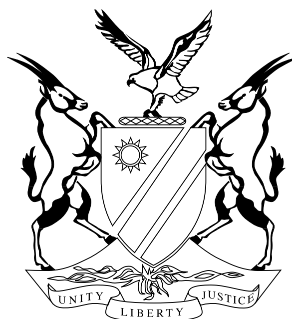

GOVERNMENT GAZETTE

OF THE

REPUBLIC OF NAMIBIA

N$10.40 WINDHOEK - 20 April 2012 No. 4933

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General Notice

BANK OF NAMIBIA

No. 107 2012

DETERMINATION UNDER THE BANKING INSTITUTIONS ACT, 1998
(ACT NO. 2 OF 1998): CONSOLIDATED SUPERVISION

In my capacity as Governor of the Bank of Namibia (The Bank) and under the powers vested in the Bank by virtue of sections 71(3) of the Banking Institutions Act, 1998 (Act No. 2 of 1998), read in conjunction with amendments to the aforementioned Act, I hereby issue this **Determination on Consolidated Supervision (BID-24),** which Determination shall become effective on 1 April 2012.

I. SHIIMI
GOVERNOR Windhoek, 1 April 2012

Determination No. BID –24 **CONSOLIDATED SUPERVISION**

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PART I: PRELIMINARY

1. <u>Short Title</u> - Consolidated Supervision.

2. <u>Authorisation</u> - Authorization for the Bank to issue this Determination is provided in Section 71(3) of the Banking Institutions Act, 1998(“Act”), as amended.

3. <u>Application</u> - This Determination shall apply to every bank controlling company and banking institution operating in Namibia.

4. <u>Definitions</u> - Terms used within this Determination are as defined in the Act, as further defined below, or as reasonably implied by contextual usage:

a) “**Act**” means the Banking Institutions Act, 1998, as amended.

b) “**Bank controlling company**” is as defined in the Act.

c) “**banking group**” is as defined in the Act.

d) “**commercial entity**” includes any entity primarily involved in the production of goods or delivery of non-financial services.

e) “**consolidation**” means a process of adjusting and combining financial statements of a parent entity and its subsidiaries, to produce regulatory consolidated financial statements prepared in accordance with the regulatory reporting standards outlined in this determination and in the relevant directives for completion of the returns.

f) “**double gearing**” occurs whenever one entity holds regulatory capital issued by the parent entity within the same group and the issuer is allowed to count the capital in its own balance sheet. In that situation, external capital of the group is geared up twice; first by the parent, and then a second time by the dependant. Double gearing can also take the form of an entity holding regulatory capital issued by any other entity within the same group.

g) “**(50/50) deduction approach**” means deductions from capital are made 50 per cent from Tier 1 capital and 50 per cent from Tier 2 capital.

h) “**group capital**” shall mean the aggregate capital of the consolidated entities subject to adjustments as outlined in this determination.

i) “**intra -group transactions and exposures (ITEs)”** are transactions between entities in the same banking group. These transactions must be removed from the regulatory consolidated accounts, so as not to inflate the net income or capital of parent entity and also of the entities of the group.

j) “**minority interest**” is that portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not controlled, directly or indirectly through subsidiaries, by the parent entity.

k) “**multiple gearing**” occurs when one entity which holds regulatory capital issued by its parent entity and within the same group itself down -streams regulatory capital to a third -tier entity, and the parent’s externally generated capital is geared up a third time. Multiple gearing can also take the form of an entity holding regulatory capital issued by any other entity within the same group.

l) “**parent entity**” means an entity that has majority ownership or control of another entity (subsidiary).

m) “**related party transactions**” shall be as defined in the relevant Financial Reporting Standards. It should be noted that related party transactions encompass intra -group transactions and exposures (ITEs) as well as connected lending issues.

n) “**Significant minority investment or interest**” means any ownership interest between 20 per cent and 50 per cent of the voting rights or capital held by the reporting bank or controlling company in the relevant entity.

PART II: STATEMENT OF POLICY

5. The purpose of this Determination is to:

(a) provide for prudential limits and requirements for banking institutions and bank controlling companies on a consolidated basis;

(b) institute reporting requirements for banking institutions and bank controlling companies so as to enable the Bank to fully understand and to effectively evaluate the structure and business of the entire group and the risk environment in which it operates;

(c) provide for the scope and manner of consolidated supervision; and

(d) provide the methods of regulatory consolidation to be adopted by banking institutions and bank controlling companies.

6. Matters Relating to Consolidated Supervision

6.1 Focus of Consolidated Supervision

(a) Consolidated supervision encompasses an overall evaluation, both quantitative and qualitative of the risks incurred by and the strength of a banking group to which a banking institution belongs, primarily to assess the potential impact of other group financial entities on the bank. Therefore, the prime focus of consolidated supervision remains at all times the banking institution.

(b) Consolidated supervision is generally regarded as a complement to, not a substitute for, solo supervision. Therefore, solo supervision shall continue to be conducted by

the responsible supervisory authorities in terms of their mandates set out in their respective statutes.

6.2 Regulatory versus Accounting Consolidation

(a) Consolidation, wherever referred to in this Determination, denotes consolidation rules only for the purposes of computing regulatory minimum capital requirements and as such these do not impact on accounting consolidations of banking institutions and banking groups, for which there are separate applicable standards and best practices.

(b) Although regulatory consolidation may closely track the accounting consolidation, it is not identical because of a different approach that is prescribed or required for treatment of certain types of transactions and/or subsidiaries.

7. Scope

7.1 As a minimum, the scope of quantitative consolidated supervision shall apply to all financial entities within a banking group including those entities which are not under the supervision of the Bank unless specifically exempted under the relevant section. The entities will include:

(a) All bank controlling companies (BCCs) registered and operating in Namibia. This encompasses any holding company that is the ultimate parent entity within a banking group to ensure that the risk of the whole banking group is captured;

(b) Financial entities engaged in banking business;

(c) Financial entities based in Namibia which share the same parent/ultimate controller with a banking institution operating in Namibia regardless whether the parent/ultimate controller is registered in Namibia or not;

(d) Every financial entity which is part of a Namibian banking group having cross border operations; and

(e) Every banking institution which is part of a foreign group, but operating in Namibia. Provided that the extent of quantitative consolidation may be limited to Namibian based entities where the global operations are subject to effective consolidated supervision by a competent Home Country supervisory authority to the satisfaction of the Bank.

