BANK OF MAURITIUS

Guideline on Scope of Application of Basel III and Eligible Capital

June 2014

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INTRODUCTION

In December 2010, the Basel Committee on Banking Supervision (BCBS) issued a comprehensive reform package entitled 'Basel III: A global regulatory framework for more resilient banks and banking systems'[1]. The reform measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, improve risk management and governance and strengthen banks' transparency and disclosures.

Purpose

This document sets out the rules text and timelines to implement some of the elements related to the strengthening of the capital framework. It formulates the characteristics that an instrument must have in order to qualify as regulatory capital, and the various adjustments that have to be made in determining the regulatory capital of a bank. In addition, it outlines the operation of the capital conservation buffer which is designed to ensure that banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. It also lays down the transitional arrangements for implementing certain elements of the Basel III capital framework, as well as the limits and minima of the different components of capital.

Authority

This guideline is issued under the authority of section 100 of the Banking Act 2004 and section 50 of the Bank of Mauritius Act 2004.

Scope of application

This guideline applies to all banks licensed under the Banking Act 2004.

Previous guideline superseded

This guideline supersedes the *Guideline on Eligible Capital* issued in April 2008 and the *Guideline on Scope of Application of Basel II* issued in May 2008.

Effective date

This guideline shall come into effect on 1 July 2014.

[1] The document was revised in June 2011 and is available on the website of the BIS at www.bis.org.

Interpretation

1. In this guideline,

   (a) “bank” has the same meaning as in the Banking Act 2004;

   (b) “Bank” means the Bank of Mauritius;

   (c) “component of capital” is any form of capital defined in this guideline as eligible for inclusion in regulatory capital;

   (d) “category of capital” is a group of components of capital;

   (e) “CET1 CAR” means Common Equity Tier 1 capital adequacy ratio, calculated by dividing CET1 Capital by total risk-weighted assets (RWAs);

   (f) “Reporting bank” means a bank which is subject to the requirements of this guideline;

   (g) “Tier 1 Capital” means the sum of CET1 Capital and AT1 Capital;

   (h) “Tier 1 CAR” means Tier 1 capital adequacy ratio, calculated by dividing Tier 1 Capital by total RWAs;

   (i) “Total CAR” means total capital adequacy ratio, calculated by dividing total capital (capital base) by total RWAs;

   (j) Total risk-weighted assets (Total RWA) mean Credit RWA plus Operational RWA plus Market RWA.

Structure of the guideline

There are five sections in this guideline:

Section I	-	Definition of Regulatory Capital
Section II	-	Regulatory Adjustments
Section III	-	Transitional Arrangements
Section IV	-	Disclosure Requirements
Section V	-	Capital Conservation Buffer

SECTION I – DEFINITION OF REGULATORY CAPITAL

Components of capital

2. Total regulatory capital shall consist of the sum of the following elements:

   (a) Tier 1 capital (going-concern capital[2]), which comprises

      (i) Common Equity Tier 1

      (ii) Additional Tier 1 Capital

   (b) Tier 2 Capital (gone-concern capital[3])

   For each of the three categories above, there is a single set of criteria that the instruments are required to meet before they can be included in the relevant category.

Limits and minima

3. All elements above are net of the associated regulatory adjustments and are subject to the following restrictions (exclusive of the capital conservation buffer):

   (a) Common Equity Tier 1 must be at least 6.5% of risk-weighted assets[4];

   (b) Tier 1 capital must be at least 8.0% of risk-weighted assets[5];

   (c) Total Capital (Tier 1 Capital plus Tier 2 Capital) must be at least 10.0 per cent of risk-weighted assets at all times.

Capital base

4. For the purpose of determining the capital adequacy ratio of a bank, the capital base of a bank shall be the sum of Tier 1 and Tier 2 Capital net of regulatory adjustments applied.

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[2] 'Going-concern capital' refers to capital against which losses can be written off while a bank continues to operate. Going-concern capital will also absorb losses should the bank ultimately fail.

[3] 'Gone-concern capital' refers to capital that would not absorb losses until such time as a bank is wound up or the capital is otherwise written off or converted into ordinary shares.

[4] Applicable as from 1 January 2016.

[5] Applicable as from 1 January 2016.

Requirements to apply at the solo and group levels

5. A bank shall comply with the minimum capital ratio requirements set out in this guideline at two levels:

   (a) the bank standalone ("solo") level capital adequacy ratio requirements, which measure the capital adequacy of the bank based on its standalone capital strength and risk profile; and

   (b) the consolidated ("group") level capital adequacy ratio requirements, which measure the capital adequacy of the bank based on its capital strength and risk profile after consolidating the assets and liabilities of its subsidiary entities that are engaged in financial activities[6], except for entities involved in insurance and non-financial (commercial) activities.

   The framework will also apply, on a fully consolidated basis, to any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group.

Other requirements

6. A bank must ensure that any component of capital included in its capital base satisfies, in both form and substance, all applicable requirements in this guideline for the particular category of capital in which it is included.

7. The Bank may, in writing, require a bank to:

   (a) exclude from its regulatory capital any component of capital that in the opinion of the Bank does not represent a genuine contribution to the financial strength of the bank; or

   (b) reallocate to a lower category of capital any component of capital that in the opinion of the Bank does not fully satisfy the requirements of this guideline for the category of capital to which it was originally allocated.

