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PRUDENTIAL REQUIREMENTS RETURN (FORM-CBR3)

1. INTRODUCTION

Guidelines are provided to assist with the completion of compliance with prudential requirements return (FORM-CBR3). FORM-CBR3 is part of the Co-operative Banks Act Supervisors' Rules (the Rules) as published in *Government Gazette* No.32860 dated 12 January 2010. These guidelines should be read in conjunction with the Co-operatives Act, 2006 (Act No.14 of 2005) (the Co-operatives Act), the Co-operative Banks Act 2007 (Act No.40 of 2007) (the Act), the regulations issued in terms of Section 86 of the Act (the Regulations) and the Rules. Explanatory notes on the completion of FORM-CBR3 are discussed in this document.

2. PURPOSE

Prudential requirements are the statutory provisions listed in the Act and the Regulations. Their main purpose is to ensure that prudent risk management policies are applied in order to minimise potential risks to co-operative banks and losses to their members. The key prudential requirement is capital adequacy, which establishes the minimum amount of capital that must be held as a solvency buffer. Other prudential requirements also place limits on risk exposures in order to reduce the potential for sudden shocks to co-operative banks.

3. COMPLETION OF FORM-CBR3

The completed return (FORM-CBR3) should be submitted under cover of a signed FORM-CBR0 within twenty (20) business days immediately following the month end to which it relates. Both the managing director and the chief financial officer of the co-operative bank must sign FORM-CBR0. In cases where the managing director is also the Chief Financial Officer, the chairperson of the board must co-sign FORM-CBR0 with the managing director. Every page of the attachments to FORM-CBR0 must be initialled by the signatories.

4. INABILITY TO MEET PRUDENTIAL REQUIREMENTS

A co-operative bank that is unable to meet or maintain the prudential requirements must immediately report to the relevant Supervisor and give reasons for non-compliance. Management members must also indicate how and when they intend to regularise the matter. In cases where the matter was previously reported, the reporting date must be reflected in the "Date inability reported" column provided on FORM-CBR3.

The mere completion of FORM-CBR3 must therefore not be construed in any way as a report to the relevant Supervisor regarding the inability of a co-operative bank to meet the prudential standards as contemplated in Section 21(1) of the Act.

The following guidance notes clarify the relevant extracts from FORM-CBF3, which are reflected in the shaded areas. The item numbers reflected in the ratios refer to the relevant item numbers of the balance sheet return (FORM-CBR1) and the income statement return (FORM-CBR2).

5. CAPITAL ADEQUACY

Reference to regulation	Prudential Requirements		Regulatory Standard
4(1)a(i)	Capital adequacy as a % of total assets	%	Min 6%

5.1. Purpose

The purpose of reporting the capital adequacy ratio is to enable the relevant Supervisor to track the co-operative bank's ability to absorb a reasonable amount of loss that may suddenly incur. The capital adequacy requirement involves a definition stipulating which instruments constitute regulatory capital and the specification of the minimum amount of capital that co-operative banks must hold in relation to its total assets. Capital must be of a permanent nature.

For the purposes of calculating the capital adequacy of a co-operative bank, in terms of Regulation 4.1, only the following qualify as capital:

1. Membership shares issued by the co-operative bank.
   (Since there is a limitation to members' shares in terms of Section 24(1) of the Co-operatives Act, members' shares qualify as capital when calculating the capital adequacy ratio, including voluntary shares with the same rights and privileges as membership shares. The aforementioned section of the Co-operatives Act determines that "despite any provisions contained in its constitution, if a co-operative determines that the repayment of shares would adversely affect its financial well-being, the co-operative may direct that the repayment be deferred for a period not exceeding two years after the effective date of the notice of withdrawal". The Supervisor must be informed immediately when payment has been deferred. "Share

savings" with the same characteristics as savings deposits and redeemable shares do not qualify as share capital when calculating capital adequacy).

2. Indivisible reserves as required in terms of section 3(1)(e) of the Co-operatives Act.
3. Non-distributable reserves created or increased by appropriations of surpluses (retained earnings).
4. Any other non-distributable funds of a permanent nature not subject to a legal claim by any person held by a co-operative bank approved by the relevant supervisor in writing.

