUIREMENTS

Each institution shall submit to Central Bank of Kenya the return on Capital to Risk Weighted Assets, Form CBK/PR3, at the end of every month, to be received by the 5th day of the following month in which the return relates. The Central Bank may require such other information as is necessary to evaluate compliance with this guideline and may call for adjustments to capital where necessary.

- i) Banks are required to report internal loss data on a quarterly basis, to be received by the 5th day of the following month after the quarter which the return relates.
- ii) Banks are required, at a minimum, to report both the capital measure and the exposure measure on a quarterly basis. They should also be able to calculate and report the leverage ratio on a quarterly basis, 30 days after the end of the quarter for internal monitoring purposes to ensure ongoing compliance with internal limits.
- iii) Banks are required to provide an explanation for the key drivers of material changes in their Basel III leverage ratio observed from the end of the previous reporting period to the end of the current reporting period.
- iv) On an annual basis, banks shall, not later than 30th April, submit to the CBK their ICAAP report as at 31st December of the previous year.

PART XII: REMEDIAL MEASURES

12.1 Remedial measures – Central Bank may pursue any or all remedial actions as provided under Sections 33, 34 and 55 of the Banking Act and the Prompt Corrective Action Guideline (CBK/PG/21).

12.2 Administrative sanctions - In addition to the use of corrective actions noted in 5.1 above, the Central Bank may pursue any or all of the following administrative sanctions against an institution, its board of directors, or its officers:

- i) Prohibition from declaring or paying dividends;
- ii) Prohibition from establishing new branches;
- iii) Prohibition from engaging in new activities or from expanding existing activities;
- iv) Suspension of lending, investment, and credit extension operations;
- v) Prohibition from acquiring, through purchase or lease, additional fixed assets;
- vi) Prohibition from accepting further deposits or other lines of credit;
- vii) Prohibition from declaring or paying bonuses, salary incentives, severance packages, management fees or other discretionary compensation to directors or officers.

PART XIII: EFFECTIVE DATE

13.1 Effective date - The effective date of this Guideline shall be 1st January 2027.

13.2 Transition Provision - The transition date for this Guideline will be determined by the outcome of the Quantitative Impact Assessment, which will be conducted by the Central Bank.

13.3 Supersedence - This guideline supercedes the Guideline on Capital Adequacy (CBK/PG/03) issued on 1st January 2013.

ENQUIRIES - Any enquiries on this Guideline should be forwarded to:

Director, Bank Supervision Department

Central Bank of Kenya

P. O. Box 60000 - 00200

NAIROBI

TEL..2860000 e-mail: fin@centralbank.go.ke

APPENDIX 1

Recognition of External Credit Assessment Institutions (ECAIs)

- (1) The Central Bank of Kenya may recognise an ECAI if it is satisfied that the ECAI meets the recognition criteria set out in paragraphs (5) (i) to (viii), including for short-term external credit assessments.
- (2) The recognition of an ECAI by the Central Bank is for the sole purpose of calculating regulatory capital requirements by a Reporting Bank or Institutions pursuant to this Guideline, and must not be taken as regulation of the ECAI or licensing or approval of the ECAI to do business in Kenya.
- (3) ECAIs shall be as specified by the Central Bank of Kenya from time to time.
- (4) The Central Bank may revoke its recognition of an ECAI if the ECAI no longer meets the criteria set out in paragraphs (5) (i) to (viii).

Recognition Criteria

- (5) CBK will determine on a continuous basis whether an ECAI meets its eligibility criteria as specified below:
 - (i) **Objectivity:** The methodology for assigning external ratings must be rigorous, systematic, and subject to some form of validation based on historical experience. Moreover, external ratings must be subject to ongoing review and responsive to changes in financial condition. Before being recognised by supervisors, a rating methodology for each market segment, including rigorous backtesting, must have been established for at least one year and preferably three years.
 - (ii) **Independence:** An ECAI should be independent and should not be subject to political or economic pressures that may influence the rating. In particular, an ECAI should not delay or refrain from taking a rating action based on its potential effect (economic, political or otherwise). The rating process should be as free as possible from any constraints that could arise in situations where the composition of the board of directors or the shareholder structure of the credit rating agency may be seen as creating a conflict of interest.

Furthermore, an ECAI should separate operationally, legally and, if practicable, physically its rating business from other businesses and analysts.

- (iii) International access/transparency: The individual ratings, the key elements underlining the ratings assessments and whether the issuer participated in the rating process should be publicly available on a non-selective basis, unless they are private ratings, which should be at least available to both domestic and foreign institutions with legitimate interest and on equivalent terms. In addition, the ECAI's general procedures, methodologies and assumptions for arriving at ratings should be publicly available.
- (iv) Disclosure: An ECAI should disclose the following information: its code of conduct; the general nature of its compensation arrangements with assessed entities; any conflict of interest, the ECAI's compensation arrangements, its rating assessment methodologies, including the definition of default, the time horizon, and the meaning of each rating; the actual default rates experienced in each assessment category; and the transitions of the ratings, e.g. the likelihood of AA ratings becoming A over time.

A rating should be disclosed as soon as practicably possible after issuance. When disclosing a rating, the information should be provided in plain language, indicating the nature and limitation of credit ratings and the risk of unduly relying on them to make investments.

- (v) Resources: An ECAI should have sufficient resources to carry out high-quality credit assessments. These resources should allow for substantial ongoing contact with senior and operational levels within the entities assessed in order to add value to the credit assessments.

In particular, ECAIs should assign analysts with appropriate knowledge and experience to assess the creditworthiness of the type of entity or obligation being rated. Such assessments should be based on methodologies combining qualitative and quantitative approaches.

- (vi) Credibility: To some extent, credibility is derived from the criteria above. In addition, the reliance on an ECAI's external ratings by independent parties (investors, insurers, trading partners) is evidence of the credibility of the ratings of an ECAI. The credibility of an ECAI is also underpinned by the existence of internal procedures to prevent the misuse of confidential information. In order to be eligible for recognition, an ECAI does not have to assess firms in more than one country.
- (vii) No abuse of unsolicited ratings: ECAIs must not use unsolicited ratings to put pressure on entities to obtain solicited ratings. CBK shall consider whether to continue recognising such ECAIs as eligible for capital adequacy purposes, if such behaviour is identified.

- (viii) Cooperation with CBK. ECAIs should notify the Central Bank of significant changes to methodologies and provide access to external ratings and other relevant data in order to support initial and continued determination of eligibility.
- (6) Regarding the disclosure of conflicts of interest referenced in (5) (ii) above, at a minimum, the following situations and their influence on the ECAI's credit rating methodologies or credit rating actions shall be disclosed:
- (i) The ECAI is being paid to issue a credit rating by the rated entity or by the obligor, originator, underwriter, or arranger of the rated obligation;
 - (ii) The ECAI is being paid by subscribers with a financial interest that could be affected by a credit rating action of the ECAI;
 - (iii) The ECAI is being paid by rated entities, obligors, originators, underwriters, arrangers, or subscribers for services other than issuing credit ratings or providing access to the ECAI's credit ratings;
 - (iv) The ECAI is providing a preliminary indication or similar indication of credit quality to an entity, obligor, originator, underwriter, or arranger prior to being hired to determine the final credit rating for the entity, obligor, originator, underwriter, or arranger; and
 - (v) The ECAI has a direct or indirect ownership interest in a rated entity or obligor, or a rated entity or obligor has a direct or indirect ownership interest in the ECAI.
- (7) Regarding the disclosure of an ECAI's compensation arrangements referenced in (5) (iv) above:
- (i) An ECAI should disclose the general nature of its compensation arrangements with rated entities, obligors, lead underwriters, or arrangers.
 - (ii) When the ECAI receives from a rated entity, obligor, originator, lead underwriter, or arranger compensation unrelated to its credit rating services, the ECAI should disclose such unrelated compensation as a percentage of total annual compensation received from such rated entity, obligor, lead underwriter, or arranger in the relevant credit rating report or elsewhere, as appropriate.
 - (iii) An ECAI should disclose in the relevant credit rating report or elsewhere, as appropriate, if it receives 10% or more of its annual revenue from a single client (e.g. a rated entity, obligor, originator, lead underwriter, arranger, or subscriber, or any of their affiliates).