7.2 The scope of quantitative regulatory consolidation shall be determined using the two criteria of “degree of ownership or control” and “nature of activity”:

(a) To determine the ‘degree of ownership or control’ of a group entity, the Bank shall consider the percentage shareholding of the banking institution or controlling company in that entity and/ or whether control exists. The regulatory consolidation shall include the results of entities in which the interest or holding of the supervised banking institution or bank controlling company is equal to or more than 20%.

(b) With regard to the nature of activity, only those related entities whose activities are banking or financial[1] services shall be covered by quantitative consolidated supervision.

[1]Appendix 2 outlines the activities considered as financial.

7.3 Qualitative evaluation shall apply to the whole banking group including non-financial entities. Therefore risks inherent in deconsolidated entities including non-financial entities of the corporate group shall be assessed qualitatively. The qualitative information to be used in the assessment will include those outlined in Appendix 1 or any additional information as the Bank may specify for the purpose of conducting qualitative evaluation/assessment.

7.4 Notwithstanding the criteria for quantitative consolidation discussed above, the Bank may determine which entities are to be included in the regulatory consolidation for the purposes of computing regulatory capital requirements.

8. Exclusion of insurance and other entities

Notwithstanding the requirements of International Financial Reporting Standards, the entities listed below are exempted from regulatory consolidation outlined in this determination:

(a) Commercial entities (subject to the provision of paragraph 11.3 (d));

(b) Insurance companies (subject to the provision of paragraph 11.3 (b):

(i) Although insurance business is clearly a financial activity, insurance companies shall be exempted in computing regulatory capital and other requirements outlined in this determination. This is because of the dissimilarity in the balance sheet structures of the insurance entities versus banks and therefore the insurance operations have to be carved out;

(ii) Insurance companies that control or owned a banking group will be required in terms of section 12A(6) of the Banking Institutions Amendment Act, 2010, to establish an intermediate holding company to facilitate the conduct of consolidated supervision. A transition period will be granted in instances where prior to the commencement of this Determination, a banking group is controlled by an insurance company. This is to allow the holding company to be set up. The transition period will be granted on a case by case basis.

(c) Financial entities which do not meet the criteria under paragraph 7.2 above, namely significant minority investments (20% -50%) and financial entities where the bank controlling company has less than 20% ownership. These will be subject to the provisions outlined under paragraph 11, "Treatment of entities in a banking group".

(d) Entities which otherwise would be consolidated, but are of negligible interest with respect to the objectives of consolidated supervision, that is, for the purpose of this sub -clause, where assets of an entity are lower than 1% of the combined balance sheets of the entities which meet the criteria for consolidation in line with the provisions of paragraph 7.2, i.e. financial in nature and where ownership exceeds 20%.

(e) Entities which otherwise would be consolidated but the inclusion would be inappropriate or result in misleading conclusions regarding the financial position of that group. For example:

(i) a dormant company; or

(ii) any financial entity acquired through the realisation of security held in respect of debt previously contracted, which financial entity is held by the banking institution or bank controlling company on a temporary basis.

(f) For the purposes of clauses (d) and (e) above, a bank controlling company shall in writing notify the Bank of the exclusion of certain financial entities from consolidation, in terms of the requirements of the said provisions, provided the bank controlling company furnishes the Bank with a detailed motivation to exclude such financial entities from consolidation.

9. Responsibility

The board of every bank controlling company shall be responsible for:

a) Policy formulation relating to the bank controlling company's businesses and subsidiaries and supervising all activities engaged in by the group;

b) Establishing clear organisational structures, management reporting lines, internal information systems and controls appropriate to its size, complexity and risk profile;

c) Establishing robust risk management system over all entities in a banking groups; and

d) Ensuring that the banking institutions maintain a separate corporate existence from its affiliates. This separateness also pertains to the sound principle that all financial and other pertinent records for the financial institution affiliate be accessible on location.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

10. Reporting Requirements

10.1 Every bank controlling company shall be required to submit to the Bank, information set out in Appendix 1, as at 31st December of each year for all its group member entities, not later than the 1st of April of the following year. This will include the deconsolidated entities (including non-financial), as this covers qualitative information, which is applicable to the whole group.

10.2 Bank controlling companies shall on a consolidated basis comply with section 47 of the Act on Financial Statements.

10.3 In addition to the reporting requirements specified in clauses 10.1 and 10.2, the Bank shall specify in writing by way of notices or circulars, any additional information that may be required from bank controlling company and any of its group member entities, in order to satisfy itself that the operations and affairs of such entities are not detrimental to the safety and soundness of the banking institution concerned and are in compliance with the Act.

10.4 Every bank controlling company shall submit to the Bank consolidated returns containing quantitative elements listed hereunder:

a) capital adequacy;

b) financial condition;

c) financial performance;

d) credit concentration;

e) Related party transactions; and

f) Such other prudential requirements as the Bank may specify in writing, by way of notices or circulars.

10.5 The format, reporting frequency, submission dates and directives for completion of these returns shall be specified by the Bank.

10.6 The entities to be included in the consolidated returns must be agreed individually between the concerned bank controlling company and the Bank, beforehand.

11. Treatment of Entities under Regulatory Consolidation

11.1 Financial Subsidiaries: Full Consolidation

(a) A banking institution or a bank controlling company shall, based on the requirements outlined in the regulatory reporting framework (returns), fully consolidate all financial subsidiaries unless specifically otherwise provided in this determination.

(b) A financial subsidiary is an entity that is (majority) owned or controlled by a bank or a bank controlling company. Majority ownership occurs when one entity holds more than 50% of the equity of another entity. The definition of control shall be as defined in the Act.

11.2 Significant Minority Owned or Controlled Financial Entities: Pro-rata Consolidation

(a) Where a banking institution or bank controlling company has a significant minority ownership investment (20-50%) in a financial entity, but does not exercise control and which entity has other significant shareholder or parent entity has means and will to provide support in addition to that provided by the banking institution or bank controlling company, pro-rata or proportionate consolidation shall apply. A banking institution or bank controlling company which has a significant minority ownership investment (20-50%) in a financial entity may in exceptional cases and with the consent of the Bank use the equity based method.

11.3 Financial entities as Exceptions to Consolidation: Deduction Approach

(a) If any financial entities cannot be consolidated for regulatory capital purposes due to reasons provided under paragraph 8 clauses (d) and (e) above, deduction method shall apply.

(b) Insurance Companies (Subsidiaries and Significant Minority Investments) as per paragraph 8 (b) (i) and (ii).