5.2. The Capital Adequacy Ratio (CAR)

The CAR is calculated as follows:

$$CAR = \frac{\text{Total Members' Share Capital (110)} + \text{Total Institutional Capital (124)}}{\text{Total Assets (79)}} \times 100$$

5.3. Prudential Requirement

The minimum CAR for co-operative banks is **6%** (Regulation 4(1)(a)(i)).

6. MAXIMUM FIXED AND NON-EARNING ASSETS

Reference to regulation	Prudential Requirements		Regulatory Standard
4(1)(c)(i)	Fixed and non earning assets/total assets	%	Max 5%

6.1. Purpose

The purpose of the prudential requirement on fixed and non-earning assets is to minimise assets that do not earn income. Examples of non-earning assets include fixed assets (land, buildings, equipment, etc.), accounts receivable, cash on hand, pledged assets in liquidation and prepaid expenses.

6.2. Ratio: Minimum Fixed and Non-Earning Assets

The ratio is calculated as follows:

$$\frac{\text{Total fixed and non-earning assets (78)}}{\text{Total assets (79)}} \times 100$$

6.3. Prudential Requirement: Maximum Fixed and Non-Earning Assets

The maximum fixed and non-earning asset that a co-operative bank must hold is **5%** of total assets (Regulation 4(1)(c)(i)).

7. LIQUIDITY

7.1. Purpose

The purpose of the prudential requirements on liquidity is to ensure that a co-operative bank maintains a minimum level of liquid assets or demand deposits to meet day-to-day deposit withdrawals, expenses and payments. In general, co-operative banks fund their longer-term loans and investments mostly with short-term liabilities such as members' deposits, of which the major part is normally withdrawable on demand. One of the main challenges for a co-operative bank is to ensure its level of liquidity is reasonable, given its unique circumstances. Liquidity requirements include the following:

1. Minimum liquid assets as a percentage of total deposits (Paragraph 6.2).
2. Minimum deposits to be held at the CBDA or higher tier co-operative bank (Paragraph 6.3).
3. Maximum loans as a percentage of assets (Paragraph 6.4).

7.2. Liquid Assets as a Percentage of Deposits

Reference to regulation	Prudential Requirements		Regulatory Standard
4(1)(c)(ii)	Liquid assets as a percentage of deposits	%	Min 10%

7.2.1 Introduction

Liquid assets include non-earning liquid assets and liquid investments with a tenure not exceeding 32 days that are convertible into cash at any time, without incurring any penalty or being subject to a discount rate substantially higher than the average rate that applies to liquid assets with a similar term. Liquid investments, in terms of Regulation 3.2(a), include the following:

1. Deposits held with a commercial bank;
2. Deposits held with secondary or tertiary co-operative banks of which a co-operative bank is a member;

3. Government co-operative retail savings bonds and treasury bills issued under the Public Finance Management Act, 1999 (Act No.1 of 1999);
4. Participatory interests in portfolios of collective investment schemes approved by the Registrar of Collective Schemes and administered by a manager registered under the Collective Investment Schemes Control Act, 2002 (Act No.45 of 2002) as determined by the supervisor by notice on its official website;
5. Bonds and debentures determined by the supervisor by notice on its official website issued by national government or public entities listed under the Public Finance Management Act, (Act No.1 of 1999) or the Reserve Bank.

7.2.2 Ratio: Liquid Assets as a Percentage of Deposits

The ratio is calculated as follows:

$$\frac{\text{Total liquid investments (18) + Total liquid assets (43)}}{\text{Total deposits (88)}} \text{ X } 100$$

7.2.3 Prudential Requirement:

The minimum liquid assets amount that a co-operative bank must hold is **10%** of total deposits (Regulation 4(1)(c)(ii)).

7.3 Deposits with Agency or Higher Tier Co-operative Banks

Reference to regulation	Prudential Requirements		Regulatory Standard
4(1)(c)(iii)	Deposits held with the Agency or higher tier co-op banks	%	Min 2.5%

7.3.1 Introduction

Over and above the requirement set out in paragraph 6.2 above, it is a requirement to hold additional funds at the Co-operative Banks Development Agency (CBDA) or at a higher tier co-operative bank. These funds are therefore immediately available to cater for extraordinary liquidity needs.