The Mapping Process

- (8) CBK will be responsible for assigning eligible ECAIs' ratings to the risk weights available under the standardised risk weighting framework, i.e. deciding which

rating categories correspond to which risk weights. The mapping process should be objective and should result in a risk weight assignment consistent with that of the level of credit risk reflected in the tables. It should cover the full spectrum of risk weights.

- (9) When conducting the mapping process, CBK shall assess, among others, the size and scope of the pool of issuers that each ECAI covers, the range and meaning of the ratings that it assigns, and the definition of default used by the ECAI.
- (10) Banks must use the chosen ECAIs and their ratings consistently for all types of exposure where they have been recognised by their supervisor as an eligible ECAI, for both risk-weighting and risk management purposes. Banks are not allowed to “cherry-pick” the ratings provided by different ECAIs and to arbitrarily change the use of ECAIs.

Long Term mapping

Credit Quality Step	Fitch's Assessments	Moody's Assessments	S&P Assessments
1	AAA to AA-	Aaa to Aa3	AAA to AA-
2	A+ to A-	A1 to A3	A+ to A-
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
5	B+ to B-	B1 to B3	B+ to B-
6	CCC+ and below	Caa1 and below	CCC+ and below

Short term mapping

Credit Quality Step	Fitch	Moody's	S&P
1	F1+, F1	P-1	A-1+, A-1
2	F2	P-2	A-2
3	F3	P-3	A-3
4	Below F3	NP	All short-term ratings below A-3

Determination of Whether an Exposure is Rated: Issue-Specific and Issuer Ratings

- (11) Where a bank invests in a particular issue that has an issue-specific rating, the risk weight of the exposure will be based on this rating. Where the bank’s exposure is not an investment in a specific rated issue, the following general principles apply:
 - (i) In circumstances where the borrower has a specific rating for an issued debt – but the bank’s exposure is not an investment in this particular debt – a high-

quality credit rating (one which maps into a risk weight lower than that which applies to an unrated exposure) on that specific debt may only be applied to the bank's unrated exposure if this exposure ranks in all respects pari passu or senior to the exposure with a rating. If not, the external rating cannot be used, and the unassessed exposure will receive the risk weight for unrated exposures.

- (ii) In circumstances where the borrower has an issuer rating, this rating typically applies to senior unsecured exposures to that issuer. Consequently, only senior exposures to that issuer will benefit from a high-quality issuer rating. Other unassessed exposures of a highly rated issuer will be treated as unrated. If either the issuer or a single issue has a low-quality rating (mapping into a risk weight equal to or higher than that which applies to unrated exposures), an unassessed exposure to the same counterparty that ranks pari passu or is subordinated to either the senior unsecured issuer rating or the exposure with a low-quality rating will be assigned the same risk weight as is applicable to the low-quality rating.
- (iii) In circumstances where the issuer has a specific high-quality rating (one which maps into a lower risk weight) that only applies to a limited class of liabilities (such as a deposit rating or a counterparty risk rating),

Domestic currency and foreign currency ratings

- (12) Where exposures are risk-weighted based on the rating of an equivalent exposure to that borrower, the general rule is that foreign currency ratings would be used for exposures in foreign currency. Domestic currency ratings, if separate, would only be used to risk-weight exposures denominated in the domestic currency.

Short-term/long-term ratings

- (13) For risk-weighting purposes, short-term ratings are deemed to be issue-specific. They can only be used to derive risk weights for exposures arising from the rated facility. They cannot be generalised to other short-term exposures. In no event can a short-term rating be used to support a risk weight for an unrated long-term exposure. Short-term ratings may only be used for short-term exposures against banks and corporates.

Level of Application of the Rating

- (14) External ratings for one entity within a corporate group cannot be used to risk weight other entities within the same group.

Use of Unsolicited Ratings

- (15) As a general rule, banks should use solicited ratings from eligible ECAIs. National supervisors may allow banks to use unsolicited ratings in the same way as solicited ratings if they are satisfied that the credit assessments of unsolicited ratings are not inferior in quality to the general quality of solicited ratings.

APPENDIX II

List of recognised ECAIs

The ratings of the following ECAIs may be used for in determining the risk weights as provided in this Guideline.

1. Standard and Poor's (S&P) Global Ratings
2. Moody's Investors Service (Moody's)
3. Fitch Ratings (Fitch)
4. Any other ECAIs that may be recognised by the Central Bank.

Institution:	
Financial Year:	
Start Date:	
End Date:	

FORM A: CBK PR 3 - CAPITAL SUMMARY*(only complete in the yellow space)*

CAPITAL COMPONENTS	AMOUNT (KHS' 000)
Common Equity Tier (CET) 1 Capital	-
Additional Tier 1 Capital	-
Total Tier 1 Capital	-
Total Tier 2 Capital	-
Total Eligible Capital (Tier 1 + Tier 2)	-
RISK WEIGHTED ASSETS SUMMARY	
CREDIT RISK	AMOUNT (KHS' 000)
On balance Credit Risk	-
Off balance Credit Risk	-
Total Credit Risk Weighted Assets	-
OPERATIONAL RISK	
Total Operational Risk Weighted Assets	-
MARKET RISK	
Total Market Risk weighted Assets	-
TOTAL RISK WEIGHTED ASSETS	-
TOTAL DEPOSITS	
CAPITAL RATIO COMPUTATION	
CET 1 Capital to Total Risk weighted Assets Ratio	0.0%
Minimum CET 1 Capital to Total Risk weighted Assets Ratio	10.5%
Excess/(Deficiency)	0.0%
TIER 1 Capital to Total Risk weighted Assets Ratio	0.0%
Minimum TIER 1 Capital to Total Risk weighted Assets Ratio	12.5%
Excess/(Deficiency)	0.0%
Total Capital to Total Risk weighted Assets Ratio	0.0%
Minimum Total Capital to Total Risk weighted Assets Ratio	14.5%
Excess/(Deficiency)	0.0%
CET 1 Capital to Deposits Ratio	0.0%
Minimum CET 1 Capital to Deposits Ratio	8.0%
Excess/(Deficiency)	0.0%

AUTHORIZATION:

We declare that this return, to the best of our knowledge and belief is correct.