8. A bank must provide the Bank, as soon as practicable, with copies of documentation associated with the issue of Tier 1 and Tier 2 capital instruments.

9. A bank must forthwith inform the Bank prior to any subsequent modification of the terms and conditions of an instrument that may affect its eligibility to continue to qualify as regulatory capital.

[6] Activities that financial entities might be involved in include financial leasing, issuing credit cards, portfolio management, investment advisory, custodial and safekeeping services and other activities that are ancillary to the business of banking. It excludes insurance activities.

10. The Bank may require a bank to provide an independent expert opinion, addressed to the Bank by an audit/and or a legal firm of the Bank’s choice and at the bank’s expense, confirming that an instrument is eligible for inclusion in the relevant category of capital.

Common Equity Tier 1

11. Common Equity Tier 1 (CET1) capital shall consist of the sum of the following elements:

    (a) Ordinary shares (paid-up equity capital) issued by the bank for classification as ordinary shares for regulatory capital purposes;

    (b) Share premium resulting from the issue of ordinary shares included in CET1;

    (c) Retained earnings after deducting any interim or final dividends which have been declared by the board of the bank or any banking group entity on any class of shares and any interim losses incurred since the end of the last financial reporting period;

    (d) Accumulated other comprehensive income and other disclosed reserves, excluding revaluation surpluses on land and building assets;

    (e) The current year's interim profits may be included provided they have been verified by the bank's external auditors. In the absence of such verification, current year's interim profits will not be included in the capital base. The verification by external auditors should entail at least the following:

        (i) satisfying themselves that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;

        (ii) reviewing the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the bank in drawing up its annual financial statements;

        (iii) performing analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s);

        (iv) discussing with management the overall performance and financial position of the bank;

        (v) obtaining adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and

        (vi) following up problem areas of which the auditors are already aware in the course of auditing the bank's financial statements.

The external auditors must submit an opinion to the Bank on whether the interim results are fairly stated, and whether the provisions for bad and doubtful debts are adequate.

(f) Ordinary shares issued by consolidated subsidiaries of the bank and held by third parties (i.e. minority interest) that meet the criteria for inclusion in CET1.

(g) Regulatory adjustments (deductions) applied in the calculation of CET1.

Criteria for classification as ordinary shares for regulatory capital purposes

12. An instrument must satisfy all of the following criteria to be classified as ordinary shares:

(a) It represents the most subordinated claim in liquidation of the bank.

(b) The holder of the instrument is 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. there is an unlimited and variable claim, not a fixed or capped claim).

(c) The principal amount of the instrument is perpetual (i.e. it has no maturity date) and is never repaid outside of liquidation This excludes discretionary repurchases or other means of reducing capital in a discretionary manner that is allowable under the law and approved by the Bank.

(d) The bank does not 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 that might give rise to such an expectation.

(e) Distributions are paid out of distributable items (including retained earnings). The level of distributions must not be tied or linked to the amount paid up 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).

(f) There are no circumstances under which the distributions are obligatory. Non-payment of distributions is not an event of default.

(g) Distributions are paid only after all legal and contractual obligations have been met and after 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 Common Equity Tier 1 Capital.

(h) The instrument takes the first and proportionately greatest share of any losses as they occur[7]. Within Common Equity Tier 1 Capital, each instrument absorbs losses on a

[7] In cases where capital instruments have a permanent write-off feature, this criterion is still deemed to be met by ordinary shares.

going concern basis proportionately and *pari passu* with all the other instruments included in Common Equity Tier 1 Capital.

(i) Only the paid-up amount of the instrument, irrevocably received by the issuer, is recognised as equity capital (i.e. it is not recognised as a liability) for determining balance sheet insolvency.

(j) The paid in amount is classified as equity under the applicable accounting standards.

(k) The instrument is directly issued and paid-up and the bank or any other member of the group to which the bank belongs, or any related entity, cannot directly or indirectly have funded the purchase of the instrument.

(l) The paid-up amount of the instrument is neither secured nor covered by a guarantee of the issuer or related entity[8] or subject to any other arrangement that legally or economically enhances the seniority of the claim.

(m) The instrument is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by the law, given by the board of directors or by other persons duly authorised by the owners.

(n) The instrument is clearly and separately disclosed on the bank's balance sheet.

Additional Tier 1 capital

13. Additional Tier 1 (AT1) capital shall consist of the sum of the following elements:

(a) Instruments issued by the bank that meet the criteria for inclusion in Additional Tier 1 capital (and are not included in CET1);

(b) Share premium[9] resulting from the issue of instruments included in Additional Tier 1 capital;

(c) 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;

(d) Regulatory adjustments applied in the calculation of Additional Tier 1 Capital.

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

[9] Share premium that is not eligible for inclusion in Common Equity Tier 1, will only be permitted to be included in Additional Tier 1 capital if the shares giving rise to the share premium are permitted to be included in Additional Tier 1 capital.