(c) Investments in Financial Entities and Insurance Below 20%:

(i) Investments in banking institutions below 20% of the voting rights or capital held by the reporting bank or bank controlling company in the relevant entity shall not be consolidated. A deduction approach shall be used; and

(ii) Investments in non-bank financial entities and insurance entities below 20% of the voting rights or capital held by the reporting banking institution or controlling company in the relevant entity shall not be consolidated. The investments must be risk-weighted using the relevant risk-weights outline

under paragraph 15 of The Determinations on Measurement and Calculation of Capital Charges for Credit Risk, Operational Risk and Market Risk (BID-5).

(d) Commercial Entities:

(i) Significant investments in commercial entities which exceed certain materiality levels. The amount to be deducted will be that portion of the investment that exceeds the materiality levels and should be applied as follows:

(aa) Deduct the excess amount from consolidated capital if the investments exceed a materiality level of 15% of the said bank or controlling company's capital on an individual basis; and

(bb) Deduct the excess amount from consolidated capital if the aggregate amount of all investments of 15% or more of the concerned bank or bank controlling company exceeds the 60% threshold of the banking institution or bank controlling company's capital.

(ii) Investments in commercial entities below the materiality levels noted above will be risk weighted using the relevant weights applicable to these entities under BID-5.

An illustrative example is provided in Appendix 4 Examples 1 and 2.

(e) Special Purpose Vehicles (SPVs)

(i) Banking institutions and Bank controlling companies shall consolidate SPVs in accordance with the applicable accounting standards and best practises which may be subject to change from time to time;

(ii) This means that the treatment of the SPVs under accounting standards shall also be applied for the purposes of regulatory consolidation provided the SPVs are financial in nature, and meet the requirements of paragraph 7.2; and

(iii) Non-financial SPVs shall not be consolidated and will be treated as commercial entities.

11.4 Consolidation Techniques

Full Consolidation

(a) In the regulatory consolidated returns of the relevant reporting bank or controlling company, line -by -line all the relevant assets and liabilities of the entity should be consolidated.

Pro-rata/Proportionate Consolidation

(b) In the regulatory consolidated returns of the relevant reporting banking institution or controlling company, only the relevant shares of the assets and liabilities of the entity in which the banking institution or controlling company and any of its related person has participation. It reflects the fact that the banking institution or controlling company has an interest in an entity in which a significant shareholder other than the bank or controlling company has the means and will to provide parental support and also has participation.

Deduction Approach

(c) The assets of an entity are not fully or pro-rata consolidated with the risk-weighted exposure amount of a bank or controlling company in accordance with the relevant requirements specifies in the Determinations; but instead as a minimum, the amounts specified below are deducted from the capital of the reporting banking institution or controlling company:

(i) In the case of a majority owned or controlled entity, the investment by the banking institution or controlling company in the equity or other regulatory capital instruments of the relevant entity; plus any shortfall in the capital requirement of the entity, calculated in accordance with the rules and regulations of the relevant supervisor responsible for the supervision of the entity;

(ii) In the case of a significant minority owned or controlled financial entity, the investment by the banking institution or controlling company in the equity or other regulatory capital instrument of the relevant entity. Such investments referred to under 11.4 (c) (i) and (ii) are recorded using the equity basis of accounting and are risk-weighted at 0%.

An illustrative example of the deduction approach is provided in Appendix 4, Example 3 and 4.

See the matrix in Figure 1, Appendix 3 for treatment of entities in banking groups as discussed above.

Equity Method

(d) Under this method, the equity investment is initially recorded at cost and subsequently adjusted to reflect the investor's share of the net assets of the associate (investee) or the net profit or loss of the associate.

12. Prudential Requirements and Limits

Banking groups shall on a consolidated basis, comply with the following prudential requirements or limits:

12.1 Capital Adequacy Requirements

(a) Bank controlling companies are required to have in place policies to ensure that the group is adequately capitalised to cover the risks that it faces, as well as to meet regulatory, market and strategic needs.

(b) Bank controlling companies shall provide the Bank with a copy of its policies with regard to group capital adequacy, including the methodology used to measure group capital adequacy, as and when required by the Bank.

(c) The minimum capital funds, unimpaired by losses, of a banking group shall not, on a consolidated basis, be less than the greater of:

(i) the amount of capital of the sum of the amounts of the required capital funds determined, for the respective entities constituting the banking group, in accordance with the rules and regulations of the respective regulators responsible for supervision of those entities; or

(ii) an amount equal to 10 per cent of its total risk-weighted assets of the group.

(d) A bank controlling company shall, on a consolidated basis, also comply with:

(i) a minimum leverage ratio of 6 per cent or higher; and

(ii) a minimum tier 1 ratio of 7% or higher.

(e) In calculating the minimum capital funds under paragraphs 12.1(c)(ii) and 12.1(d)(i) and (ii) of this determination, bank controlling companies shall at all times comply with minimum capital adequacy requirements established by (BID-5).

(f) Bank controlling companies are required to ensure that the capital and reserve funds of any regulated entity included in the banking group and structured under such bank controlling companies do not at any time amount to less than the required amount of capital and reserve funds determined in respect of the relevant regulated entity included in such banking group in accordance with the rules and regulations of the relevant regulators responsible for supervision of relevant entity.

(g) In the case of unregulated entities, a proxy capital requirement shall be applied. Unregulated entities within a group are not however, obliged to comply with the capital adequacy requirement on an individual basis. The requirement is for the purposes of calculating regulatory capital requirements on a consolidated basis.

(h) The qualifying capital for unregulated entities comprises only of Tier 1 capital elements and is calculated as outlined below:

Required capital:

$$\frac{((\text{Total assets of unregulated entity} + \text{off-balance sheet activities}) - \text{exposures to group entities}) \times 10}{100}$$

12.1.1 Deductions from capital

In line with the provisions of section 28A subsection (2) of the Act, in calculating the consolidated amount of qualifying capital and reserve funds, the bank controlling company shall deduct from its consolidated capital and reserve funds the following :

(a) From Tier 1 capital, goodwill relating to:

(i) any relevant entity subject to the deduction approach (deconsolidated entities); and

(ii) any consolidated subsidiary;

(b) Entities subject to the deduction approach using the 50/50 approach

(i) Investments in financial subsidiaries which are not consolidated as provided under 8 (d) and (e). Any equity or other regulatory capital instrument invested in the subsidiary is deducted;

(ii) Investments in significant minority owned financial entities. Any equity or other regulatory capital instruments invested in the significant minority owned or controlled entity is deducted;

(iii) Investments in insurance subsidiaries. Any equity and other regulatory capital investments in insurance subsidiaries are deducted; and

(iv) Investments in insurance entities in which the bank or controlling company has a significant minority interest. Any equity and other regulatory capital investments in such insurance entities are deducted.
An illustrative example is provided in Appendix 4, Examples 2, 3 and

(c) Investments in commercial entities exceeding materiality levels using the 50/50 approach:

(i) The application should be undertaken as per paragraph 11.3 (d)(i) and (ii).