Name of Compiling Officer:	Date:
Name of authorizing officer (1):	Date:
Name of authorizing officer (2):	Date:

COMPOSITION OF CAPITAL AND REGULATORY ADJUSTMENTS	
Institution:	
Financial Year:	
Start Date:	
End Date:	

FORM B: CAPITAL COMPOSITION

(only complete in the yellow spaces)

1	Common Equity Tier 1 (CET1) Capital: Instruments and Reserves	AMOUNT (KHS' 000)
1.1	Ordinary Shares/ stock (issued and paid up that relate to directly issued qualifying CET1 capital instruments)	
1.2	Stock Surplus (Share Premium) resulting from the issue of instruments included Common Equity Tier 1;	
1.3	Retained earnings less foreseeable dividends	
1.3.1	Previous years retained earnings	
1.3.2	Eligible profit or loss	
1.4	Accumulated other comprehensive income	
1.5	Statutory loan loss reserve	
1.6	Other disclosed reserves approved by CBK	
1.7	Minority interest that meet the criteria for inclusion in Common Equity Tier 1 capital	
	CET1 Capital Before Deductions (A)	-
2	Deductions from CET 1 (Regulatory Adjustments)	
2.1	Goodwill and other intangible assets	
2.2	Deferred tax assets	
2.3	Cash flow hedge reserve (that relates to the hedging of financial instruments that are not fair valued on the balance sheet)	
2.4	Gain on sale related to securitisation transactions	
2.5	Cumulative gains and losses due to changes in own credit risk on fair valued liabilities	
2.6	Defined benefit pension fund assets (and liabilities)	
2.7	Investments in own shares (Treasury stock CET1 capital instruments)	
2.8	Reciprocal cross holdings in CET1 capital instruments issued by of Banking, Financial and Insurance Entities	
2.9	Investments in the Capital of Banking, Financial and Insurance Entities that are Outside the Scope of Regulatory Consolidation and where the bank does not own more than 10% of the issued common share capital of the entity	
2.10	Significant 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 percent of the issued common share capital of the issuing entity or where the entity	
2.11	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	
2.12	Any other adjustments required by the Central Bank of Kenya	
	CET 1 Capital After Deductions (B)	-
3	Additional Tier 1 Capital: Instruments	
3.1	Instruments issued by the bank that meet the criteria for inclusion in AT1 capital	
3.2	Stock surplus (share premium) resulting from the issue of instruments included in AT1 capital	
3.2	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in AT1 capital and are not included in CET1 (Minority interest)	
	Additional Tier 1 Before Deductions (C)	-
4	Deductions from Add.Tier 1 (Regulatory Adjustments):	
4.1	Investment in own Additional Tier 1 instruments	
4.2	Reciprocal cross holdings in Additional Tier 1 instruments	
4.3	Investments in the Capital of Banking, Financial and Insurance Entities that are Outside the Scope of Regulatory Consolidation	
4.4	Significant investments in the Capital of Banking, Financial and Insurance Entities that are Outside the Scope of Regulatory Consolidation	
4.5	Regulatory adjustments applied to Additional Tier 1 Capital due to insufficient Tier 2 to cover deductions	
4.6	Other deductions from Tier 1 capital as determined by the Central Bank of Kenya	
	Additional Tier 1 After Deductions (D)	-
	TOTAL TIER 1 CAPITAL AFTER DEDUCTIONS (B) + (D) = (E)	-
5	Tier 2 Capital: Instruments and Provisions	
5.1	Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital	
5.2	Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital	
5.3	Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in Tier 2 capital and are not included in Tier 1 capital (Minority interest)	
5.3	Subordinated debt meeting Tier 2 eligibility criteria	
5.4	Certain loan-loss provisions such as prudential general provisions up to a maximum of 1.25 percent of credit risk weighted assets calculated in line with CBK Prudential Guidelines	
	Accumulated other comprehensive income (only 50% of Property Valuation Gains, excluding financial instruments, to be recognized)	
	Tier 2 Capital Before Deductions (F)	-
6	Deductions from Tier 2 (Regulatory Adjustments):	
6.1	Investments in own Tier 2 capital instruments	
6.2	Reciprocal cross holdings in Tier 2 capital instruments	
6.3	Investments in the Capital of Banking, Financial and Insurance Entities that are Outside the Scope of Regulatory Consolidation	
6.4	Significant investments in the Capital of Banking, Financial and Insurance Entities that are Outside the Scope of Regulatory Consolidation	
	Other deductions from Tier 2 capital as determined by the Central Bank of Kenya	
	Tier 2 Capital After Deductions (G)	-
	TOTAL ELIGIBLE CAPITAL BASE (TIER 1 + TIER 2) (E) + (G) = (H)	-

Minimum Capital Requirement for Credit Risk
Institution:
Financial Year:
Start Date:
End Date:
FORM C1 - CREDIT RISK TABLE I: ON-BALANCE SHEET ITEMS
Amounts in KES. '000'
(only complete in the yellow spaces)

Item No.	On Balance Sheet Items	Risk Weight Determination Criteria	Exposures without CRM coverage	Exposures with CRM coverage	Applicable Risk Weight(%)	Risk Weighted Assets
1	Cash Items		-	-		-
1.1	Cash owned and held at the bank or in transit				0	-
1.2	Gold bullion held at the bank or held in another bank on an allocated basis, to the extent the gold bullion assets are backed by gold bullion liabilities.				0	-
1.3	Gold Bullion - Other				100	-
1.4	Silver Bullion, precious metals & other gemstones				100	-
1.5	Cash items in the process of collection				20	-
2	Exposures to Sovereigns and Central Banks		-	-		-
2.1	Exposures to the Government of Kenya and the Central Bank of Kenya, denominated and funded in Kenya Shillings				0	-
2.2	Exposures to ther Sovereign exposures, and exposures to the Government of Kenya and the Central Bank of Kenya denominated in FCY		-	-		-
2.2.1	Risk weights for sovereigns and Central Banks based on sovereign ratings	AAA to AA-			0	-
2.2.2		A+ to A-			20	-
2.2.3		BBB+ to BBB-			50	-
2.2.4		BB+ to B-			100	-
2.2.5		Below B-			150	-
2.2.6		Unrated			100	-
3	Exposures to Non-Central Government Public Sector Entities (PSEs)		-	-		-
3.1	Exposures to Non-Central Government PSEs and exposures to County		-	-		-
3.1.1	Risk weights for PSEs and county governments based on external ratings	AAA to AA-			20	-
3.1.2		A+ to A-			50	-
3.1.3		BBB+ to BBB-			50	-
3.1.4		BB+ to B-			100	-
3.1.5		Below B-			150	-
3.1.6		Unrated			100	-
4	Exposures to Multilateral Development Banks (MDBs)		-	-		-
4.1	(1) Exposures to the World Bank Group comprising: (a) International Bank for Reconstruction and Development (b) International Finance Corporation (c) the Multilateral Investment Guarantee Agency (d) International Development Association Exposures to: (2) Asian Development Bank (3) African Development Bank (4) European Bank for Reconstruction and Development (5) Inter-American Development Bank (6) European Investment Bank (7) European Investment Fund (8) Nordic Investment Bank (9) Caribbean Development Bank (10) Islamic Development Bank, (11) Council of Europe Development Bank (12) International Finance Facility for Immunization				0	-
4.2	Other MDBs		-	-		-
4.2.1	Risk weights for MDBs based on external ratings	AAA to AA-			20	-
4.2.2		A+ to A-			30	-
4.2.3		BBB+ to BBB-			50	-
4.2.4		BB+ to B-			100	-
4.2.5		Below B-			150	-
4.2.6		Unrated			50	-
5	Exposures to Banks and other financial institutions covered under the Banking Act		-	-		-
	Exposures to other financial institutions covered under the Banking Act shall be treated as exposures to banks.					
	External Credit Risk Assessment Approach (ECRA) - for rated exposures					
5.1	Exposures to banks and other financial institutions covered under the Banking Act with original maturity of more than three months:		-	-		-
5.1.1	Risk weights based on external ratings	AAA to AA-			20	-
5.1.2		A+ to A-			30	-
5.1.3		BBB+ to BBB-			50	-
5.1.4		BB+ to B-			100	-
5.1.5		Below B-			150	-
5.2	Exposures with original maturity of three months or less*		-	-		-
5.2.1	Risk weights based on external ratings	AAA to AA-			20	-
5.2.2		A+ to A-			20	-
5.2.3		BBB+ to BBB-			20	-
5.2.4		BB+ to B-			50	-
5.2.5		Below B-			150	-