Criteria for inclusion in Additional Tier 1 capital

14. An instrument must satisfy the following criteria to be included in Additional Tier 1 Capital.

    (a) The instrument is issued and fully paid-up in cash;

    (b) The instrument represents, prior to any conversion to CET1 Capital, the most subordinated in liquidation of the bank after CET1 Capital instruments. In other words, the instrument is subordinated to depositors and general creditors of the bank and holders of Tier 2 capital instruments issued by the bank;

    (c) The paid-up amount of the instrument 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;

    (d) The instrument is perpetual, i.e. there is no maturity date, and there are no step-ups or other incentives to redeem;

    (e) The instrument may only be callable at the initiative of the issuer only after a minimum of five years from the issue date, subject to the following requirements:

        (i) A call option can be exercised only with the prior approval of the Bank;

        (ii) The bank shall not create an expectation that the call option will be exercised; and

        (iii) The bank must not exercise a call option unless:

            (1) the bank replaces 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

            (2) the bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

    (f) Any repayment of principal (e.g. through repurchase or redemption) can only be made with the prior approval of the Bank and banks should not assume or create market expectations that supervisory approval will be given;

    (g) With regard to dividend or coupon on the capital instrument:

        (i) the bank must have full discretion at all times to cancel distributions/payments. Any waived distributions are non-cumulative (i.e. are not required to be made up by the issuer at a later date). The instrument must not provide for payment of a higher dividend or interest rate if dividend or interest payments are not made on time;

(ii) cancellation of discretionary payments must not be an event of default. Holders of the instruments must have no right to apply for the winding-up or administration of the bank, or cause a receiver, or receiver and manager, to be appointed in respect of the bank on the grounds that the bank fails to make, or is or may become unable to make, a distribution on the instruments;

(iii) the bank must have full access to cancelled payments to meet obligations as they fall due;

(iv) the bank must ensure that cancellation of distributions/payments does not impose restrictions on the bank except in relation to distributions to ordinary shareholders.

(h) Dividends/coupons on the instrument must be paid out of distributable items;

(i) 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 credit standing of the bank or the group or any other member of the group to which it belongs;

(j) The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of any national insolvency law governing the provisions of the capital instrument;

(k) Where the instrument is classified as a liability for accounting purposes, it must have principal loss absorption through either (i) conversion to ordinary shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

(i) It reduces the claim of the instrument in liquidation;

(ii) It reduces the amount repaid when a call option is exercised; and

(iii) It partially or fully reduces coupon/dividend payments on the instrument.

(l) Neither the bank nor any other member of the group to which the bank belongs, nor any related entity can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument;

(m) 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;

(n) 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 an 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

(o) The terms and conditions of the capital instrument contain provisions which ensure its loss absorbency at the point of non-viability that meet the requirements set out in Annex 1.

Tier 2 capital

15. Tier 2 Capital includes other components of capital that, to varying degrees, fall short of the quality of Tier 1 Capital but nonetheless contribute to the overall strength of a bank and its capacity to absorb losses.

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

(a) Instruments issued by the bank that meet the criteria for inclusion in Tier 2 capital (and are not included in Tier 1 capital);

(b) Share premium[10] resulting from the issue of instruments included in Tier 2 capital;

(c) 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.

(d) Provisions or loan-loss reserves which are held against future, presently unidentified losses and are freely available to meet losses which subsequently materialise will qualify for inclusion within Tier 2 capital[11], subject to a maximum of 1.25 percentage points of credit risk-weighted risk assets calculated under the standardised approach.

(e) Surplus arising from revaluation of land and buildings that is owned by the bank and reflected on the face of the audited financial statements as revaluation reserves subject to a discount of 55 per cent.

Banks should ensure that the values of their premises are reflective of market values and on this basis, therefore, the assets must be valued prudently at least once every three years or where there is evidence that the value of the land and buildings is likely to be substantially impaired. The valuation must be undertaken by an independent

[10] 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 share premium are permitted to be included in Tier 2 capital.

[11] Provisions ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded.

professional valuer on a basis satisfactory to both the external auditors and the Bank, and explicitly reported in the audited accounts of the bank. Only 45 per cent of the revaluation reserves arising from land and buildings will be eligible for inclusion in Tier 2 capital.

(f) Regulatory adjustments applied in the calculation of Tier 2 Capital.

Instruments issued by the bank that meet the Tier 2 criteria

17. The objective of Tier 2 is to provide loss absorption on a gone-concern basis.

Criteria for inclusion in Tier 2 Capital

18. An instrument is required to meet the following minimum set of criteria in order for it to be included in Tier 2 capital.

(a) The instrument should be issued by the bank and fully paid-up in cash.

(b) The instrument represents, prior to any conversion to Common Equity Tier 1 Capital, the most subordinated claim in liquidation of the issuer after Common Equity Tier 1 capital instruments and Additional Tier 1 capital instruments;

(c) The paid-up amount of the instrument 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;

(d) The instrument must have a minimum original maturity of at least five years and there are no step-ups or other incentives to redeem;

(e) The amount of the instrument that will be eligible for inclusion in Tier 2 capital shall be amortised on a straight line basis as follows:

Years to Maturity	**Amount Eligible for Inclusion in Tier 2 Capital**
More than 4	100 per cent
Less than and including 4 but more than 3	80 per cent
Less than and including 3 but more than 2	60 per cent
Less than and including 2 but more than 1	40 per cent
Less than and including 1	20 per cent

(f) The instrument may be callable at the initiative of the issuer only after a minimum of five years from the issue date, subject to the following requirements:

(i) A call option can be exercised only with the prior approval of the Bank;

(ii) The bank must not do anything which creates an expectation that the call will be exercised; and

(iii) The bank must not exercise a call unless:

(1) The bank replaces 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

(2) The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised;

(g) The instrument must confer no rights on holders to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation;

(h) 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 credit standing of the bank or the group or any other member of the group to which it belongs;

(i) Neither the bank nor any other member of the group to which the bank belongs, nor any related entity can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument;

(j) 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 an 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; and

(k) The terms and conditions of the capital instrument contain provisions which ensure its loss absorbency at the point of non-viability that meet the requirements set out in Annex 1.