(d) Reciprocal Investments.

Reciprocal investments arise when there is crossholding of capital between a bank or bank controlling company and any other entity. These have to be deducted for regulatory capital purposes as they:

(i) inflate the capital position of banking institutions and bank controlling companies as they do not represent externally generated capital; and

(ii) may increase contagion risk.

An illustration is provided under Appendix 4, Example Two.

(e) Intra-group holdings of shares among consolidated entities.

Through consolidation of parent and subsidiaries, intra -group holdings of shares should be eliminated and thus, importantly, double gearing and multiple gearing are eliminated.
An illustration is provided under Appendix 4, Example 5.

(f) Capital shortfalls in Entities subject to the deduction approach

(i) Bank controlling companies shall ensure that entities which are not consolidated and for which capital investments are deducted, are themselves adequately capitalised to reduce the possibility of future potential losses to the group and its banking institution. Any shortfalls in the capital for such entities shall be deducted from the group's total (tier 1+2+3) consolidated capital.

(ii) The amount of shortfall to be deducted from the group consolidated capital shall be proportionate to the bank controlling company's equity stake in such unconsolidated companies. However, where the group has control over the entity, a pro rata attribution of any deficit may understate a parent's de facto responsibility to provide additional capital. Any solo deficits in such dependants should therefore be attributed in full.
An illustration is provided under Appendix 4, Example 3 and 4.

(g) Minority Interests

Bank controlling companies may in the case of any minority interest arising from the consolidation of less than wholly owned financial entities, include in its consolidated group capital such percentage of or amount relating to the said minority interest subject to:

(i) their ability to absorb losses; and

(ii) the availability of the amount arising from the said minority interest to the said bank controlling company and the members of the relevant banking group.

If the above conditions in (i) and (ii) are not met, then such capital will not be eligible for inclusion in the group's consolidated capital and the reporting bank controlling company after consultation with the Bank and in order to ultimately determine the qualifying amount of capital, shall adjust the relevant minority interest amount that may be included in the consolidated group capital by such a percentage of or amount relating to the relevant minority interest.

(h) Capital shortfalls from the consolidated financial entities

Deduct Shortfalls, if any, in the regulatory capital (as prescribed by the solo regulators), of the regulated consolidated financial entities from the group's total consolidated capital.

(i) Lending of a capital nature to subsidiaries and significant minority investment entities

Deduct lending of a capital nature to significant minority investment entities and subsidiaries, from the group's total consolidated capital. Lending of a capital nature shall mean long term loans (maturity period over one year) and subordinated loans.

(j) Encumbered assets

Deduct encumbered assets from the group's total consolidated capital. Encumbered assets shall mean property owned by the banking group but subject to the legal claims of another party.

(k) Portion of unsecured loans and advances in excess of prudential lending limits.

Deduct from group total consolidated capital, portion of unsecured loans and advances in excess of prudential limits. For example, the single borrowers and large exposures limit; inter-bank exposure limit; connected lending limit; etc. The collateral to be considered shall be the required collateral types in accordance with the rules and regulations set by the Bank.

(l) Other deductions

Bank controlling companies shall also deduct all other deductions relating to securitisations as specified under BID - 5.

12.1.2 Deduction of Investments

(a) Where deductions of investments are made as outlined in paragraph 12.1.1, the deductions will be 50% from Tier 1 and 50% from Tier 2 (50/50 approach), unless specified otherwise in this Determination.

(b) If the amount deductible from Tier 2 exceeds the consolidated group's actual Tier 2, the group should deduct the shortfall amount (balance) from Tier 1 capital. The limits on Tier 2 capital will be based on the amount of Tier 1 capital after all deductions. Note that total eligible Tier 2 Capital may not exceed Tier One Capital.
See Appendix 4, Example 2 for details of how these limits work in practice.

(c) Goodwill relating to consolidated subsidiaries and entities subject to a deduction approach should be deducted from Tier 1 as provided under 12.1.1 (a), and the remainder of the investments should be deducted as provided for in the relevant sections of paragraph 12.1.1 (b) (50/50 approach).

An illustrative example is provided in Appendix 4, Example 2 and 4.

12.1.3 Bank may Require Additional Capital

When the Bank determines that a banking institution has insufficient capital to shield against the risks arising from its group relationships, pursuant to section 10 of the Capital Adequacy Determination BID-5, the Bank shall direct the banking institution to increase its capital above the minimum requirements to such level as the Bank may determine. This provision shall also apply to bank controlling companies.

12.1.4 Bank controlling companies not to Engage in Excessive Leveraging

(a) Where a bank controlling company issues long term debt to fund equity capital in banking subsidiaries (double leveraging), the said bank controlling company shall not engage in excessive debt which will in turn result in the bank controlling company placing inordinate financial pressure on its subsidiary bank(s) by any method including the following:

(i) payment of excessive dividends. For the purposes of this determination, excessive dividend payment shall occur when such payment (1) will impact the ability of the bank or controlling company to maintain adequate capital in terms of section 28A and/or to support its business expansion or (2) will exceed current audited profits;

(ii) pressure subsidiary banks to invest in high risk assets to increase asset yields;

(iii) purchase and/or trade its high quality assets for the other affiliate's lower quality assets;

(iv) purchase of unnecessary services from affiliates; and

(v) payment of excessive management or other fees.

(b) Management and other fees paid by subsidiary banks shall have a direct relationship to the value of actual goods or services rendered based on reasonable costs consistent with current market values for such services.

(c) Banking institution's files shall contain adequate information to permit a determination as to what goods and services are being provided and on what basis they are being priced.

(d) Charges shall not be based on resources, deposits, or earnings of the banking institution.

(e) The provisions of section 32 of the Act on restriction of dividends, shall apply to bank controlling companies with respect to dividends from banking institutions.

12.1.5 Bank controlling companies not to Engage in Double, Multiple Gearing Practises

(a) Bank controlling companies shall not engage in double or multiple gearing where the same capital is used simultaneously as a buffer against risk in two or more legal entities.

(b) Shareholdings in subsidiaries or associates shall therefore be deducted to avoid double counting of capital.