	Standardised Credit Risk Assessment Approach (SCRA) - For exposures to banks that are unrated.					
5.3	Exposures to banks and other financial institutions covered under the Banking Act with original maturity of more than three months:		-	-		-
5.3.1		Grade A			40	-
5.3.2	Risk weights based on SCRA	Grade B			75	-
5.3.3		Grade C			150	-
5.4	Exposures with original maturity of three months or less*		-	-		-
5.4.1		Grade A			20	-
5.4.2	Risk weights based on SCRA	Grade B			50	-
5.4.3		Grade C			150	-
6 Exposures to Corporates			-	-		-
	<i>Exposures to all other securities firms and other financial institutions will be treated as exposures to corporates</i>					
6.1	General corporate exposures		-	-		-
6.1.1	Based on external credit rating of corporate	AAA to AA-			20	-
6.1.2		A+ to A-			50	-
6.1.3		BBB+ to BB-			100	-
6.1.4		Below BB-			150	-
6.1.5		Unrated			100	-
6.1.7	Corporate SMEs				85	-
6.2	Specialised lending exposures with issue specific external ratings		-	-		-
6.2.1	Issue specific external ratings	AAA to AA-			20	-
6.2.2		A+ to A-			50	-
6.2.3		BBB+ to BB-			100	-
6.2.4		Below BB-			150	-
6.2.5		Unrated			100	-
6.3	Specialized lending exposures where an issue specific external rating is not available		-	-		-
6.3.1	Project finance - pre-operational phase				130	-
6.3.2	Project finance - operational phase				100	-
6.3.3	Project finance operational phase (high quality)				80	-
6.3.4	Object finance and commodity finance				100	-
7 Retail Exposures			-	-		-
7.1	Regulatory retail exposures that do not arise from exposures to transactors**				100	-
7.2	Regulatory retail exposures that meet the criterion that arise from obligors who qualify as "transactors"				45	-
7.3	Other Retail exposures that do not meet criteria for Inclusion Regulatory Retail Portfolio				100	-
8 Real Estate Exposures			-	-		-
8.1	Regulatory residential real estate exposures that are not materially dependent on cash flows generated by the property		-	-		-
8.1.1	Risk weights based on the exposure's Loan to Value (LTV) ratio	LTV ≤ 50%			20	-
8.1.2		50% < LTV ≤ 60%			25	-
8.1.3		60% < LTV ≤ 80%			30	-
8.1.4		80% < LTV ≤ 90%			40	-
8.1.5		90% < LTV ≤ 100%			50	-
8.1.6		LTV > 100%			70	-
8.2	Regulatory residential real estate exposures that are materially dependent on cash flows generated by the property		-	-		-
8.2.1	Risk weights based on the exposure's Loan to Value (LTV) ratio	LTV ≤ 50%			30	-
8.2.2		50% < LTV ≤ 60%			35	-
8.2.3		60% < LTV ≤ 80%			45	-
8.2.4		80% < LTV ≤ 90%			60	-
8.2.5		90% < LTV ≤ 100%			75	-
8.2.6		LTV > 100%			105	-
8.3	Regulatory commercial real estate exposures that are not materially dependent on cash flows generated by the property		-	-		-
8.3.1	Min (60%, RW of counterparty)	LTV ≤ 60%				-
8.3.2	Risk weight of the counterparty	LTV > 60%				-
8.4	Regulatory commercial real estate exposures that are materially dependent on cash flows generated by the property		-	-		-
8.4.1	Risk weights based on the exposure's Loan to Value (LTV) ratio	LTV ≤ 60%			70	-
8.4.2		60% < LTV ≤ 80%			90	-
8.4.3		LTV > 80%			110	-
8.5	Other Real Estate Exposures		-	-		-
8.5.1	Exposures to individuals				75	-
8.5.2	Exposures to SMEs				85	-
8.5.3	Exposures to other counterparties, the risk weight applied is the risk weight that would be assigned to an unsecured exposure to that counterparty.					-
8.5.4	Other real estate exposures that are materially dependent on the cash flows generated by the property.				150	-
8.6	Land Acquisition, Development and Construction Exposures		-	-		-
8.6.1	ADC exposures				150	-
8.6.2	ADC exposures to residential real estate that meet specific criteria on prudential underwriting standards and pre-sale lease contracts				100	-
9 Risk Weight Multiplier to Certain Exposures with Currency Mismatch			-	-		-
9.1	Unhedged retail exposures to individuals where the lending currency differs from the currency of the borrower's source of income	1.5 times multiplier to the applicable risk weight,				-
9.2	Unhedged real estate exposures to individuals where the lending currency differs from the currency of the borrower's source of income	subject to a maximum risk weight of 150%.				-
10 Defaulted loans			-	-		-

10.1	The unsecured portion of a defaulted exposure, risk weighted net of specific provisions and partial write-offs, where specific provisions => 20%				100	-
10.2	The unsecured portion of a defaulted exposure, risk weighted net of specific provisions and partial write-offs, where specific provisions < 20%				150	-
10.3	Defaulted residential real estate exposures where repayments do not materially depend on cash flows generated by the property securing the loan, net of specific provisions and partial write-offs				100	-
11 Subordinated debt, equity and other capital instruments exposures		-	-			-
10.1	Speculative unlisted equity exposures				400	-
10.2	Other equity holdings				250	-
10.3	Subordinated debt and capital instruments other than equities				150	-
10.4	Investments in significant minority- or majority-owned and -controlled commercial entities in excess of materiality thresholds				1250	-
12 Securitisation Exposures		-	-			-
12.1	Securitization exposures – Long term rating category	-	-			-
12.1.1	Risk weights based on the long term ratings of the securitization exposure	AAA to AA-			20	-
12.1.2		A+ to A-			50	-
12.1.3		BBB+ to BBB-			100	-
12.1.4		BB+ to BB-			350	-
12.1.5		B+ and below or unrated			Deduction	-
12.2	Securitization exposures – short term rating category	-	-			-
12.2.1	Risk weights based on the short term ratings of the securitization exposure	A-1/P-1			20	-
12.2.2		A-2/P-2			50	-
12.2.3		A-3/P-3			100	-
12.2.4		All other ratings or unrated			Deduction	-
13 Other Assets		-	-			-
13.1	All other assets				100	
13.2	The below three threshold deductions not deducted in CET 1 capital	-	-			
13.2.1	Significant investments in the common shares of unconsolidated financial institutions (banks, insurance and other financial entities)				250	-
13.2.2	mortgage servicing rights; and				250	-
13.2.3	DTAs that arise from temporary differences.				250	-
TOTAL ON BALANCE SHEET CREDIT RISK RISK WEIGHTED ASSETS		-	-			-

* Exposures to banks with an original maturity of three months or less, as well

** (3) Transactors are obligors in relation to facilities such as credit cards and

Minimum Capital Requirement for Credit Risk							
Institution:							
Financial Year:							
Start Date:							
End Date:							
FORM C2 – CREDIT RISK TABLE II: OFF-BALANCE SHEET ITEMS							
		Amounts in KES. '000'			(only complete in the yellow spaces)		
Off-balance sheet items (non-derivative instruments) Indirect credit instruments	Counterparty and Rating	Risk Weight of Counterparty	Exposures without CRM		Exposures with CRM		Risk Weighted Assets
			Notional Principal Amount before CCF	Credit Equivalent Exposure	Notional Principal Amount before CCF	Credit Equivalent Exposure with CRM	
CCF 10%							
Commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness							
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
CCF 20%							
Applies to both the issuing and confirming banks of short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralized by the underlying shipment).							
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
CCF 40%							
Commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF							

				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
CCF 50%							
Certain transaction-related contingent items including performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions. Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility							
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
CCF 100%							
Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including							
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
Sale and repurchase agreements and asset sales with recourse where the credit risk remains with the bank							
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	
				-		-	

