



KINGDOM OF CAMBODIA
NATION RELIGION KING

NATIONAL BANK OF CAMBODIA

Number.....B7.020.002.C.L.

(Unofficial Translation)

Phnom Penh, June 25, 2020

Additional Circular
on
The Implementation of Prakas on Capital Buffer
in Banking and Financial Institutions

With reference to the Royal Kram NS/RKM/1199/13 of November 18, 1999 promulgation the Law on Banking and Financial Institutions and Prakas N° B7-018-068 Prokor dated February 22, 2018 on Capital Buffer in Banking and Financial Institutions, the National Bank of Cambodia (NBC) herewith introduces the additional implementation information of this Prakas as follow:

1. Guidance on earnings definition

Article 4.-

[...] Earnings refer to distributable profits of a financial year calculated prior to the deduction of elements subject to the restriction on distributions, which are specified in Article 10 of this Prakas. Earnings are calculated after the tax that would have been reported prior to withdrawing the distributable items. As such, any tax impact of making such distribution is reversed out.

Distributable profits of a financial year refer to the net profit reported in monthly report on income statement (item “net profit/loss of the period”) as of December, but after the financial statement is audited, the institution shall use the net profit from the audited report. Distributable profits are calculated after tax without taking into account any tax impact on distributable items.

2. Guidance on Article 5

Article 5.-

The capital conservation buffer is designed to ensure that Institutions build up capital buffers under normal financial situation that could be drawn down when losses would occur. When the capital conservation buffer in an institution has been drawn down whether partially or totally, the Institution shall rebuild it as soon as possible. In case the institution could not

rebuild immediately, it shall submit to the NBC a “capital management plan” explaining the methods and determining the date it intends to build its capital conservation buffer.

As stated in Article 11 of Prakas on Capital Buffer in Banking and Financial Institutions, the minimum capital conservation ratio at the end of a financial year (n) shall be used as a basis for calculation of the restriction of earnings’ distribution of the next financial year (n+1). In case the institution cannot rebuild the capital conservation buffer with the amount of earnings immediately, it shall submit to the NBC a capital management plan to get back on track as soon as possible. Under normal financial situation, the institution should not choose to operate within the buffer range simply to compete with other banks and win market share.

For example, in January 2019, an institution has a Tier 1 capital ratio at 8% (Tier 1 = 7.5% and capital buffer = 0.5%). In that case, according to table 1.1 in appendix 2, the institution should retain 80% of its 2018 earnings to comply with the requirement of capital buffer. Therefore, the institution must keep 80% of its 2018 earnings as retained earnings and 20% as dividends or bonuses etc.

When the institution has to comply with 2.5% capital conservation buffer but in case that the institution cannot rebuild it, the institution needs to submit a capital management plan approved by board of directors to NBC immediately in accordance with Article 5 of the Prakas.

Board of directors and senior management are responsible for prioritizing and quantifying the capital actions available to them to cushion against unexpected events. Capital management plan should include the reductions in or cessation distribution of dividends, new capital injection or balance sheet reductions. The NBC will evaluate the appropriateness of the capital management plan.

3. Guidance on Article 8

Article 8.-

In case the Institution has Tier 1 Capital above the minimum capital requirement for Tier 1 Capital (MCR1=7.50%), the Institution may use the exceeded amount Tier 1 Capital to meet the minimum capital requirement for Total Capital (MCRt=15%), but the Institution may not include the exceeded amount in the capital conservation buffer according to minimum capital requirements (MCRs) as stated in Article 4 of this Prakas. A template for the calculation and explanation of the capital buffers to be built up by institutions is provided in Appendix 1 and Appendix 2 accordingly.

Any amount of Tier 1 Capital ratio beyond 7.5% shall be used to meet the minimum capital requirement (solvency ratio) before being eligible to be included in the capital conservation buffer.

Case 1:

An Institution that has a solvency ratio of 16% where the Tier 1 Capital and the Tier 2 Capital are both 8% of the Risk Weighted Assets. The Institution makes use of 7.50% within the 8% of the Tier 1 Capital ratio to cover its MCR for Tier 1 and for Total Capital. The Institution shall be considered as having only implemented a 0.50% capital conservation buffer. Therefore, Institution needs additional Tier 1 capital ratio 2% for fulfilling MCR1 10% as stated in Article 7 of this Prakas.