12.2 Single Borrower's and Large Exposures Limit

(a) A bank controlling company shall manage its affairs in such a way that, the maximum amount of exposure which the banking group shall incur towards a single person or group of related persons shall not exceed 30% of the consolidated group's capital. This relates to the consolidated entities only. However, the Bank may require information relating to non -consolidated entities if there is need to determine certain information based on circumstances which may arise, which may be on exceptional cases.

(b) In addition, the limit on large exposures in relation to the consolidated group's capital base shall be limited to a maximum of 800%.

(c) Every bank controlling company shall report to the Bank, in line with the reporting requirements specified under 10.4, all large exposures of 10% or more of the consolidated group's capital.

(d) In calculating the limits and requirements under paragraphs 12.2 (a) and (b), bank controlling companies shall at times comply with minimum requirements established by the Determination, on Single Borrowers and Large Exposures (BID-4).

(e) The definition of related person shall be as defined in (BID-4).

12.3 Intra-Group Transactions and Exposures (ITEs)

(a) Every bank controlling company shall have in place board -approved policies and risk -management processes and procedures relating to intergroup transactions or exposures (ITEs), which policies, processes and procedures:

I. shall duly address matters relating to:

(i) cross -shareholding;

(ii) any trading activities in terms of which one entity within the banking group deals with or on behalf of another entity within the banking group;

(iii) any central management function in respect of the liquidity structure or requirements within the relevant banking group;

(iv) guarantees, loans or commitments provided to or received from any entity within the banking group;

(v) any material exposure (exceeding 5% of the banking institution's capital) to a major shareholder of the banking institution or controlling company, including any guarantee, loan or commitment;

(vi) provision of services or support functions, such as internal audit or back -office services, provided to or received from any entity within the banking group;

(vii) any exposure arising from the placement of funds or assets of clients with any other entity within the banking group;

(viii) any purchase or sale of assets between entities within the banking group;

(ix) risk transfers between entities within the banking group, such as reinsurance or securitisations; and

(x) any relevant risk arising from double or multiple gearing of funds.

II. shall ensure that intragroup transactions or exposures are duly documented, reported and accounted for;

III. shall ensure that intragroup transactions or exposures are subject to appropriate oversight by the board of directors and senior management of the relevant bank or controlling company;

IV. shall ensure adequate control in respect of any transfer mechanism adopted within the relevant banking group, including any transfer mechanism relating to:

(i) capital;

(ii) funding;

(iii) risk; or

(iv) income.

V. shall ensure that:

(i) both sides of bilateral transactions can be analysed and that the relevant banking institution or bank controlling company identifies, monitors and controls the nature and extent of the intragroup transaction or exposure; and

(ii) the board of directors and senior management of the relevant banking institution or controlling company have an adequate understanding of the incurred risks and any subsequent changes in the said risk profile due to an intragroup transaction or exposure.

(b) In order to prevent any potential abuse arising from lending to a group entity, every banking institution and every controlling company shall have in place board approved policies, processes, procedures and systems, amongst other things, to ensure that the banking institution or controlling company, as the case may be, lends money to a group entity on an arm's-length basis, that is, no exposure to a group member of a banking institution or controlling company shall be extended on terms or under conditions more favourable than a corresponding loan or exposure to a company which is not part of the banking group, which terms or conditions may relate to matters such as credit assessment, tenor, interest rate or a requirement for collateral.

(c) Every bank controlling company shall, in accordance with paragraph 10.4 of this determination report to the Bank, all significant intra group transactions and exposures within the group (including deconsolidated entities). An intragroup transaction shall be deemed to be significant if it is equal to or more than 5% of the total amount of consolidated group capital.

(d) When the Bank is of the opinion that the bank controlling company's policies, processes, procedures and systems relating to intragroup transactions or exposures are inadequate, the Bank may:

(i) require the bank controlling company to deduct from its capital and reserve funds such amount relating to such transactions or exposure as may be specified in writing by Bank;

(ii) require the banking institution or controlling company to obtain adequate collateral in respect of the relevant exposure;

(iii) in addition to any limit specified in the Act specify limits in respect of intragroup transactions or exposures; and

(iv) in writing specify such further conditions as the Bank in the circumstances deems appropriate.

12.4 Connected Lending

Every bank controlling company shall on a consolidated basis, comply with the provisions of Determination on Connected Lending as may be issued by the Bank from time-to-time.

12.5 Liquidity Requirements

(a) A bank controlling company shall manage its affairs in such a way that the liquidity requirements prescribed by the relevant regulatory authorities of its entities shall be complied with at all times.

(b) Bank controlling companies shall be required to design an adequate contingency liquidity plan for its consolidated position.

(c) Board members of the bank controlling company shall exercise adequate oversight over liquidity issues of the group.

13. Minimum Structural Requirements

13.1 Group Restructuring

(a) All bank controlling companies shall be required to establish corporate structures that are transparent and which do not hinder effective banking supervision or endanger the stability of the banking sector, in line with the requirements of section 11(g) of the Act.

(b) The Bank may require any banking group to amend its existing organisational structure if it is considered that the structure may hamper effective consolidated supervision. This will be communicated by the Bank to the banking group concerned. Further, a transition period will be granted to allow for the organisational structure to be changed.

(c) A structure may be perceived to hamper/hinder the conduct of effective consolidated supervision from accessing information on or determining the nature and extent of any relationships or transaction between banks that may impact on its safety and soundness. A good example is that of parallel structure.

(d) Pursuant to section 12E of the Act, no restructuring of the companies within a group to which a banking institution belongs shall be effected without the prior written approval of the Bank. After receipt of an application made in terms of section 12E of the Act, the Bank shall, before taking any decision relating to the application, consult with Namfisa.

(e) Where the Bank concludes that there is inadequate access to information about material parts of a group to which a banking institution belongs, the operations of the banking institution shall be ring fenced. This involves limiting or in the extreme cases prohibiting transactions of the bank with other members of the corporate group and its related entities, and vice -versa.

13.2 Acquisition and Disposal of Entities by Bank controlling companies

Bank controlling companies shall comply with section 14, subsections (3) and (4) of the Act, with respect to the acquisition, disposal or closure of a subsidiary or of any interest in any other undertaking.

14. Other Requirements

14.1 Investments by Bank controlling companies

The percentage determined by the Bank, for the purposes of Section 12D of the Act, shall be 40%.The method of valuation used for the investment should be the normal accounting practice followed by the bank or bank controlling company.