Minority interest (i.e. non-controlling interest) and other capital issued out of consolidated subsidiaries that is held by third parties

Ordinary shares issued by consolidated subsidiaries

19. Minority interest arising from the issue of ordinary shares by a fully consolidated subsidiary of the bank may receive recognition in Common Equity Tier 1 only if:

(a) the instrument giving rise to the minority interest would, if issued by the bank, meet all of the criteria for classification as ordinary shares for regulatory capital purposes; and

(b) the subsidiary that issued the instrument is itself a bank.

Tier 1 qualifying capital issued by consolidated subsidiaries

20. Tier 1 capital instruments issued by a fully consolidated subsidiary of the bank to third party investors 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.

    The amount of this Tier 1 capital that will be recognised in Additional Tier 1 will exclude amounts recognised in Common Equity Tier 1.

Tier 1 and Tier 2 qualifying capital issued by consolidated subsidiaries

21. Total capital instruments (i.e. Tier 1 and Tier 2 capital instruments) issued by a fully consolidated subsidiary of the bank to third party investors may receive recognition in Total Capital only if the instruments would, if issued by the bank, meet all of the criteria for classification as Tier 1 or Tier 2 capital.

    The amount of this Total Capital that will be recognised in Tier 2 will exclude amounts recognised in Common Equity Tier 1 and amounts recognised in Additional Tier 1.

Special Purpose Vehicle

22. Where capital has been issued to third parties out of a special purpose vehicle (SPV), none of this capital can be included in Common Equity Tier 1. However, such capital can be included in consolidated Additional Tier 1 or Tier 2 and treated as if the bank itself had issued the capital directly to the third parties only if it meets all the relevant entry criteria and the only asset of the SPV is its investment in the capital of the bank in a form that meets or exceeds all the relevant entry criteria.

    In cases where the capital has been issued to third parties through an SPV via a fully consolidated subsidiary of the bank, such capital may, subject to the requirements of this paragraph, be treated as if the subsidiary itself had issued it directly to the third parties and may be included in the bank's consolidated Additional Tier 1 or Tier 2.

SECTION II: REGULATORY ADJUSTMENTS

Regulatory adjustments applied to Common Equity Tier 1 Capital

23. A bank must make the following regulatory adjustments to determine Common Equity Tier 1 at the solo or group level, as the case may be, in accordance with the transitional arrangements set out in Section III. Assets deducted from Common Equity Tier 1 capital should not be included in risk-weighted assets.

Goodwill and other intangibles

24. A bank must deduct the following net of any associated deferred tax liabilities which would be extinguished if the intangible assets become impaired or derecognised under applicable accounting standards:

    (a) goodwill and any other intangible assets[12] arising from an acquisition, net of adjustments to profit or loss reflecting any changes from 'impairment' of goodwill; and

    (b) other intangible assets net of adjustments to profit or loss reflecting amortisation and impairment.

Deferred tax assets

25. A bank must deduct from its Common Equity Tier 1 Capital deferred tax assets (DTAs) that rely on future profitability of the bank. DTAs may be netted with associated deferred tax liabilities[13] (DTLs) prior to being deducted in the calculation of Common Equity Tier 1 Capital only if offsetting is permitted by the relevant taxation authority. The DTLs permitted to be netted against DTAs shall exclude amounts that have been netted against the deduction of goodwill, intangible assets and defined benefit pension assets.

26. DTAs arising from any other source will be required to be deducted from Common Equity Tier 1 as a prudent measure.

Cash flow hedge reserve

27. A bank must deduct from its Common Equity Tier 1 Capital the amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance

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[12] Intangible assets include but are not limited to copyright, patents, intellectual property and capitalised information technology software costs.

[13] In the event that deferred tax liabilities exceed the amount of deferred tax assets, the excess cannot be added to Common Equity Tier a Capital (i.e. the net deduction is zero).

sheet (including projected cash flows). In this regard, positive amounts shall be deducted and negative amounts shall be added back.

Cumulative gains and losses due to changes in own credit risk on fair valued financial liabilities

28. A bank must derecognise in the calculation of Common Equity Tier 1, all unrealised 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.

Defined benefit pension fund assets and liabilities

29. Defined benefit pension fund assets net of the amount of obligations under the fund and any associated deferred tax liabilities shall be deducted from Common Equity Tier 1. Assets in the fund to which the bank has unrestricted and unfettered access can, with the approval of the Bank, offset the deduction, and be risk-weighted at 100 per cent.

30. 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. In other words, the creation of the liability on the balance sheet of the bank will automatically result in a reduction in the bank's common equity (through a reduction in reserves) and no adjustment should be applied in respect of this in the calculation of Common Equity Tier 1.

Investments in own shares (treasury shares)

31. All of a bank's investments in its own ordinary shares (including treasury shares), whether held directly or indirectly, must be deducted in the calculation of Common Equity Tier 1 unless already derecognised under the relevant accounting standards. In addition, any own shares which the bank could be contractually obliged to purchase shall be deducted from Common Equity Tier 1. The adjustment shall apply to exposures in both the banking book and the trading books.