According to Table 1.2, the Institution is in first quartile of capital buffer (MCR1 + available Tier 1 capital = 7.50% + 0.50% = 8%) which requires the Institution to maintain its earnings 100%.

Case 2:

An Institution that has a solvency ratio of 17% where the Tier 1 Capital is 9.50% of the Risk Weighted Assets and the Tier 2 Capital is 7.50% of the Risk Weighted Assets. The Institution makes use of 7.50% within the 9.50% to cover its MCRs for Tier 1 and for Total Capital. The Institution shall be considered as having implemented a 2% capital conservation buffer. Therefore, Institution needs additional Tier 1 capital ratio 0.50% for fulfilling MCR1 10% as stated in Article 7 of this Prakas.

According to Table 1.2, the Institution is in fourth quartile of capital buffer (MCR1 + available Tier 1 capital = 7.50% + 2% = 9.50%) which requires the Institution to maintain its earnings 40%.

Case 3:

An Institution that has a solvency ratio of 16.50% where the Tier 1 Capital is 11.50% of the Risk Weighted Assets and the Tier 2 Capital 5% of the Risk Weighted Assets. The Institution makes use of 10% within the 11.50% to cover its MCR for Total Capital. It shall be considered as having implemented a 1.50% capital conservation buffer. Therefore, Institution needs additional Tier 1 capital ratio 1% for fulfilling MCR1 10% as stated in Article 7 of this Prakas.

According to Table 1.2, the Institution is in third quartile of capital buffer (MCR1 + available Tier 1 capital = 7.50% + 1.50% = 9%) which requires the Institution to maintain its earnings 60%.

In case 3, the excess amount of Tier 1 capital is 4% (11.5% - 7.5%) but this excess amount cannot be included in the capital conservation buffer because the rule of minimum capital requirement is 15%. The institution must use 10% out of 11.5% to meet the MCR (Tier1 10% + Tier2 5%). Therefore, only 1.5% could be included in the capital conservation buffer. The institution needs additional Tier 1 capital of 1% for fulfilling the minimum of 10% (7.5% + 2.5%).

Case 4:

An Institution that has a solvency ratio of straight 15% where the Total Capital is only made of Tier 1 Capital. The Institution shall be considered as not having implemented any capital conservation buffer. Therefore, Institution needs additional Tier 1 capital ratio 2.50% for fulfilling MCR1 10% as stated in Article 7 of this Prakas.

According to Table 1.2, the Institution is in first quartile of capital buffer (MCR1 + available Tier1 capital = 7.50% + 0% = 7.50%) which requires the Institution to maintain its earnings 100%.

Case 5:

An Institution that has a solvency ratio of 18% where the Tier 1 Capital is 12% of the Risk Weighted Assets and the Tier 2 Capital 6% of the Risk Weighted Assets. The Institution makes use of 9% within the 12% to cover its MCR for Total Capital. The Institution shall be considered as having implemented a 3% capital conservation buffer. Therefore, Institution

does not need to have additional Tier 1 capital ratio for fulfilling MCR1 10% as stated in Article 7 of this Prakas.

According to Table 1.2, the Institution can distribute all of its earnings.

Case 6:

An institution has a solvency ratio of 16% where the Total Capital is only made of Tier 1 Capital. The institution can make use of 15% for MCR, meaning that the institution has already implemented a 1% capital conservation buffer, but it still needs additional capital conservation buffer of 1.5%.

According to Table 1.2, the Institution is in second quartile of capital buffer (MCR1 + available Tier 1 capital = 7.5% + 1% = 8.5%) which requires the Institution to maintain its earnings 80%.

4. Guidance on Article 9

Article 9.-

Earnings distribution constraints will apply when the Tier 1 Capital ratio (MCR1=7.50%) of the Institution fall within the capital conservation buffer quartile ranges outlined in article 11 of this Prakas. The constraints shall apply only to distributions per financial year, not to the operations of the Institution.

Institutions shall maintain a capital conservation buffer ratio above the minimum capital requirement for Tier 1 (7.5%). Under normal financial situation, institutions should keep a minimum Tier 1 capital ratio of 10%. In case the capital conservation ratio falls within capital buffer range between 0% and 2.5%, earnings distribution constraints will apply. The constraints imposed only relate to distributions per financial year, such as dividends, which would not impact the operation of the institution.