				-		-		
Lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions).								
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
off-balance sheet items that are credit substitutes not explicitly included in any other category								
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
				-		-		
Off-balance sheet items (non-derivative instruments) Indirect credit instruments	Underlying Asset Type	Risk Weight applicable to Underlying Asset	Other Risk Weights (Where Applicable)	Exposures without CRM		Exposures with CRM		Risk Weighted Assets
				Notional Principal Amount before CCF	Credit Equivalent Exposure	Notional Principal Amount before CCF	Credit Equivalent Exposure with CRM coverage after CCF	
Forward asset purchases, forward deposits and partly paid shares and securities which represent commitments with certain drawdown and shall be weighted according to the type of asset and not accordingly to the type of counterparty with whom the transaction has been entered into.								
					-		-	
					-		-	
					-		-	
					-		-	
					-		-	
					-		-	
					-		-	
					-		-	
					-		-	

	Securitisation Exposure – Long-Term Rating B+ and Below / Unrated	Deduction			-		-	-
	Securitisation Exposure – Short-Term All Other Ratings / Unrated	Deduction			-		-	-
	Regulatory Commercial Real Estate – Not Materially Dependent on Property Cash Flows – LTV ≤ 60%	60% or Counterparty RW, whichever is lower			-		-	
	Regulatory Commercial Real Estate – Not Materially Dependent on Property Cash Flows – LTV > 60%	Counterparty Risk Weight			-		-	
	Other Real Estate Exposures – Other Counterparties	Counterparty Risk Weight			-		-	
	Unhedged Retail Exposures to Individuals – Currency Mismatch	1.5 × Applicable RW, subject to maximum of 150%			-		-	
	Unhedged Real Estate Exposures to Individuals – Currency Mismatch	1.5 × Applicable RW, subject to maximum of 150%			-		-	
TOTAL OFF-BALANCE SHEET (NON-DERIVATIVES WHETHER SFT) CREDIT RWA								-

Minimum Capital Requirement for Credit Risk	
Institution:	
Financial Year:	
Start Date:	
End Date:	

FORM C3 – CREDIT RISK TABLE III: OTC - DERIVATIVES

Amounts in KES. '000'

(only complete in the yellow spaces)

		Exposures without CRM			Exposures with CRM			Counterparty and Rating	RW of counterparty or guarantee/or if CRM	Risk Weighted Assets
Off-balance sheet items (Derivatives)		Add-On	Replacement cost of contracts	Notional Principal amounts	Credit equivalent exposure	Replacement cost of contracts	Notional Principal amounts	Credit equivalent exposures with CRM		
A	INTEREST RATE RELATED CONTRACTS									
A.1	Residual maturity 1 year or less									
		0			-			-		
		0			-			-		
		0			-			-		
		0			-			-		
A.2	Residual maturity > 1 year to 5 years									
		0.50			-			-		
		0.50			-			-		
		0.50			-			-		
		0.50			-			-		
A.3	Residual maturity > 5 years									
		1.50			-			-		
		1.50			-			-		
		1.50			-			-		
		1.50			-			-		
A.4	Total									-
B	FOREIGN EXCHANGE & GOLD CONTRACTS									
B.1	Residual maturity 1 year or less									
		1			-			-		
		1			-			-		
		1			-			-		
		1			-			-		
B.2	Residual maturity > 1 year to 5 years									
		5			-			-		
		5			-			-		
		5			-			-		
		5			-			-		
B.3	Residual maturity > 5 years									
		7.50			-			-		
		7.50			-			-		
		7.50			-			-		
		7.50			-			-		
B.4	Total									-
C	EQUITY CONTRACTS									
C.1	Residual maturity 1 year or less									
		6			-			-		
		6			-			-		
		6			-			-		
		6			-			-		
C.2	Residual maturity > 1 year to 5 years									
		8			-			-		
		8			-			-		
		8			-			-		

		8			-			-			
		8			-			-			
C.3	Residual maturity > 5 years										
		10			-			-			
		10			-			-			
		10			-			-			
		10			-			-			
		10			-			-			
C.4	Total										-
D	PRECIOUS METAL CONTRACTS (OTHER THAN GOLD)										
D.1	Residual maturity 1 year or less										
		7			-			-			
		7			-			-			
		7			-			-			
		7			-			-			
		7			-			-			
D.2	Residual maturity > 1 year to 5 years										
		7			-			-			
		7			-			-			
		7			-			-			
		7			-			-			
		7			-			-			
D.3	Residual maturity > 5 years										
		8			-			-			
		8			-			-			
		8			-			-			
		8			-			-			
		8			-			-			
D.4	Total										-
E	OTHER COMMODITIES CONTRACTS (OTHER THAN PRECIOUS METALS)										
E.1	Residual maturity 1 year or less										
		10			-			-			
		10			-			-			
		10			-			-			
		10			-			-			
		10			-			-			
E.2	Residual maturity > 1 year to 5 years										
		12			-			-			
		12			-			-			
		12			-			-			
		12			-			-			
		12			-			-			
E.3	Residual maturity > 5 years										
		15			-			-			
		15			-			-			
		15			-			-			
		15			-			-			
		15			-			-			
E.4	Total										-
F	Other Market Related Contracts										
F.1	Residual maturity 1 year or less										
		10			-			-			
		10			-			-			
		10			-			-			
		10			-			-			
		10			-			-			
F.2	Residual maturity > 1 year to 5 years										
		12			-			-			
		12			-			-			
		12			-			-			
		12			-			-			

		12			-			-			
F.3	Residual maturity > 5 years										
		15			-			-			
		15			-			-			
		15			-			-			
		15			-			-			
		15			-			-			
F.4	Total										-
TOTAL OFF BALANCE SHEET OTC DERIVATIVES CREDIT RISK WEIGHTED ASSETS											-

Minimum Capital Requirement for Credit Risk

Institution:	
Financial Year:	
Start Date:	
End Date:	

FORM C5- CREDIT RISK TABLE V: CREDIT RISK MITIGATION

No.	Counterparty / Obligor	Facility ID	On-Balance Exposure	Pre-CRM Exposure	CRM Provider / Issuer	CRM Type	Collateral / Protection Value	Eligible Value After Haircut	Maturity Mismatch Adjustment	Currency Mismatch Adjustment	Adjusted CRM Value	Exposure Covered by CRM	Provider RW %	Exposure Class	Exposure RW %	RWA After CRM	Remarks
1				0.00				0.00			0.00	0.00				0.00	
2				0.00				0.00			0.00	0.00				0.00	
3				0.00				0.00			0.00	0.00				0.00	
4				0.00				0.00			0.00	0.00				0.00	
5				0.00				0.00			0.00	0.00				0.00	
6				0.00				0.00			0.00	0.00				0.00	
7				0.00				0.00			0.00	0.00				0.00	
8				0.00				0.00			0.00	0.00				0.00	
9				0.00				0.00			0.00	0.00				0.00	
10				0.00				0.00			0.00	0.00				0.00	
11				0.00				0.00			0.00	0.00				0.00	
12				0.00				0.00			0.00	0.00				0.00	
13				0.00				0.00			0.00	0.00				0.00	
14				0.00				0.00			0.00	0.00				0.00	
15				0.00				0.00			0.00	0.00				0.00	
16				0.00				0.00			0.00	0.00				0.00	
17				0.00				0.00			0.00	0.00				0.00	
18				0.00				0.00			0.00	0.00				0.00	
19				0.00				0.00			0.00	0.00				0.00	
20				0.00				0.00			0.00	0.00				0.00	
21				0.00				0.00			0.00	0.00				0.00	
22				0.00				0.00			0.00	0.00				0.00	
23				0.00				0.00			0.00	0.00				0.00	
24				0.00				0.00			0.00	0.00				0.00	
25				0.00				0.00			0.00	0.00				0.00	
26				0.00				0.00			0.00	0.00				0.00	
27				0.00				0.00			0.00	0.00				0.00	
28				0.00				0.00			0.00	0.00				0.00	
29				0.00				0.00			0.00	0.00				0.00	
30				0.00				0.00			0.00	0.00				0.00	
31				0.00				0.00			0.00	0.00				0.00	
32				0.00				0.00			0.00	0.00				0.00	
33				0.00				0.00			0.00	0.00				0.00	
34				0.00				0.00			0.00	0.00				0.00	
35				0.00				0.00			0.00	0.00				0.00	
36				0.00				0.00			0.00	0.00				0.00	
37				0.00				0.00			0.00	0.00				0.00	
38				0.00				0.00			0.00	0.00				0.00	
39				0.00				0.00			0.00	0.00				0.00	
40				0.00				0.00			0.00	0.00				0.00	
41				0.00				0.00			0.00	0.00				0.00	
42				0.00				0.00			0.00	0.00				0.00	
43				0.00				0.00			0.00	0.00				0.00	
44				0.00				0.00			0.00	0.00				0.00	
45				0.00				0.00			0.00	0.00				0.00	
46				0.00				0.00			0.00	0.00				0.00	
47				0.00				0.00			0.00	0.00				0.00	
48				0.00				0.00			0.00	0.00				0.00	
49				0.00				0.00			0.00	0.00				0.00	
50				0.00				0.00			0.00	0.00				0.00	
51				0.00				0.00			0.00	0.00				0.00	
52				0.00				0.00			0.00	0.00				0.00	
53				0.00				0.00			0.00	0.00				0.00	
54				0.00				0.00			0.00	0.00				0.00	
55				0.00				0.00			0.00	0.00				0.00	