32. Following the same approach outlined above, banks must deduct investments in their own Additional Tier 1 in the calculation of their Additional Tier 1 capital and must deduct investments in their own Tier 2 in the calculation of their Tier 2 capital.

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

33. This regulatory adjustment applies to 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 ordinary share capital of the entity.

34. Investments include:

    (a) 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 books. Capital includes ordinary shares 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); and

    (c) underwriting positions held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included.

    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 ordinary shares for the purposes of this regulatory adjustment.

    Banks may, with the prior approval of the Bank, exclude temporarily certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

35. If the total of all holdings listed in paragraph 34 above in aggregate exceed 10% of the bank's common equity (after applying all other regulatory adjustments in full listed prior to this one) then the amount above 10% is required to be deducted, 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.

36. The amount to be deducted is to be calculated as follows:

    (a) aggregate all of the bank's holdings of investments issued by financial sector entities and compare with 10% of the bank's own Common Equity Tier 1 capital;

    (b) investments that are more than 10% will be deducted following the corresponding deduction approach.

37. The amounts of such capital investments that do not exceed the 10% threshold calculated in accordance with the paragraph 36(a) above and are not deducted shall continue to be risk-weighted according to the banking and trading book rules. 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 shall be allocated on a pro rata basis between those below and those above the threshold.

38. The same approach is to be applied for a bank's non-significant capital investments in financial sector entities that are to be deducted from Additional Tier 1 capital and Tier 2 capital.

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

39. This regulatory adjustment applies to investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation where the bank owns more than 10% of the issued ordinary share capital of the issuing entity or where the entity is an affiliate of the bank.

40. Investments comprise:

    (a) 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 books are to be included. Capital includes ordinary shares 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); and

    (c) underwriting positions held for five working days or less can be excluded. Underwriting positions held for longer than five working days must be included.

    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 ordinary shares for the purposes of this regulatory adjustment.

    Banks may be allowed, with prior approval of the Bank, to exclude temporarily certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

41. The amount to be deducted is to be calculated as follows:

(a) aggregate all of the bank's holdings in entities where the bank owns more than 10% of the ordinary share capital of the individual entity;

(b) compare the aggregated equity investments calculated in (a) above with 10% of the bank's Common Equity Tier 1 capital;

(c) investments that are less than 10% of the bank's Common Equity Tier 1 capital will be risk weighted at 250%;

(d) investments that are more than 10% of the bank's Common Equity Tier 1 capital will be deducted from Common Equity Tier 1 capital applied in line with the Transitional Arrangements mentioned under Section III. More specifically, 50% of significant investments will be deducted from Common Equity Tier 1 up to 31 December 2016, 60% of the investments will be deducted as from 1 January 2017, 80% of the investments as from 1 January 2018 and 100% as from 1 January 2019.

42. The remaining amount under paragraph 41(d) not deducted in Common Equity Tier 1 capital during the transitional period will continue to be deducted from Tier 2 capital until 31 December 2018.

43. All investments that are not ordinary 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.

Former deductions from capital

44. Significant investments in commercial entities, which under Basel II were deducted 50% from Tier 1 and 50% from Tier 2 (or had the option of being deducted or risk weighted), will receive a 1250% risk weight.

45. Investments in commercial entities that are equal to or below 10% of the issued share capital of the issuing entity shall be assigned a 125% risk weight or the risk weight as warranted by rating or lack of it, whichever higher.

Other adjustments

46. A bank shall make any other deductions required under any other guidelines and/or as may be required by the Bank.

General rules for regulatory adjustments

47. For the purposes of regulatory adjustments to Additional Tier 1 Capital and Tier 2 Capital:

(a) where the amount of Additional Tier 1 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Common Equity Tier 1 Capital; and

(b) where the amount of Tier 2 Capital is insufficient to cover the amount of deductions required to be made from this category of capital, the shortfall must be deducted from Additional Tier 1 Capital and, if Additional Tier 1 Capital is insufficient to cover the amount of the deductions required, the remaining amount must be deducted from Common Equity Tier 1 Capital.

Regulatory adjustments applied to Additional Tier 1 Capital

48. A reporting bank shall apply the following regulatory adjustments in the calculation of its Additional Tier 1 Capital at the solo or group level, as the case may be:

Investment in own Additional Tier 1 Capital

49. Investments in the bank's own Additional Tier 1 capital instruments, whether held directly or indirectly by the bank or any of its banking group entities, shall be deducted in the calculation of Additional Tier 1 Capital. Any own Additional Tier 1 capital instruments, which the reporting bank or any of its banking group entities could be contractually obliged to purchase, shall also be included in the deduction. This adjustment shall apply to exposures in both the banking book and trading books.

Investments in the capital of banking, financial and insurance entities

50. These comprise

(a) direct, indirect and synthetic holdings of Additional Tier 1 Capital instruments in banking, financial and insurance entities. This includes:

(i) holdings of Additional Tier 1 Capital instruments held in the banking book;

(ii) net long positions[14] in Additional Tier 1 Capital instruments[15] held in the trading book; and

[14] 'Net long positions' are the gross long positions net of the short positions in the same underlying exposures where the maturity of the short positions either match the maturity of the long positions or have residual maturities of at least one year. They include netting positions in physical instruments and derivatives over the same underlying exposure (including those associated with looking through holdings of index securities).