7.3.2 Ratio: Deposits held with the agency or higher tier co-operative banks

This ratio is calculated as follows:

$$\frac{\text{Deposits held with CBDA (11) + 2nd tier Co-op Bank (12) + 3rd tier Co-op Bank (13)}}{\text{Total deposits (88)}} \text{ X } 100$$

7.3.3 Prudential Requirement

The minimum deposits to be held at a higher tier co-operative bank and/or the CBDA as a percentage of total deposits are **2.5%** of total deposits (Regulation 4(1)(c)(iii)).

7.3.4 Total loans as a percentage of total assets (Savings and Loans co-operative bank)

Reference to regulation	Prudential Requirements		Regulatory Standard
4(1)(c)(iv)(ii)	Total loans/total assets	%	Max 80%

7.3.5 Introduction

The loans to assets ratio measures the total loans outstanding (excluding loan loss allowance) as a percentage of total assets. A high ratio indicates that a co-operative bank has extended a large portion of available funds as loans.

7.3.6 Ratio: Total loans/Total Assets

The ratio is calculated as follows:

$$\frac{\text{Total Loans (4+5+6+7-8)}}{\text{Total Assets (79)}} \text{ X100}$$

7.3.7 Prudential Requirement

The maximum percentage of assets that a Savings and Loans co-operative bank may extend as loans to members is **80%** (Regulation 4(1)(c)(iv)(ii)).

8 EXTERNAL BORROWINGS

Reference to regulation	Prudential Requirements		Regulatory Standard
3(1)	Total external borrowings/total assets	%	Max 15%

8.2 Purpose

The purpose of this prudential requirement is to limit the extent of reliance on external funding and to promote a savings culture. The sustainability of co-operative banks is, amongst other variables, dependent on their ability to grow organically through the principle of "self-help". Co-operative banks should, in general, rely primarily on members' deposits as a cheaper means of funding loans and investments. External borrowing is defined in the

Regulations to "include any monies secured through a loan, excluding members' deposits, for which a co-operative bank has entered into an agreement and must repay the funds with or without interest at a later date, including a loan from the Co-operative Banks Development Agency, a higher tier co-operative bank and any member".

8.3 The Ratio: External Borrowings

The ratio is calculated as follows:

$$\frac{\text{Sum of external borrowing (95)}}{\text{Total assets (79)}} \times 100$$

8.4 Prudential requirement

The maximum percentage of total assets that a co-operative bank may secure as external borrowings is **15%** (Regulation 3(1)).

9 GRANTS FROM CASH DONATIONS

Reference to regulation	**Prudential Requirements**		**Regulatory Standard**
4(1)(c)(v)	Loans granted from cash donations as % of deposits	%	Max 15%

9.2 Purpose

The purpose of this requirement is to measure the extent of loans granted from cash donations received in relation to total deposits. This limit ensures that a savings and loan co-operative bank primarily relies on deposits from its members for on-lending purposes and is aimed to stimulate a savings culture to support sustainable organic growth.

9.3 Ratio

The ratio is calculated as follows:

$$\frac{\text{Loans granted from cash donations*}}{\text{Total deposits (88)}} \times 100$$

*A separate record must be kept in respect of loans granted from cash donations.

9.4 Prudential Requirement

For a co-operative bank that provides saving and loan services, the loans that may be granted to members that are sourced from cash donations may not exceed **15%** of total deposits.

10 LOAN LOSS PROVISIONING

10.2 Purpose

The purpose of loan loss provisioning is to cater for potential future losses. Since loan loss provisioning is treated **as an expense**, it safeguards a co-operative bank's solvency and capitalisation if and when loan losses occur. Co-operative banks must make loan loss provision in accordance with the Regulations in respect of all loans and delinquent loans. A delinquent loan is defined in the Regulation as follows:

> *"delinquent loan" means any loan in respect of which a payment due and payable has not been received in accordance with the terms of a contractual arrangement, and includes –*
>
> *(i) in respect of loans that provide for monthly payments, a loan in respect of which a payment was not received 31 calendar days after the due date for payment;*
>
> *(ii) in respect of loans that provide for daily or weekly payments, a loan in respect of which a payment was not received one day after the due date for payment".*

The prudential requirements and the calculation of statutory provisioning are explained in paragraph 9.2.