Although capital buffer aims at mitigating financial uncertainty in avoiding breaches of the minimum capital requirement, capital buffer should not be viewed as a new minimal capital requirement. The replenishment of capital buffer should come first from retained earnings.

5. Guidance on Article 10

Article 10.-

Distributions that effect Tier 1 Capital are subjected to restrictions, such as dividends and share buybacks, discretionary bonus payments to staff, and so on.

The institution should have corporate governance policy regarding bonuses to management and staff and should have capital planning process before earnings' distribution which might affect Tier 1 capital.

The capital planning process should ensure that any distributions of staff bonuses do not take place before the calculation of capital conservation ratio. Any bonus staff scheme should comply with the regulation preventing financial institutions to distribute retained earnings where they must keep them to replenish or build up capital buffers.

The value of Tier 1 ratio at the end of a financial year shall be used as the basis for calculation of the earnings' distribution of the subsequent financial year. Staff bonuses are

usually provisioned on the previous financial year (t-1) and distributed in the first quarter of the subsequent financial year (t). To make the right calculation of the restriction of earnings distribution, the provisioned bonuses should be reintegrated in net profit to obtain the level of Tier 1 ratio and hence the minimum capital conservation ratio.

6. Guidance on Article 20

Article 20.-

By exception, the following particular provisions apply to Institutions that the NBC required to maintain its solvency ratio above the minimum requirements as following:

- *The minimum capital requirements above which such Institutions must build a capital conservation buffer and a countercyclical capital buffer are the minimum capital requirements (MCR) 15% specified in Article 4 of this Prakas increased by the amount of their specific additional capital requirement as mentioned in Article 6 of Prakas N° B7-011-082 Prokor dated on February 23, 2011 on the Implementing of Risk-based and Forward Looking Supervision.*
- *The NBC may decide that such Institution will be subject to specific individual requirements of capital conservation buffer and countercyclical capital buffer that will be no more than 2.50% of their own increased minimum capital requirement and no less than the one needed to augment their capital requirement, including buffers, at the levels mentioned in articles 7 and 14 of this Prakas.*
- *The institution that shall maintain its solvency ratio above the minimum requirements shall act in accordance with particular provisions determined by the NBC.*

The institutions which are required to increase their additional solvency ratio as mentioned in Article 6 of Prakas N° B7-011-082 Prokor dated February 23, 2011 on Implementing Risk-based and Forward Looking Supervision, has to follow the following principles:

- Principle 1: Every institution shall comply with the level of each capital buffer, meaning that 2.5% for the capital conservation buffer and not more than 2.5% for the countercyclical capital buffer. For the calculation of the minimum capital conservation ratio, the institution shall apply the rules stated in Article 4, but for the MCR and MCR1, the institution shall apply the rule stated in Article 6 of Prakas N° B7-011-082 Prokor.
- Principle 2: According to Article 20 and Article 15, NBC may decide to modify the level of countercyclical capital buffer for a particular Institution if capital buffers ratio and capital surcharge ratio are deemed particularly stringent regarding the systemic risk bearing by the Institution.

Examples: Capital conservation is 2.5% and countercyclical capital buffer is 2%. For the calculation of the minimum conservation ratio, see appendix 3 and the examples below:

Example1: If institution XYZ has been required to increase its solvency ratio by 3% over the minimum MCR (15%), this institution should apply the rule to build both capital

buffers with the new MCR. In that case, MCR is 18% (15%+3%) and Tier 1 is more than or equal to 50% of Total capital, meaning that new MCR1 is more than or equal to 9%. Therefore, there is no capital available to build capital buffers (CCB and CCyB) in case of institution XYZ solvency ratio = 18% and Tier 1 ratio= 9%.

Example 2: NBC has required institution XYZ to have minimum MCR of 16% based on risk assessment. Therefore, the institution shall have total capital of 20.5% with 16% of MCR, 2.5% of capital conservation buffer and 2% capital countercyclical buffer (refer to appendix 3 of Prakas on Capital Buffer in Banking and Financial Institutions).

However, the current solvency ratio of the institution is 18% with 10% of Tier 1, which means the institution XYZ has capital conservation buffer of 2% already. So, institution XYZ must build a 0.5% capital conservation buffer and 2% countercyclical capital buffer to have the total capital of 20.5%.

This additional circular shall take effect from the signing date.

The Governor

Signed and Sealed: **Chea Chanto**