56				0.00				0.00			0.00	0.00				0.00		
57				0.00				0.00			0.00	0.00				0.00		
58				0.00				0.00			0.00	0.00				0.00		
59				0.00				0.00			0.00	0.00				0.00		
60				0.00				0.00			0.00	0.00				0.00		
61				0.00				0.00			0.00	0.00				0.00		
62				0.00				0.00			0.00	0.00				0.00		
63				0.00				0.00			0.00	0.00				0.00		
64				0.00				0.00			0.00	0.00				0.00		
65				0.00				0.00			0.00	0.00				0.00		
66				0.00				0.00			0.00	0.00				0.00		
67				0.00				0.00			0.00	0.00				0.00		
68				0.00				0.00			0.00	0.00				0.00		
69				0.00				0.00			0.00	0.00				0.00		
70				0.00				0.00			0.00	0.00				0.00		
71				0.00				0.00			0.00	0.00				0.00		
72				0.00				0.00			0.00	0.00				0.00		
73				0.00				0.00			0.00	0.00				0.00		
74				0.00				0.00			0.00	0.00				0.00		
75				0.00				0.00			0.00	0.00				0.00		
76				0.00				0.00			0.00	0.00				0.00		
77				0.00				0.00			0.00	0.00				0.00		
78				0.00				0.00			0.00	0.00				0.00		
79				0.00				0.00			0.00	0.00				0.00		
80				0.00				0.00			0.00	0.00				0.00		
81				0.00				0.00			0.00	0.00				0.00		
82				0.00				0.00			0.00	0.00				0.00		
83				0.00				0.00			0.00	0.00				0.00		
84				0.00				0.00			0.00	0.00				0.00		
85				0.00				0.00			0.00	0.00				0.00		
86				0.00				0.00			0.00	0.00				0.00		
87				0.00				0.00			0.00	0.00				0.00		
88				0.00				0.00			0.00	0.00				0.00		
89				0.00				0.00			0.00	0.00				0.00		
90				0.00				0.00			0.00	0.00				0.00		
91				0.00				0.00			0.00	0.00				0.00		
92				0.00				0.00			0.00	0.00				0.00		
93				0.00				0.00			0.00	0.00				0.00		
94				0.00				0.00			0.00	0.00				0.00		
95				0.00				0.00			0.00	0.00				0.00		
96				0.00				0.00			0.00	0.00				0.00		
97				0.00				0.00			0.00	0.00				0.00		
98				0.00				0.00			0.00	0.00				0.00		
99				0.00				0.00			0.00	0.00				0.00		
100				0.00				0.00			0.00	0.00				0.00		
TOTAL				0.00	0.00		0.00	0.00			0.00	0.00				0.00		
No.	Counterparty / Obligor	Facility ID	Off-Balance Exposure	CCF %	Pre-CRM Exposure	CRM Provider / Issuer	CRM Type	Collateral / Protection Value	Eligible Value After Haircut	Maturity Mismatch Adjustment	Currency Mismatch Adjustment	Adjusted CRM Value	Exposure Covered by CRM	Provider RW %	Exposure Class	Exposure RW %	RWA After CRM	Remarks
1					0.00				0.00			0.00	0.00				0.00	
2					0.00				0.00			0.00	0.00				0.00	
3					0.00				0.00			0.00	0.00				0.00	
4					0.00				0.00			0.00	0.00				0.00	
5					0.00				0.00			0.00	0.00				0.00	
6					0.00				0.00			0.00	0.00				0.00	
7					0.00				0.00			0.00	0.00				0.00	
8					0.00				0.00			0.00	0.00				0.00	
9					0.00				0.00			0.00	0.00				0.00	
10					0.00				0.00			0.00	0.00				0.00	
11					0.00				0.00			0.00	0.00				0.00	
12					0.00				0.00			0.00	0.00				0.00	
13					0.00				0.00			0.00	0.00				0.00	
14					0.00				0.00			0.00	0.00				0.00	
15					0.00				0.00			0.00	0.00				0.00	

16						0.00					0.00				0.00	0.00							0.00
17						0.00					0.00				0.00	0.00							0.00
18						0.00					0.00				0.00	0.00							0.00
19						0.00					0.00				0.00	0.00							0.00
20						0.00					0.00				0.00	0.00							0.00
21						0.00					0.00				0.00	0.00							0.00
22						0.00					0.00				0.00	0.00							0.00
23						0.00					0.00				0.00	0.00							0.00
24						0.00					0.00				0.00	0.00							0.00
25						0.00					0.00				0.00	0.00							0.00
26						0.00					0.00				0.00	0.00							0.00
27						0.00					0.00				0.00	0.00							0.00
28						0.00					0.00				0.00	0.00							0.00
29						0.00					0.00				0.00	0.00							0.00
30						0.00					0.00				0.00	0.00							0.00
31						0.00					0.00				0.00	0.00							0.00
32						0.00					0.00				0.00	0.00							0.00
33						0.00					0.00				0.00	0.00							0.00
34						0.00					0.00				0.00	0.00							0.00
35						0.00					0.00				0.00	0.00							0.00
36						0.00					0.00				0.00	0.00							0.00
37						0.00					0.00				0.00	0.00							0.00
38						0.00					0.00				0.00	0.00							0.00
39						0.00					0.00				0.00	0.00							0.00
40						0.00					0.00				0.00	0.00							0.00
41						0.00					0.00				0.00	0.00							0.00
42						0.00					0.00				0.00	0.00							0.00
43						0.00					0.00				0.00	0.00							0.00
44						0.00					0.00				0.00	0.00							0.00
45						0.00					0.00				0.00	0.00							0.00
46						0.00					0.00				0.00	0.00							0.00
47						0.00					0.00				0.00	0.00							0.00

82					0.00				0.00			0.00	0.00				0.00	
83					0.00				0.00			0.00	0.00				0.00	
84					0.00				0.00			0.00	0.00				0.00	
85					0.00				0.00			0.00	0.00				0.00	
86					0.00				0.00			0.00	0.00				0.00	
87					0.00				0.00			0.00	0.00				0.00	
88					0.00				0.00			0.00	0.00				0.00	
89					0.00				0.00			0.00	0.00				0.00	
90					0.00				0.00			0.00	0.00				0.00	
91					0.00				0.00			0.00	0.00				0.00	
92					0.00				0.00			0.00	0.00				0.00	
93					0.00				0.00			0.00	0.00				0.00	
94					0.00				0.00			0.00	0.00				0.00	
95					0.00				0.00			0.00	0.00				0.00	
96					0.00				0.00			0.00	0.00				0.00	
97					0.00				0.00			0.00	0.00				0.00	
98					0.00				0.00			0.00	0.00				0.00	
99					0.00				0.00			0.00	0.00				0.00	
100					0.00				0.00			0.00	0.00				0.00	
TOTAL					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00				0.00	