[15] This includes investments in capital instruments resulting from the holdings of index securities. Financial institutions are permitted to net long short positions in the same index security subject to maturity matching provisions.

(iii) underwriting positions in Additional Tier 1 Capital instruments held for more than five working days.

(b) the amount of such capital investments to be deducted in the calculation of Additional Tier 1 Capital shall be in accordance with paragraphs 33 to 38 above.

Regulatory adjustments applied to Tier 2 Capital

A reporting bank shall apply the following deductions in the calculation of its Tier 2 Capital at solo or group level, as the case may be.

Capital investments in financial institutions

51. These comprise

(a) direct, indirect and synthetic holdings of Tier 2 Capital instruments in financial entities. This includes:

(i) holdings of Tier 2 Capital instruments held in the banking book;

(ii) the net long positions in Tier 2 Capital instruments held in the trading book; and

(iii) all underwriting positions in Tier 2 Capital instruments held for more than five working days.

(b) the amount of such capital investments to be deducted in the calculation of Tier 2 Capital shall be in accordance with paragraphs 33 to 38 above.

Investment in own Tier 2 capital holdings

52. Investments in the bank's own Tier 2 capital instruments, whether held directly or indirectly by the bank or any of its banking group entities, shall be deducted in the calculation of Tier 2 Capital. Any own Tier 2 capital instruments, which the reporting bank or any of its banking group entities could be contractually obliged to purchase, shall also be included in the deduction. This adjustment shall apply to exposures in both the banking book and trading books.

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

53. The remainder of any significant capital investment in banking, financial and insurance entities not deducted in Common Equity Tier 1 Capital in accordance with paragraph 42.

SECTION III: TRANSITIONAL ARRANGEMENTS

The transitional arrangements for implementing the new standards will help to ensure that the banking sector can meet the higher capital standards through reasonable earnings retention and capital raising, while still supporting lending to the economy.

54. As of 1 July 2014, banks will be required to meet the following new minimum requirements in relation to risk-weighted assets (RWAs):

    (a) 5.5% Common Equity Tier 1/RWAs;

    (b) 6.5% Tier 1 capital/RWAs, and

    (c) 10.0% total capital/RWAs.

    Annex 2 sets out the phase-in arrangements of capital requirements for banks operating in Mauritius.

55. The minimum Common Equity Tier 1 and Tier 1 requirements will be phased in between 1 July 2014 and 1 January 2016. On 1 July 2014, the minimum Common Equity Tier 1 requirement shall be 5.5%. The Tier 1 capital requirement shall be 6.5%. On 1 January 2015, banks will have to meet a 6.0% minimum Common Equity Tier 1 requirement and a Tier 1 requirement of 7.5%. On 1 January 2016, banks will have to meet the 6.5% Common Equity Tier 1 and the 8.0% Tier 1 requirements. The total capital requirement remains at the existing level of 10.0% and so does not need to be phased in. The difference between the total capital requirement of 10.0% and the Tier 1 requirement can be met with Tier 2 and higher forms of capital.

56. Most of the regulatory adjustments will apply to Common Equity Tier 1 and will not require a phase-in period except for significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation and which will be phased in as under.

57. 50% of significant investments will be deducted from Common Equity Tier 1 up to 31 December 2016, 60% of the investments will be deducted as from 1 January 2017, 80% of the investments as from 1 January 2018 and 100% as from 1 January 2019. The remaining amount not deducted in Common Equity Tier 1 capital during the transitional period will continue to be deducted from Tier 2 capital until 31 December 2018.

58. The treatment of capital issued out of subsidiaries and held by third parties (e.g. minority interest) will also be phased in. Where such capital is eligible for inclusion in one of the three components of capital, it can be included from 1 July 2014. Where such capital is not eligible for inclusion in one of the three components of capital but is included under the existing national treatment, 20% of this amount should be excluded from the relevant

component of capital on 1 January 2015, 40% on 1 January 2016, 60% on 1 January 2017, 80% on 1 January 2018, and reach 100% on 1 January 2019.

59. Capital instruments that no longer qualify as non-common equity Tier 1 capital or Tier 2 capital will be phased out beginning 1 July 2014. Fixing the base at the nominal amount of such instruments outstanding on 1 July 2014, their recognition will be capped at 90% from 1 July 2014, with the cap reducing by 10 percentage points in each subsequent year[16]. This cap will be applied to Additional Tier 1 and Tier 2 separately and refers to the total amount of instruments outstanding that no longer meet the relevant entry criteria. To the extent an instrument is redeemed, or its recognition in capital is amortised, after 1 July 2014, the nominal amount serving as the base is not reduced. In addition, instruments with an incentive to be redeemed will be treated as follows:

(a) For an instrument that has a call and a step-up prior to 1 July 2014 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward-looking basis will meet the new criteria for inclusion in Tier 1 or Tier 2, it will continue to be recognised in that tier of capital.

(b) For an instrument that has a call and a step-up on or after 1 July 2014 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward looking basis will meet the new criteria for inclusion in Tier 1 or Tier 2, it will continue to be recognised in that tier of capital. Prior to the effective maturity date, the instrument would be considered an "instrument that no longer qualifies as Additional Tier 1 or Tier 2" and will therefore be phased out from 1 July 2014.