14.2 Conduct of Examinations

(a) The provisions of sections 52 and 53 of the Act, in respect to conduct of examinations, shall apply to the banking group on a consolidated basis.

(b) Where applicable the examination to be conducted may be done in coordination with the relevant authority or body which exercises supervision or regulation over such affiliates, associates, or subsidiary companies.

14.3 Compliance with the ACT and other Prudential Determinations

Banking institutions and Bank controlling companies shall on a consolidated basis fully comply with the provisions of:

(a) The applicable sections of the Banking Institutions Act, 1998, as amended;

(b) The following determinations issued by the Bank, to the extent to which that they are consistent with this Determination:

(i) Appointment, Duties and Responsibilities of Directors and Principal Officers of Banks (BID-1);

(ii) Limits on Exposures to Single Borrowers, Large Exposures and Concentration Risk (BID-4);

(iii) Measurement and Calculation of Capital Charges for Credit Risk, Operational Risk and Market Risk (BID-5); and

(iv) Appointment, Duties and Responsibilities of Independent Auditors (BID-10).

(c) any other determinations issued under the Act which the Bank may deem to be relevant on a consolidated basis.

Reference to banking institution in these Determinations shall also, be to the bank controlling company where applicable.

PART IV: CORRECTIVE MEASURES

15. Remedial Measures

Where a banking group fails to comply with this Determination, then the Bank may pursue any remedial measures as provided under the Act or any other measures the Bank may deem appropriate in the interest of prudent banking practice.

PART V: EFFECTIVE DATE

16. EffectiveDate

The effective date for this Determination shall be 1 April 2012.

Questions relating to this determination shall be addressed to the Director, Banking Supervision Department, Bank of Namibia: Tel 283 -5040.

PART VI: APPENDICES

Appendix 1: Information Requirements

a) A chart or series of charts which shows the relationship among the group entities and the extent of outside shareholders' interests;

b) A chart of the group management structure which clearly indicates the way in which group senior management responsibilities (including the names and job titles) are allocated;

c) A brief outline of the nature of each of the above mentioned companies business, types of products or range of services being offered and locations of principal places of business;

d) A list of shareholders, directors and officers of each of such company or controlling person;

e) The name and contact details of the authority or body responsible for regulation and supervision of each of such company or controlling person if any; and

f) The name and contact details of the external auditors for each of such company or controlling person.

Appendix 2: List of Companies considered 'financial'.

Companies undertaking one or more of these activities are classified as '*financial institutions*' for the purposes of consolidated supervision:

a) Ancillary banking services (defined as 'an undertaking the principal activity which consists in owning and managing property, managing data processing services, or any other similar activity which is ancillary to the principal activity of one or more credit institutions');

b) Lending (including, consumer credit, mortgage credit, factoring with or without recourse, financing of commercial transactions (including forfaiting));

c) Financial leasing;

d) Money transmission services;

e) Issuing and administering means of payment (e.g. credit cards, travellers' cheques and bankers' drafts);

f) Guarantees and commitments;

g) Trading for own account or account of customers in;

(i) money market instruments (cheques, bills, CDs etc.);

(ii) foreign exchange;

(iii) financial futures and options;

(iv) exchange and interest rate instruments;

(v) transferable securities.

h) Participation in securities issues and the provision of services relating to such issues;

i) Advisory services to undertakings on capital structure, industrial strategy, related questions, and mergers and purchase of undertakings. Services rendered relating to mergers and the purchase of undertakings;

j) Money broking;

k) Portfolio management and advice. This category includes fund management companies;

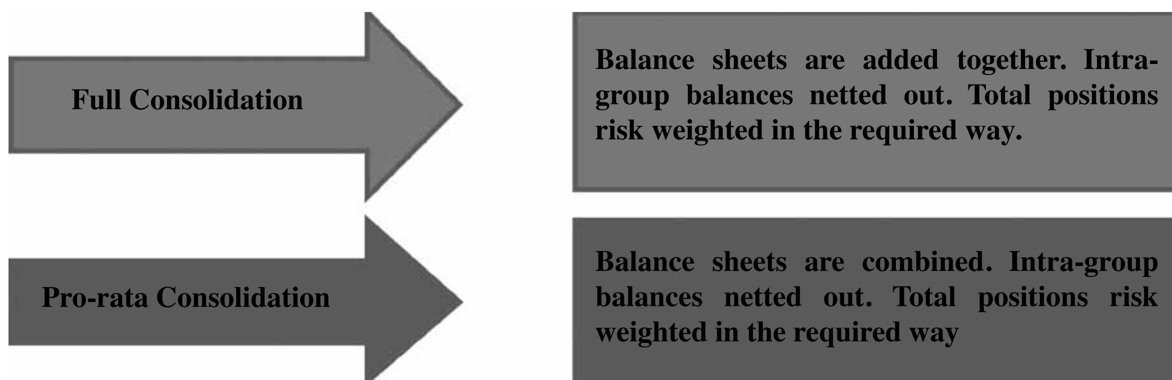
l) Safekeeping and administration of securities; or

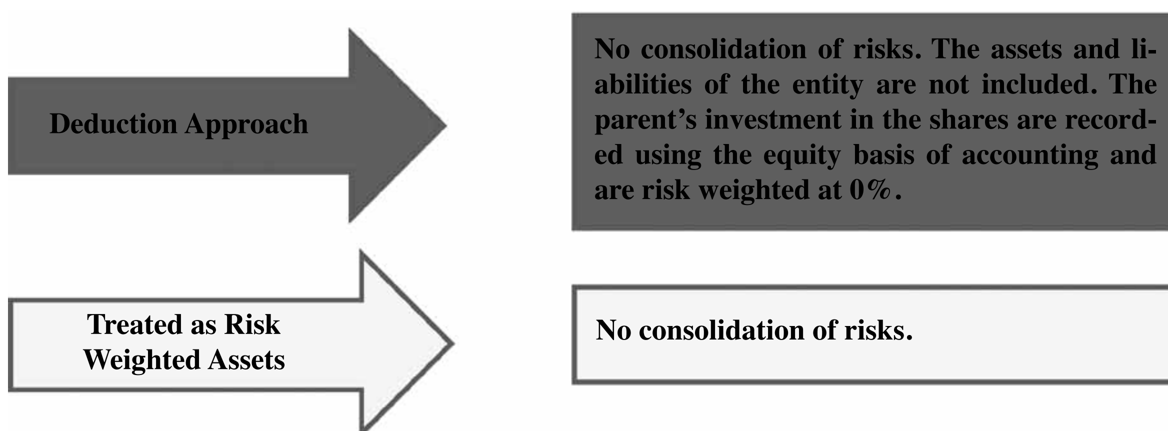
m) Any institutions specified by the Bank.

