



**CENTRAL BANK OF SRI LANKA
BANK SUPERVISION DEPARTMENT**

18 July 2019

EXPLANATORY NOTE

No. 03 of 2019

**Interpretations for Banking Act Directions No. 01 of 2016 on Capital Requirements under
Basel III for Licensed Commercial Banks and Licensed Specialised Banks**

The banking sector in Sri Lanka has adopted Sri Lanka Accounting Standard - SLFRS 9: Financial Instruments for financial reporting periods beginning on or after 01.01.2018 as stipulated by the Institute of Chartered Accountants of Sri Lanka. Currently, when computing capital adequacy ratio under the above Directions the Capital Measure is calculated on Sri Lanka Accounting Standards based figures and Risk Weighted Assets (RWA) are computed based on the balance sheet prepared for regulatory reporting in line with Directions issued by the Central Bank of Sri Lanka.

In order to implement a consistent approach to measure Capital and RWA when computing capital adequacy ratio, the following measures are introduced:

**1. Impairment eligible for inclusion in Tier 2 capital under web based return code
20.2.3.1.1.3 - General Provisions**

100 per cent of impairment for assets in Stage 1 and 50 per cent of impairment for assets in Stage 2 under SLFRS subject to a maximum limit of 1.25 per cent of RWA on credit risk under the Standardised Approach shall be eligible for inclusion in Tier 2 capital. Accordingly, licensed banks shall report the eligible impairment under the web-based return code 20.2.3.1.1.3.

2. Application of Risk Weights for Non-Performing Assets (NPA)

2.1 Impairment for NPA other than qualifying residential mortgage loans

Impairment for assets in stage 3 under SLFRS shall be deducted from the respective credit exposures to arrive at net exposure¹ and risk weighted as follows:

¹ In the case of collective impairment where it is not possible to identify the impairment with specific assets, licensed banks shall apportion the impairment charges on a pro rata basis.



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- (i) **Web-based return code 20.3.1.11.1.0** – licensed banks shall report unsecured portion of NPA, other than qualifying residential mortgage loans, where stage 3 impairment under SLFRS is equal to or more than 20 per cent of the carrying value of the respective financial asset or group of assets.
- (ii) **Web-based return code 20.3.1.11.2.0** - licensed banks shall report unsecured portion of NPA, other than qualifying residential mortgage loans, where stage 3 impairment under SLFRS is less than 20 per cent of the carrying value of the respective financial asset or group of assets.

2.2 Impairment for NPA secured by Residential Property

Impairment for assets in stage 3 under SLFRS shall be deducted from the respective credit exposures to arrive at net exposure¹ and risk weighted as follows:

- (i) **Web-based return code 20.3.1.12.1.0** - licensed banks shall report NPA secured by residential property, where stage 3 impairment under SLFRS is equal to or more than 20 per cent of the carrying value of the respective financial asset or group of assets.
- (ii) **Web-based return code 20.3.1.12.2.0** - licensed banks shall report NPA secured by residential property, where stage 3 impairment under SLFRS is less than 20 per cent of the carrying value of the respective financial asset or group of assets.

3. Foreign Claims on Central Government

- (i) **Web-based return code 20.3.1.1.1.2** - Licensed banks shall deduct respective SLFRS based impairment charge, if any, from claims on foreign currency denominated securities issued by Government of Sri Lanka before applying the risk weight when computing the capital charge under Basel III.

A handwritten signature in blue ink, appearing to be 'A A M Thassim'.

A A M Thassim

Director of Bank Supervision