(c) For an instrument that has a call and a step-up between 31 October 2012 and 1 July 2014 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in Tier 1 or Tier 2, it will be fully derecognised in that tier of regulatory capital from 1 July 2014.

(d) For an instrument that has a call and a step-up on or after 1 July 2014 (or another incentive to be redeemed), if the instrument is not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in Tier 1 or Tier 2, it will be derecognised in that tier of regulatory capital from the effective maturity date. Prior to the effective maturity date, the instrument would be considered an "instrument that no longer qualifies as Additional Tier 1 or Tier 2" and will therefore be phased out from 1 July 2014.

(e) For an instrument that had a call and a step-up on or prior to 31 October 2012 (or another incentive to be redeemed), if the instrument was not called at its effective maturity date and on a forward looking basis does not meet the new criteria for inclusion in Tier 1 or Tier 2, it will be considered an "instrument that no longer qualifies as Additional Tier 1 or Tier 2" and will therefore be phased out from 1 July 2014.

[16] The applicable date shall be 1 January of each subsequent year.

60. Capital instruments that do not meet the criteria for inclusion in Common Equity Tier 1 will be excluded from Common Equity Tier 1 as of 1 July 2014. However, instruments meeting the following three conditions will be phased out over the ten-year horizon described in paragraph 59 above: (1) they are issued by a non-joint stock company; (2) they are treated as equity under the prevailing accounting standards; and (3) they receive unlimited recognition as part of Tier 1 capital under the Banking Act 2004.

61. Only those instruments issued before 31 October 2012 qualify for the above transition arrangements.

SECTION IV: DISCLOSURE REQUIREMENTS

62. To help improve transparency of regulatory capital and improve market discipline, banks are required to disclose the following:

    (a) a full reconciliation of all regulatory capital elements back to the balance sheet in the audited financial statements;

    (b) separate disclosure of all regulatory adjustments and the items not deducted from Common Equity Tier 1;

    (c) a description of all limits and minima, identifying the positive and negative elements of capital to which the limits and minima apply; and

    (d) a description of the main features of capital instruments issued.

    Banks which disclose ratios involving components of regulatory capital (e.g. "Equity Tier 1", "Core Tier 1" or "Tangible Common Equity" ratios) must accompany such disclosures with a comprehensive explanation of how these ratios are calculated.

63. Banks are also required to make available on their websites the full terms and conditions of all instruments included in regulatory capital.

64. During the transition phase banks are required to disclose the specific components of capital, including capital instruments and regulatory adjustments that are benefiting from the transitional provisions.

SECTION V: CAPITAL CONSERVATION BUFFER

65. The capital conservation buffer (CCB) aims at promoting the conservation of capital and the build-up of adequate buffers above the minimum during normal times (i.e. outside periods of stress) which can be drawn down as losses are incurred during a stressed period.

    Outside the period of stress, banks should hold buffers of capital above the regulatory minimum.

    When buffers have been drawn down, one way banks should look to rebuild them is through reducing discretionary distributions of earnings. This could include reducing dividend payments, share buybacks and discretionary bonus payments to staff. Banks may also choose to raise new capital from the market as an alternative to conserving internally generated capital.
    In the absence of raising capital from the market, the share of earnings retained by banks for the purpose of rebuilding their capital buffers should increase the nearer their actual capital levels are to the minimum capital requirement.

    Banks which have depleted their capital buffers should not use future predictions of recovery as justification for maintaining generous distributions to shareholders, other capital providers and employees.

    Banks which have depleted their capital buffers should not try and use the distribution of capital as a way to signal their financial strength.

    The capital conservation buffer can be drawn down only when a bank faces a systemic or idiosyncratic stress. A bank should not choose in normal times to operate in the buffer range simply to compete with other banks and win market share. This aspect would be specifically looked into by the Bank during the Supervisory Review and Evaluation Process.

The framework

66. In addition to complying with the minimum ratios set out in paragraphs 54 and 55, a bank is required to maintain a capital conservation buffer of 2.5% comprising Common Equity Tier 1 capital. The framework applies to all banks operating in Mauritius, at the solo or both solo and consolidated levels, as the case may be.

67. A reporting bank's CET1 Capital shall first be used to meet the minimum capital ratios specified in paragraphs 54 and 55 before the remainder can count towards its capital conservation buffer.

68. Distribution constraints will be imposed on banks when capital levels fall within the capital buffer ranges outlined in Annex 3. However, 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, therefore, are related to the distributions only and are not related to the operations of banks. Items subject to the restriction on distributions include dividends, share buybacks, discretionary payments on AT1 capital instruments and discretionary bonus payments to staff.

69. A bank must apply to the Bank to make payments in excess of the constraints imposed by the capital conservation buffer regime. However, any approval granted by the Bank shall be subject to the express condition that the bank raises capital from the market equal to or greater than the amount above the constraint which it wishes to distribute and to such other conditions as may be imposed by the Bank.