The following activities are not covered by the above list: insurance.

Appendix 3: Treatment of Entities in Banking Groups
Figure 1: Matrix to show Treatment of Entities in Banking Groups

	Financial Institution	**Non -Financial Company**	**Insurance Company/Broker**
Below 20%	Weight as risk asset	Deduct amount above materiality levels: Risk weight amount below materiality levels	Weight as risk asset
20% -50%	Pro-rata Consolidation	Deduct amount above materiality levels: Risk weight amount below materiality levels	Deduction approach
Above 50%/ control	Full consolidation	Deduct investment amount above materiality levels: Risk weight amount below the materiality levels.	Deduction approach





Appendix 4: Illustrations

Example One: Investments in commercial entities

Bank "x" with eligible capital of 1,000,000 before deductions has made investment in seven commercial entities listed below:

Commercial Entity	Amount	% of Bank's capital
A	100 000	10%
B	120 000	12%
C	150 000	15%
D	160 000	16%
E	170 000	17%
F	200 000	20%
G	250 000	25%
Total	**1 150 000**	**115%**

The amount to be deducted from capital in respect of these investments will be based on the following calculation:

15% threshold (Individual basis)

Commercial Entity	Amount	15% of Bank's capital	Excess over 15% of Bank's capital
D	160,000	150,000	10,000
E	170,000	150,000	20,000
F	200,000	150,000	50,000
G	250,000	150,000	100,000
Total			**180 000**

Capital deduction on account of 15% threshold on individual basis is 180,000 (A).

60% Threshold (Aggregate basis)

Aggregate of investments equal to and/or above 15%:

Commercial Entity	
C	150 000
D	150 000
E	150 000
F	150 000
G	150 000
Total	**750 000 (B)**

60% of Bank's capital = 600,000
Aggregate (B) = 750,000
Deduction = 150,000

So the capital deduction based on the 60% threshold on aggregate basis is 150,000 (C).

Total deduction based on investments in commercial entities is 330,000 (A+C).

Net eligible capital after deductions is 670,000 (1,000,000 – 330,000).

Remaining amount of investments 820,000 (1,150,000 -330,000) will be risk weighted under the applicable risk weighting rules in paragraph 15 of BID-5.

Example Two: Comprehensive example of deductions
Bank "x" with capital base of 10,000,000 before deductions (consisting of 5,000,000 Tier 1 and 5,000,000 Tier 2) has made four investments listed below along with the amount required to be deducted from the capital for capital adequacy purposes:

Investment	**Amount**	**Deduction requirement**
Bank "a"	1,000,000	1,000,000
Insurance entity "b"	3,000,000	3,000,000 [2]
Commercial entity "c"	2,000,000	500,000 [3]
Entity "d"	500,000	400,000 [4]
Total	6,500,000	4,900,000

Determination of eligible Tier 1 and Tier 2 capital:
These deductions include Goodwill of 100,000 & reciprocal cross holdings of 400,000 in Tier 1.

Determination of eligible capital:

	Tier 1 capital	**Tier 2 capital**
Capital base	5,000,000	5,000,000
Goodwill [5]	(100,000)	-
Reciprocal cross-holding [6]	(400,000)	-

[2] This investment is 30% of the insurance "b" capital.
[3] This investment is 20% of the bank's capital. As such the amount exceeding 15% i.e. 500,000 will be deducted. The remaining amount (2,000,000 -500,000=1,500,000) is risk-weighted.
[4] This investment is 2% of entity "d"s capital. Entity "d" has also made investment in Tier 1 capital of Bank "x" amounting to 400,000. This amount (400,000), being cross-holding, is required to be deducted from regulatory capital of the bank "x".
[5] This represents goodwill arising at the time of acquisition of a consolidated subsidiary.
[6] As this cross-holding exists in Tier 1 capital (see footnote 3), this amount must be deducted from the same tier.

Other deductions (Equally from Tier 1 and Tier 2) (4,900,000 – 500,000[7] = 4,400,000/2)	(2,200,000)	(2,200,000)
Resulting capital	2,300,000	2,800,000
Eligible capital	**2,300,000**	**2,300,000** [8]

Calculation of CAR:

CAR = Eligible capital / Risk -Weighted Assets (Say) 40,000,000 = (2,300,000 + 2,300,000) / 40,000,000 = 4,600,000 / 40, 000, 000 = **11.5%**

Example Three: Full Consolidation versus Deduction Approach

The following table shows the consolidated balance sheet of a bank with insurance. Note that under this approach, the assets and liabilities of the insurance firm are recognised**.**

Bank A's Consolidated Balance Sheet			
Assets N$			
	Banking Assets	7 b	
	Insurance firm assets	3 b	
Total Assets			10 b
Liabilities N$			
	Banking Liabilities	6.4 b	
	Insurance Firm Liabilities	2.6 b	9.0 b
Shareholders' equity			1.0 b
Total Liabilities & Shareholders' Equity			10. b

The following table shows the bank's balance sheet but shows the effect of deconsolidating the assets and liabilities of the insurance firm, and records the bank's investment in its insurance subsidiary on the equity basis of accounting.

Balance Sheet-Deconsolidating Insurance Firm			
Assets N$			
	Banking Assets	7 b	
	Investment in Insurance Firm	0.4 b	
Total Assets			**7.4 b**
Liabilities N$			
	Banking Liabilities		6.4 b
Shareholder's Equity			1.0 b
Total Liabilities and Shareholders' Equity			**7.4 b**

The following tables show the calculation of the capital ratio on a fully consolidated basis and the calculation using a deduction approach. Assume for this example that all assets are risk-weighted at 100%. However, in the deduction approach, the amount of the investment in the deconsolidated (and

[7] 500,000 relates to the 400, 000reciprocal holding and 100, 000 goodwill already deducted under tier 1 capital.

[8] Tier 2 can not exceed 100% of Tier 1 (after all subsequent deductions).

deducted) subsidiary is risk-weighted at 0%. To do otherwise would result in an excessive capital requirement. That is why the level of risk weighted assets remains at N$ 7.0 bn. In this example, the use of a full consolidation approach results in a higher capital ratio (10%) than the deduction approach (8.6%). The results of consolidating financial subsidiaries will vary depending on many circumstances, primarily on the amount of capital relative to the risks in the subsidiary, and may be higher, lower (or even the same) as using a deduction approach.