Minimum Capital Requirement for Market Risk				
Institution:				
Financial Year:				
Start Date:				
End Date:				
FORM D: MARKET RISK WEIGHTED ASSETS: CAPITAL CHARGE FOR MARKET RISK SUMMARY				
		Capital Charge Ksh.	Scaling Factor	Capital Charge Requirement (Kshs '000)
1	Total Interest Rate Risk - Form D1	-	1.30	-
2	Total Foreign exchange risk (Form D2)	-	1.20	-
3	Total Commodities Risk (Form D3)	-	1.90	-
4	Total market risk capital charge (1+2+3)	-		-
5	Conversion Factor (inverse of 8%)			12.5
6	Total Market Risk Weighted Assets Equivalent (4X5)			-

Minimum Capital Requirement for Market Risk	
Institution:	
Financial Year:	
Start Date:	
End Date:	

FORM D1: MARKET RISK WEIGHTED ASSETS: CAPITAL CHARGE FOR INTEREST RATE RISK

Gross unweighted exposure	-
Net unweighted exposure	-
Capital Charges:	
Specific risk capital charge	-
Vertical disallowance	-
First horizontal disallowance	-
Second horizontal disallowance	-
Residual charge	-
Total Interest Rate Risk Capital Charge (Specific + General)	-

Col. 1Col. 2Col. 3Col. 4Col. 5Col. 6Col. 7Col. 8

#:	Instrument	Issuer Type	Time Band	Unweighted Exposure (KSh)	Specific Risk Capital Charge (KSh)	General Risk Weighted Value (KSh)	Risk-weighted Long Positions	Risk-weighted Short Positions
1					-	-	-	-
2					-	-	-	-
3					-	-	-	-
4					-	-	-	-
5					-	-	-	-
6					-	-	-	-
7					-	-	-	-
8					-	-	-	-
9					-	-	-	-
10					-	-	-	-
11					-	-	-	-
12					-	-	-	-
13					-	-	-	-
14					-	-	-	-
15					-	-	-	-
16					-	-	-	-
17					-	-	-	-
18					-	-	-	-
19					-	-	-	-

Capital Requirement for Market IRR specific risk

(only fill in the yellow cells)

Specific risk capital requirements for “government” and “other” categories

Categories	Type	External credit assessment	Maturity Period	capital requirement
Governments	G1	AAA to AA-	Any	0%
	G2	A+ to BBB-	6 months or less	0.25%
	G3		6 to 24 months	1.00%
	G4		Over 24 months	1.60%
	G5	BB+ to B-	Any	8.00%
	G6	Below B-	Any	12.00%
	G7	Unrated	Any	8.00%
Qualifying	Q1		6 months or less	0.25%
	Q2		6 to 24 months	1.00%
	Q3		Over 24 months	1.60%
Other	O1	BB+ to BB-	Any	8.00%
	O2	Below BB-	Any	12.00%
	O3	Unrated	Any	8.00%

Time Bands

Time Band	Coupon 3% or more	Coupon less than 3%	Risk Weight
1	≤ 1 month	≤ 1 month	0.00%
2	1 - 3 months	1- 3 months	0.20%
3	3 - 6 months	3 - 6 months	0.40%
4	6 - 12 months	6 - 12 months	0.70%
5	1 - 2 years	1.0 - 1.9 years	1.25%
6	2-3 years	1.9 - 2.8 years	1.75%
7	3 - 4 years	2.8 - 3.6 years	2.25%
8	4 - 5 years	3.6- 4.3 years	2.75%
9	5 - 7 years	4.3 - 5.7 years	3.25%
10	7 - 10 years	5.7 - 7.3 years	3.75%
11	10 - 15 years	7.3- 9.3 years	4.50%
12	15 - 20 years	9.3 - 10.6 years	5.25%
13	Over 20 years	10.6 - 12 years	6.00%
		12 - 20 years	8.00%
		Over 20 years	12.50%

Col. 9	Col. 10	Col. 11	Col. 12	Col. 13	Col. 14	Col. 15	Col. 16	Col. 17	Col. 18	Col. 19	Col. 20	Col. 21
Zone	Time Band	Calculation of Disallowances										
	Coupon >= 3%	Risk-weighted Long Positions	Risk-weighted Short Positions	Matched Positions in Time Bands	Vertical Disallowance	Net (Unmatched) Positions in Time bands	Matched Positions in Time Zones	First Horizontal Disallowance	Net (Unmatched) Positions in Time Zones	Matched Positions between Time	Second Horizontal Disallowance	Net (Unmatched) Positions between Time Zones
Zone 1	0 to 1 month	-	-	-	-	-				Zones 1&2	Zones 1&2	-
	1 to 3 months	-	-	-	-	-						
	3 to 6 months	-	-	-	-	-	-	-	-	-	-	
	6 to 12 months	-	-	-	-	-						
Zone 2	1 to 2 years	-	-	-	-	-				Zones 2&3	Zones 2&3	
	2 to 3 years	-	-	-	-	-	-	-	-	-	-	
	3 to 4 years	-	-	-	-	-						
Zone 3	4 to 5 years	-	-	-	-	-				Zones 1&3	Zones 1&3	
	5 to 7 years	-	-	-	-	-						
	7 to 10 years	-	-	-	-	-	-	-	-			
	10 to 15 years	-	-	-	-	-						
	15 to 20 years	-	-	-	-	-				-	-	
	Over 20 years	-	-	-	-	-						
		-	-									
Vertical Disallowance:					-	First Horizontal Disallowance:		-	Second Horizontal Disallowance:		-	

Minimum Capital Requirement for Market Risk		
Institution:		
Financial Year:		
Start Date:		
End Date:		

FORM D2: MARKET RISK WEIGHTED ASSETS: CAPITAL CHARGE FOR FOREIGN EXCHANGE RISK

(only complete in the yellow spaces)

					Amount in Shs.'000'				
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	CURRENCY TYPE	USD	GBP	EURO	JPY	CHF	ZAR	OTHERS	TOTALS
	EXCHANGE RATE								
1	FOREIGN CURRENCY ASSETS								
1.1	Balance Sheet Items	-	-	-	-	-	-	-	-
1.1.1	Cash and Balances with Banks Abroad								-
1.1.2	Loans & Advances								-
1.1.3	Investment in Govt. Securities								-
1.1.4	Other Foreign Assets								-
2	Off-balance Sheet Items	-	-	-	-	-	-	-	-
2.1	Undelivered Spot Purchases								-
2.2	Forward Purchases								-
2.3	Other Off-balance Items								-
3	Total Foreign Assets (1.1.1 to 2.3)	-	-	-	-	-	-	-	-
4	FOREIGN CURRENCY LIABILITIES								
4.1	Balance Sheet Items	-	-	-	-	-	-	-	-
4.1.1	Balances due to Banks abroad								-
4.1.2	Deposits								-
4.1.3	Loans & Advances								-
4.1.4	Other Foreign Liabilities								-
5	Off-balance Sheet Items	-	-	-	-	-	-	-	-
5.1	Undelivered Spot sales								-
5.2	Forward Sales								-
5.3	Other Off-balance Sheet Items								-
6	Total Foreign Liabilities (4.1.1 to 5.3)	-	-	-	-	-	-	-	-
7	NET OPEN POSITION (3 less 6)	-	-	-	-	-	-	-	-
7.1	Long Position (where 3 less 6 is positive)	-	-	-	-	-	-	-	-
7.2	Short Position (where 3 less 6 is negative)	-	-	-	-	-	-	-	-
8	OVERALL FOREX EXPOSURE								
8.1	Exposure (higher of net long/short position) in currencies	-	-	-	-	-	-	-	-
8.2	Gold								-
8.3	Overall net open position								-
8.4	Risk weight								10%
8.5	Capital charge for foreign exchange risk								-