ANNEX 1 - MINIMUM REQUIREMENTS TO ENSURE LOSS ABSORBENCY AT THE POINT OF NON-VIABILITY

Scope and post trigger instrument

1. The terms and conditions of all non-common Tier 1 and Tier 2 instruments issued by a bank must have a provision that requires such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of the trigger event unless:

   (a) the governing jurisdiction of the bank has in place laws that (i) require such Tier 1 and Tier 2 instruments to be written off upon such event, or (ii) otherwise require such instruments to fully absorb losses before tax payers are exposed to loss;

   (b) a peer group review confirms that the jurisdiction conforms with clause (a); and

   (c) it is disclosed by the relevant regulator and by the issuing bank, in issuance documents going forward, that such instruments are subject to loss under clause (a) in this paragraph.

2. Any compensation paid to the instrument holders as a result of the write-off must be paid immediately in the form of ordinary shares (or its equivalent in the case of non-joint stock companies).

3. The issuing bank must maintain at all times all prior authorisation necessary to immediately issue the relevant number of ordinary shares specified in the instrument's terms and conditions should the trigger event occur.

Trigger event

4. The trigger event shall be the earlier of:

   (a) a decision that a write-off, without which the reporting bank would become non-viable, is necessary, as determined by the Bank; and

   (b) the decision to make a public sector injection of capital, or equivalent support, without which the reporting bank would have become non-viable, as determined by the Bank.

5. The issuance of any new ordinary shares as a result of the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.

6. The trigger event in relation to instruments issued by a fully consolidated subsidiary of a reporting bank shall be the earlier of:

(a) the issuance of a notice by a host regulator of the overseas subsidiary that conversion or write-off of capital instruments issued by the fully consolidated subsidiary of the reporting bank is necessary because, without it, the host regulator considers that the subsidiary would become non-viable;

(b) a determination by the host regulator that without a public sector injection of capital or equivalent support, the overseas subsidiary would become non-viable; or

(c) a non-viability trigger event occurs in relation to a parent bank in accordance with paragraph 4.

7. The trigger event in relation to instruments issued by a locally-incorporated subsidiary bank of a foreign bank shall be the earlier of:

(a) the issuance of a notice by the home regulator of the foreign bank to the foreign bank that conversion or write-off of capital instruments is necessary because, without it, the foreign bank or its subsidiary bank would become non-viable; or

(b) a determination by the home regulator of the foreign bank that without a public sector injection of capital or equivalent support, the foreign bank or its subsidiary bank would become non-viable.

8. Any ordinary shares paid as compensation to the holders of the instrument must be ordinary shares of either the issuing bank or of the parent company of the consolidated group (including any successor in resolution).

Transitional arrangements

9. Instruments issued on or after 1 July 2014 must meet the criteria set out above to be included in regulatory capital. Instruments issued prior to 1 July 2014 that do not meet the criteria set out above, but that meet all of the entry criteria for Additional Tier 1 or Tier 2 capital will be considered as an "instrument that no longer qualifies as Additional Tier 1 or Tier 2" and will be phased out from 1 July 2014.

ANNEX 2 - PHASE-IN ARRANGEMENTS OF CAPITAL REQUIREMENTS FOR BANKS OPERATING IN MAURITIUS

	2014	2015	2016	2017	2018	2019	2020
	1 July	------------------- *(All dates are as of 1 January)* -------------------					
Minimum CET 1 CAR	5.5 %	6.0 %	6.5 %	6.5 %	6.5 %	6.5 %	**6.5 %**
Capital Conservation Buffer				0.625 %	1.25 %	1.875 %	**2.5 %**
Minimum CET 1 CAR plus Capital Conservation Buffer	5.5 %	6.0 %	6.5 %	7.125 %	7.75 %	8.375 %	**9.0 %**
Phase-in of deductions from CET 1*		50%	50%	60%	80%	100%	**100%**
Minimum Tier 1 CAR	6.5 %	7.5 %	8.0 %	8.0 %	8.0 %	8.0 %	**8.0 %**
Minimum Total CAR	10.0 %	10.0 %	10.0 %	10.0 %	10.0 %	10.0 %	**10.0 %**
Minimum Total CAR plus Capital Conservation Buffer	10.0 %	10.0 %	10.0 %	10.625 %	11.25 %	11.875 %	**12.5 %**
Capital instruments that no longer qualify as AT 1 capital or Tier 2 capital	Phased out over 10 year horizon beginning 1 July 2014						

* *Applicable to significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation.*

ANNEX 3 - CAPITAL CONSERVATION BUFFER

Common Equity Tier 1 Ratio	Minimum Capital Conservation Ratios (expressed as a % of earnings)
Minimum capital conservation ratios as of 1 January 2017	
6.5% - 6.65625%	100%
> 6.65625% - 6.8125%	80%
> 6.8125% - 6.96875%	60%
> 6.96875% - 7.125%	40%
> 7.125%	0%
Minimum capital conservation ratios as of 1 January 2018	
6.5% - 6.8125%	100%
> 6.8125% - 7.125%	80%
> 7.125% - 7.4375%	60%
> 7.4375% - 7.75%	40%
> 7.75%	0%
Minimum capital conservation ratios as of 1 January 2019	
6.5% - 6.96875%	100%
> 6.96875% - 7.4375%	80%
> 7.4375% - 7.90625%	60%
> 7.90625% - 8.375%	40%
> 8.375%	0%
Minimum capital conservation ratios as of 1 January 2020	
6.5% - 7.125%	100%
> 7.125% - 7.75%	80%
> 7.75% - 8.375%	60%
> 8.375% - 9%	40%
> 9%	0%