10.3 Calculation

The shaded area below is an extract from FORM-CBR3 and the non-shaded area is for explanatory purposes.

Paragraph		**1**	**2**	**3**	**4**	**5**
9.2.1	**A**	4(1)(b)(i)	All loans	R	%	Min 2%
9.2.2	**B**	4(1)(b)(ii)	Delinquent loans between 1 to 6 months	R	%	Min 35%
9.2.3	**C**	4(1)(b)(iii)	Delinquent loans between 6 and 12 months	R	%	Min 50%

9.2.4	**D**	4(1)(b)(iv)	Delinquent loans over 12 months	R	%	Min100%
9.2.5	**E**		Accumulated provision for the period under review	R		

The table below can be used for own purposes to calculate the values that must be reflected on FORM-CBR3. Complete the table below and enter the values as indicated in the corresponding section of the return (table above).

DESCRIPTION	**TOTAL RAND AMOUNT**	**ACTUAL PROVISION**
All loans	R (Value A) *(Enter this value in RowA, Column 3)*	R (Value E)
Delinquent loans between 1-6 months	R (Value B) *(Enter this value in Row B, Column 3)*	R (Value F)
Delinquent loans between 6-12 months	R (Value C) *(Enter this value in Row C, Column 3)*	R (Value G)
Delinquent loans > 12 months	R (Value D) *(Enter this value in Row D, Column 3)*	R (Value H)
	TOTAL	**R** *(Enter this value in Row E Column 3/4)* Total actual loan loss provision/ allowance. This amount must correspond with item 8 on the balance sheet return (FORM-CBR1).

10.3.1 Loan loss provision on all loans

It is important to note that a minimum of 2% provision must be made on **all current loans, even if there is no delinquency**. The total amount of loans must be entered in Row A, Column 3. The actual percentage is calculated as follows:

$$\frac{\text{Actual loan loss provision on all loans (Value E)}}{\text{Total loans (Value A)}} \times 100 = \quad \%$$

Enter the percentage obtained in Row A, Column 4 (Paragraph 9.2).

10.3.2 Loan loss provision on delinquent loans between 1 and 6 months

A minimum of 35% provision must be made on delinquent loans between 1 and 6 months. The total amount on delinquent loans between 1 and 6 months must be entered in Row B, Column 3. The actual percentage is calculated as follows:

$$\frac{\text{Actual loan loss provision on delinquent loans 1 to 6 months (Value F)}}{\text{Total amount of delinquent loans 1-6 months (Value B)}} \times 100 = \quad \%$$

Enter the percentage obtained in Row B, Column 4 (Paragraph 9.2).

10.3.3 Loan loss provision on delinquent loans between 6 and 12 months

A minimum of 50% provision must be made on delinquent loans between 6 and 12 months. The total amount on delinquent loans between 6 to 12 months must be entered in Row C, Column 3. The actual percentage is calculated as follows:

$$\frac{\text{Actual loan loss provision on delinquent loans 6 to 12 months (Value G)}}{\text{Total amount of delinquent loans 6 to 12 months (Value C)}} \times 100 = \quad \%$$

Enter the percentage obtained in Row C, Column 4 (Paragraph 9.2).

10.3.4 Loan loss provision on delinquent loans in excess of 12 months

100% provision must be made on delinquent loans in excess of 12 months. The total amount on delinquent loans in excess of 12 months must be entered in Row D, Column 3. The actual percentage is calculated as follows:

$$\frac{\text{Actual loan loss provision on delinquent loans > 12 months (Value H)}}{\text{Total amount of delinquent loans >12 months (Value D)}} \times 100 = \quad \%$$

Enter the percentage obtained in Row D, Column 4 (Paragraph 9.2).

10.3.5 Accumulated Loan loss provision on delinquent loans

The total provisioning (Value E + Value F + Value G + Value H) must be reflected in Row E, Columns 3-4.

FORM-CBR3 must be submitted under cover of FORM-CBR0 to the relevant Supervisor.

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