Minimum Capital Requirement for Market Risk

Institution:	
Financial Year:	
Start Date:	
End Date:	

FORM D3: MARKET RISK WEIGHTED ASSETS: CAPITAL CHARGE FOR COMMODITIES RISK

			Amount (KSh.'000')		
No.	Commodity	Long position	Short position	Net position	Directional Risk Capital Charge
	A	B	C	D = Absolute(B-C)	E=D*15%
1				-	-
2				-	-
3				-	-
4				-	-
5				-	-
6				-	-
7				-	-
8				-	-
		-	-	-	-
	Capital Charge Computation				
1	Capital charge for directional risk (15% of the net position, long or short				-
2	Additional capital charge against basis, interest rate and forward gap risk				-
	Total Capital Charge for Commodities Risk (1+2)				-

MINIMUM CAPITAL REQUIREMENT FOR OPERATIONAL RISK	
Institution:	
Financial Year:	
Start Date:	
End Date:	

FORM E: COMPUTATION OF OPERATIONAL RISK WEIGHTED ASSETS

(only complete in the yellow spaces)

BUSINESS INDICATOR		AMOUNT (KHS' 000)		
1	INCOME LEASE AND DIVIDEND COMPONENT (ILDC)			
Income Statement Information		Year		
	Item	t	t-1	t-2
1.1	Interest Income			
1.11	Interest income from loans and advances			
1.12	Interest income from assets available for sale			
1.13	Interest income from assets held to maturity			
1.14	Interest income from trading assets			
1.15	Interests from financial and operational leases			
1.16	Interest income from hedge accounting derivatives			
1.17	Other interest income			
1.18	Profits from leased assets			
	Total Interest income	0	0	0
1.2	Interest Expenses			
1.21	Interest expenses from deposits			
1.22	Interest expenses from debt securities issued			
1.23	Interest expenses from financial and operating leases			
1.24	Interest expenses from hedge accounting derivatives			
1.25	Other interest expenses			
1.26	Losses from leased assets			
1.27	Depreciation and impairment of operating leased assets			
	Total Interest expenses	-	-	-
Balance Sheet Information				
1.3	Interest Earning Assets			
1.31	Gross loans and advances			
1.32	Interest bearing investments*			
1.33	Interest bearing deposits and balances due from local banking institutions			
1.34	Interest bearing deposits and balances due from banking institutions abroad			
1.35	Interest bearing balances due from banking institutions in the group			
1.36	Lease assets measured at the end of each financial year			
1.37	Other interest earning assets			
	Total interest earning assets	0	0	0
1.4	Dividend income**	0	0	0
2	Services Component (SC)			
2.1	Fee and commission income			
2.1.1	Fees and commissions income on loans & advances			
2.1.2	Fees and commissions on guarantees and letters of credit			
2.1.3	Commission and fees income from foreign exchange transactions			
2.1.4	Commission and fees income from clearing and settlements			
2.1.5	Commission and fees income from asset management			

2.1.6	Commission and fees income from custody services			
2.1.7	Commissions and fees from security issuance			
2.1.8	Other fees and commissions income			
	Total fees and commissions income	0	0	0
2.2	Fee and commission expenses			
2.2.1	Commission and fees expense from foreign exchange transactions			
2.2.2	Commission and fees expense from clearing and settlements			
2.2.3	Commission and fees expense from custody services			
2.2.4	Fees expense from loan commitments and guarantees received			
2.2.5	Other fees and commissions expenses			
	Total fee and commission expenses	0	0	0
2.3	Other Operating Income			
2.3.1	Profit on sale of property and equipment			
2.3.2	Rental income from investment properties			
2.3.3	Gains from non-current assets and disposal groups ***			
2.3.4	Other operating income not referred above			
	Total other operating income from ordinary banking operations	0	0	0
2.4	Other Operating Expenses			
2.4.1	Losses incurred as a consequence of operational loss events not provisioned ****			
2.4.2	Losses from non-current assets and disposal groups ***			
2.4.3	Expenses related to establishing provisions / reserves for operational loss events			
2.4.4	Other operating expense not referred above			
	Total other operating expense from ordinary banking operations	0	0	0
3	Financial Component (SC)			
3.1	Net Profit (Loss) on the Trading Book			
3.1.1	Net profit/loss on trading assets and trading liabilities *****			
3.1.2	Net profit/loss from hedge accounting			
3.1.3	Net profit/loss from exchange differences			
	Net profit (loss) on the trading book	-	-	-
3.2	Net Profit (loss) on the Banking Book			
3.2.1	Realised gains/losses on financial assets and liabilities measured at FVTPL			
3.2.2	Realised gains/losses on financial assets and liabilities not measured at FVTPL*****			
3.2.3	Net profit/loss from hedge accounting			
3.2.4	Net profit/loss from exchange differences			
	Net profit (loss) on the banking book	-	-	-

* Includes T-bills, bonds and other interest bearing securities

** Dividend income from investments in stocks and funds not consolidated in the bank's financial statements, including dividend income from non-consolidated subsidiaries, associates and joint ventures.

*** Refers to gains and losses from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations (IFRS 5.37) typically for non recurring items.

**** e.g. fines, penalties, settlements, replacement cost of damaged assets

***** e.g. derivatives, debt securities, equity securities, loans and advances, short positions, other assets and liabilities

***** e.g. loans and advances, assets available for sale, assets held to maturity, financial liabilities measured at amortised cost

THE BUSINESS INDICATOR CALCULATION				
AMOUNT (KHS' 000)				
	Avg (Abs(Int.Inc - Int.Exp.))	2,25%* Avg (Int.Earn.Assets)	Avg (Dividend Inc.)	ILDC
ILDC:	-	-	-	-
	Max(avg(OOI); avg(OOE))	Max(avg(Fee Inc); avg(Fee Exp))	SC	
SC:	-	-	-	
	Avg(Abs(Net P&L Trading Book))	Avg(Abs(Net P&L Banking Book))	FC	
FC	-	-	-	
	BI = ILDC + SC + FC =	-		
$ILDC = \text{Min} [\overline{\text{Abs(Interest Income - Interest Expense)}}; 2,25\% \cdot \overline{\text{Interest Earning Assets}}] + \overline{\text{Dividend Income}}$ $SC = \text{Max} [\overline{\text{Other Operating Income}}; \overline{\text{Other Operating Expense}}] + \text{Max} [\overline{\text{Fee Income}}; \overline{\text{FeeExpense}}]$ $FC = \overline{\text{Abs(Net P\&L Trading Book)}} + \overline{\text{Abs(Net P\&L Banking Book)}}$				
BUSINESS INDICATOR COMPONENT				
Item			Business Indicator Component (BIC)	Bucket Amount
			AMOUNT (KHS' 000)	
Buckets and Maximal	Bucket 1	12%	-	0
	Bucket 2	15%	-	0
	Bucket 3	18%	-	0
Total BIC			0	0
INTERNAL LOSS MULTIPLIER (ILM)				
ILM (ILM=1)		1		
OPERATIONAL RISK CAPITAL REQUIREMENTS (ORC)				
BIC			0	
ILM			1	
ORC = BIC × ILM			0	
Risk-Weighted Assets (RWA) for Operational Risk			0	