(Note: the lower risk-weighted assets in the deduction approach are because the assets of the subsidiary have been deducted from total assets.)

Full Consolidation Approach	
Risk Weighted Assets	10 b
Regulatory Bank Capital	1 b
Capital Ratio (1 bn/10 bn)	**10 %**

Deduction Approach	
Risk Weighted Assets	7 b
Bank Capital	1 b
Deduct Investments in Insurance Firm	-0.4 b
Regulatory Capital Available	0.6 b
Capital Ratio (0.6 bn/7 bn)	**8.6 %**

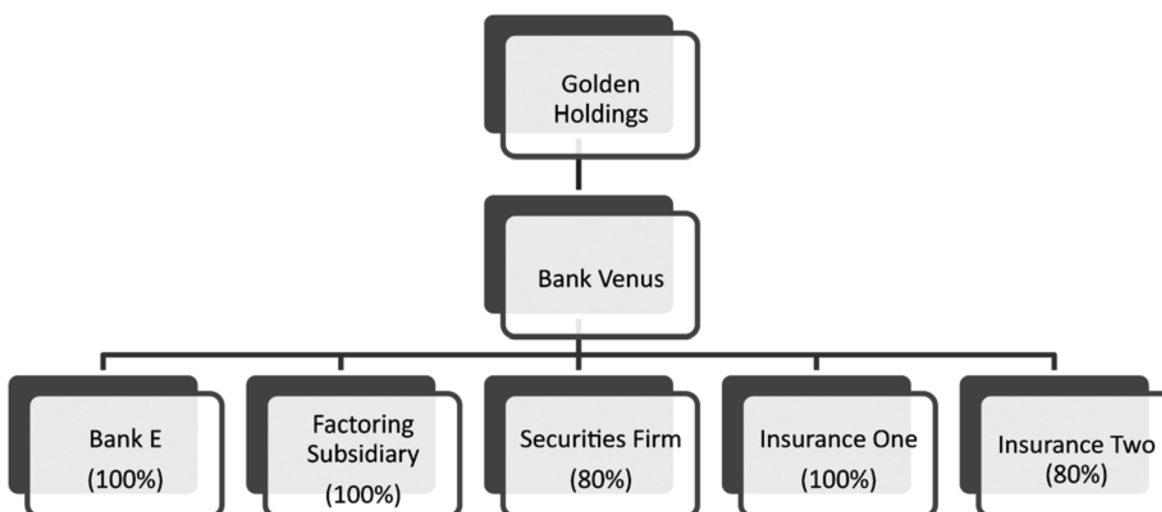
Capital Shortfall

Below is an example of the impact of adjusting the parent bank's capital in the situation where the insurance subsidiary has a capital shortfall.

Assume the same scenario as the previous example; except this time the wholly-owned insurance subsidiary that is subject to a deduction treatment has a capital shortfall of N$ 0.05 billion. Reflecting the capital shortfall in the insurance firm reduces the capital ratio from 8.6% to 7.9%. It is important that a shortfall in capital in the insurance subsidiary be deducted because, otherwise, the parent bank's capital adequacy ratio would be overstated.

Deduction Approach-Capital Shortfall	
Risk Weighted Assets	7 b
Bank Capital	1 b
Deduct Investments in insurance Firm	(0.4) b
Deduct shortfall of capital	(0.05) b
Regulatory capital available	0.55 b
Capital Ratio (0.55 b/7 b)	7.9 %

Example Four: The following information relates to a banking group operating in the Republic of Venus:



1. Bank Venus's tier 1 capital amounts to 5 billion dollars (N$) and tier 2 capital amounts to N$3 billion before deductions.
2. Bank Venus holds insurance One (100%), Insurance Two (80%) and has a 30 % interest in the equity of Minority Insurance.
3. Bank Venus's investment in Insurance One is N$1 billion, with a good will arising from the acquisition amounting to N$100 million.
4. Bank Venus's investment in Insurance Two is N$500 million.
5. Insurance Two has encountered excessive claims and has a shortfall of capital of N$100 million.
6. Bank Venus's investment in Minority Insurance totals N$ 400 million.

The table below shows how the relevant deductions are done.

		Tier 1 Capital :**N$5 b**
Deduct : goodwill in Insurance One	0.1 b	
50% investment in Insurance One	0.45b ((1 b investment –goodwill 0.1) =0.9 b/2)	
50% investment in insurance Two	0.25 b (0.5 b/2)	
50% investment in Minority Insurance	0.20 b (0.4 b/2)	**-1.0b** (0.1+0.45+0.25+0.2)
Tier 1 Capital after deductions		**4.0 b** (5b -1.0 b)
		Tier 2 Capital : N$3 b
Deduct:		
50% investment in Insurance One	0.45b	
50% investment in Insurance Two	0.25 b	
50% investment in Minority Insurance	0.20	**-0.90b** (0.45+0.25+0.20)
Tier 2 Capital after Deductions		**2.1 b**
Total Capital		6.1 b (Tier1; 4b+ Tier2; 2.1 b)
Deduct Capital shortfalls	(0.1) (Shortfall in Insurance Two	**-0.1**
Total Capital after deductions		**N$6 b**

Example Five: Deduction of Intra-group share holdings from capital

A Parent Bank has participations in another bank (Subsidiary Bank 2 in two respects: it has shares of the subsidiary bank with the book value of 50 and other capital components with a book value of 10.

Parent Bank 1	
Book value shares in subsidiary 50	500 Share Capital Tier I
	50 Loan capital Tier II
Holding of subsidiary loan capital Tier II 10	100 Loan capital Tier II
	100 Tier III

Subsidiary Bank 2	
	50 Share Capital Book Value Tier I
	100 Reserves Tier 1
	50 Loan Capital Tier II
	10 Loan capital subscribed by parent Tier II

Regulatory Consolidated Balance Sheet

Tier I Parent	500	
Tier I Subsidiary (book value)	50	
Reserves Subsidiary	100	650
Holding by Parent in Subsidiary		-50
Tier I		**600**
Tier II Parent	50	
Tier 11 Parent	100	
Tier II subsidiary held by parent	10	
Tier II subsidiary other	50	210
		-10
Tier II		**200**
Tier III		**100**
Total Capital		**900**

The full amount of the capital positions of both the parent bank and the subsidiary are added for each category (Tier I and Tier II separately). The participations of the parent bank have to be deducted from the respective Tier I or Tier II positions to prevent double counting of capital.

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