INSTRUCTIONS ON CALCULATION OF MINIMUM CAPITAL REQUIREMENTS BASED ON RISK WEIGHTED ASSETS

1. No banking company incorporated in Pakistan shall commence and carry on banking business unless it has a minimum paid up capital (net of losses) of Rs 1000 million. Similarly, no banking company incorporated outside Pakistan shall commence and carry on banking business in Pakistan unless it has a minimum paid up capital (net of losses) of Rs 1000 million.

2. No banking company shall carry on banking business in Pakistan unless it maintains capital and unencumbered general reserves the amount of which is not less than 8% of the risk weighted assets of the banking company both on consolidated as well as on stand alone basis. For the purpose, subsidiary companies engaged in banking and financial activities (excluding insurance) should be consolidated.

3. The capital and unencumbered general reserves for the purposes of the minimum requirement of 8% of risk weighted assets shall mean and include:-

A. Equity :

i. Fully paid up capital / capital deposited with SBP*
ii. Balance in share premium account
iii. Reserve for Bonus Shares
iv. General Reserves as disclosed on the balance-sheet
v. Unappropriated/unremitted* profits (net of accumulated losses, if any)

* in the case of foreign banks operating in Pakistan.

B. Supplementary Capital :

i. General Provisions or Reserves for loan losses
ii. Revaluation Reserves
iii. Undisclosed Reserves
iv. Subordinated debt.

4. The computation of the amount of Equity and Supplementary Capital shall be subject to the following limitations and restrictions: -

i. The sum total of the different components of the Supplementary Capital will be limited to the sum total of the various components of the Equity.

ii. While calculating the amount of equity the followings shall be deducted: -

a. Book value of intangible assets such as goodwill, etc.
b. Shortfall in provisions required against classified assets irrespective of any relaxation allowed by the State Bank.

Besides, investments made in the equity of subsidiary companies engaged in banking and financial activities (excluding insurance) which are not consolidated, will also be deducted from the equity in the consolidated Group balance-sheet.

iii. Subordinated debt will be limited to a maximum of 50% of the amount of equity and will also include rated and listed subordinated debt instruments (like TFCs/Bonds) raised in the capital market. To be eligible for inclusion in the supplementary capital, the instrument should be fully paid up, unsecured, subordinated as to payment of principal and profit to all other indebtedness of the bank including deposits, and should not be redeemable before maturity without prior approval of the SBP. Further the bank should also have maintained the Minimum Paid up Capital as prescribed by SBP from time to time.

iv. The banks before issuing any subordinated debt instruments (like TFCs/Bonds), to qualify for inclusion in supplementary (Tier-II) capital, will be required to obtain approval of the State Bank.

v. The Appendix-II to this circular contains rules relating to unsecured subordinated debt instruments which shall form part of this regulation relating to calculation/other requirements on minimum capital.

vi . General Provisions or Reserves for loan losses shall include only such provisions which are not created against identified losses and are as such freely available to meet unidentified losses. These provisions or reserves will be limited to maximum of 1.25% of risk assets.

vii. Undisclosed Reserves will be permitted to be included in the Supplementary Capital despite being unpublished, provided they appear in the internal accounts of the banking company and have basically arisen out of the earnings of the banking company duly certified by the External Auditors and are accepted as such by the State Bank. To be eligible to be shown as part of the Supplementary Capital, the Undisclosed Reserves should not be encumbered by any provision or known liability and should be freely available to meet unforeseen losses.

viii. Revaluation Reserves shall be the Reserves created by revaluation of fixed assets and equity instruments held by the banking company. The assets and investments must be prudently valued fully taking into account the possibility of price fluctuations and forced sale. Revaluation reserves reflecting the difference between the historical cost book value and the market value will be eligible upto 50% for treatment as Supplementary Capital subject to the condition that the reasonableness of the revalued amount is duly certified by the external auditors of the banking company.

5 CALCULATION OF MINIMUM CAPITAL REQUIREMENTS :

(A) The banking companies shall calculate MCR for their respective On- Balance Sheet assets by applying the weights as given below: -

	Assets	% Weight
a)	Cash (including approved foreign currencies and gold bullion)	0%
b)	Balances held with scheduled banks and banks abroad. (Be they term deposits, Certificates of Deposits or money at call)	20%
c)	Claims on the State Bank, the Federal Government, the Provincial Governments, and other Central Banks	0%
d)	Claims on or Guaranteed by banks of international repute incorporated in G-10 countries	20%
e)	Claims covered by cash collateral, or guarantee of the Federal Government or of the State Bank.	0%
f)	Loans to staff	0%
g)	Claims on domestic entities owned or controlled by the Federal Government	0%, 10%, 20% or 50% as may be prudently determined by the banking company.
h)	Loans fully secured by mortgage of residential or commercial property	50%
i)	Loans and advances including bills purchased / discounted (less cash margin, government securities held and deposits of the party held under lien with flawless documentation) to private sector entities	100%
j)	Investments in shares and other capital instruments of companies set up in the private sector	100%
k)	Fixed assets (land, building, equipments, furniture & fixture,	100%

	stationery) net of depreciation	
l)	Other Assets	100%

Notes:

i. All claims are to be assigned the highest risk weightage (100%) unless a lower risk-weightage can be specifically assigned to them.
ii. Netting may be done only in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.
iii. Assets which have been deducted from equity pursuant to Paragraph 4(ii) above will have a weightage of '0'.
iv. The amounts of cash margins, deposits and government securities so deducted at A (i) above shall be shown by way of foot-notes under parts 'B' and 'C'.
v. "G-10 Countries" include the following countries:
Belgium, France, Canada, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom and USA.

(B) For the purpose of calculating MCR in respect of exposure under various Off-Balance-Sheet transactions, the banks shall apply credit conversion factors as indicated below to the different types of Off-Balance-Sheet transactions. The credit conversion factors will be multiplied by the weights applicable to the corresponding On-Balance-Sheet transaction based on the credit risk involved in the Off-Balance-Sheet exposure: -

	Off-Balance-Sheet transaction	**Credit conversion factors**
a)	Loan Repayment Guarantees and Acceptances (less Cash Margin)	100%
b)	Purchase & Resale Agreements (Reverse REPO) other than those effected through SGL of State Bank	100%
c)	Performance Bonds, Bid Bonds, Warranties and similar instruments (less Cash Margin & Government Securities held)	50%
d)	Revolving Underwriting commitments	50%
e)	Standby Letters of Credit & Other Standby Facilities with an original maturity of over one year, and other Letters of Credits (less Cash Margin & Government Securities held)	50%
f)	Outstanding foreign exchange contracts	3%

Notes:

i. Foreign exchange contracts with SBP may be subjected to "Zero" risk weight and those with banks to 20% risk weights. All outstanding sale and purchase contracts will, however, be taken into account and no netting off will be done. The outstanding foreign exchange contracts with SBP and banks will be shown separately.

6. SUBMISSION OF RETURNS

Every banking company shall submit to the State Bank a half yearly return (both on consolidated as well as on stand alone basis) on the format given in the enclosed Appendix – I within a period of three months from the close of each half year ending 30th June / 31st December. The return should be certified by the external auditors of the banking company and duly signed by its authorized signatory (ies).

7. PENALTY FOR NON-COMPLIANCE

i. A banking company failing to meet the minimum capital requirements shall render itself liable to levy of penalty under the relevant provisions of the Banking Companies Ordinance, 1962.

ii. A banking company failing to submit the half-yearly return within the stipulated time or submit a wrong statement shall also render itself liable to levy of penalty under the Banking Companies Ordinance, 1962.