BANK DOWNGRADES AND MINIMUM CAPITAL REFORMS:

How higher capital thresholds are reshaping Uganda's Banking sector

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BACKGROUND

Early this month, Uganda's banking sector woke up to the news of Finance Trust Bank's downgrade from a Tier I commercial bank to a Tier II commercial bank (credit institution), following regulatory approval for a Tier II licence.

On 29 January 2026, Bank of Uganda issued a general notice to the public stating that it had approved Finance Trust Bank's application to downgrade its operating licence from a commercial bank to a credit institution, effective 1 April 2026. While to many this sounded new, several commercial banks, namely Opportunity Bank, ABC Capital Bank, and Guaranty Trust Bank, had already been downgraded by July 2024.

Capital is increasingly becoming the price of remaining in the top tier of Uganda's banking market.

Why the increase in the number of commercial banks downgrading?

Any economy depends on the strength and regulation of its banking sector. The pivotal role played by banks in a country's financial ecosystem cannot be overstated. In 1974, Germany faced one of the most notorious banking collapses after the failure of Bankhaus Herstatt. That collapse was driven by massive foreign exchange losses and triggered a global ripple effect due to settlement risk.

To prevent a recurrence of similar crises, central bank regulators established the Basel Committee on Banking Supervision in 1975 to improve global banking regulation. This framework was later developed into what is commonly known as the Basel Accords. Over time, the Accords have evolved from Basel I, which mainly focused on credit risk and established a minimum 8% capital-to-risk-weighted-assets ratio, to Basel II, which introduced minimum capital requirements, supervisory review, and disclosure. The most recent, Basel III, emerged in response to the 2008 financial crisis and focused on strengthening minimum capital requirements, introducing leverage ratios, and improving liquidity requirements.

These reforms are aimed at ensuring that banks can meet customer demand for cash in the event of a crisis by relying on liquid and near-liquid assets, without destabilising the system.

Commercial banking in Uganda is one of the most regulated sectors. The sector is regulated by the Bank of Uganda (BoU) as the central bank under the Financial Institutions Act, Cap 57 (FIA), and the regulations made under it. Among BoU's supervisory functions is setting minimum capital requirements for banks under section 25 of the FIA.

In line with internationally accepted regulatory practices under Basel III, Bou amended minimum capital requirements through the Financial Institutions (Revision of Minimum Capital Requirements) Instrument, 2022 (the Regulations).

The revised minimum capital requirements under the Regulations led to a sharp increase in the thresholds for commercial banks. Commercial banks were required to maintain a minimum capital fund, unimpaired by losses, of at least UGX 120 billion by 31 December 2022, and UGX 150 billion by 30 June 2024.

BoU also revised buffer capital requirements through the Financial Institutions (Capital Buffers and Leverage Ratio) Regulations, 2020, as follows:

1. **a capital conservation buffer of 2.5%, comprising core capital (Tier 1) of not less than 12.5% and total capital of not less than 14.5% (all percentages of total risk-adjusted assets plus risk-adjusted off-balance-sheet items);**
2. **a systemic risk buffer ranging from 0% to 3.5% of total risk-adjusted assets plus risk-adjusted off-balance-sheet items, over and above the minimum ongoing core capital requirements, the total capital requirements, and the capital conservation buffer; and**
3. **a countercyclical capital buffer ranging from 0% to 2.5% of total risk-adjusted assets plus risk-adjusted off-balance-sheet items.**

In addition to the above, commercial banks are still required to maintain core capital and total capital to total risk-weighted assets ratios of at least 8% and 12%, respectively, and a leverage ratio equal to or greater than 6% of total balance-sheet and off-balance-sheet assets.

These revised requirements, aimed at strengthening stability in the banking sector, placed financial and compliance pressure on many players in the industry. Commercial banks were given deadlines to meet the new thresholds or risk losing their licences. Those that were sufficiently capitalised survived the shift. Others restructured their assets and capital to meet the requirements. However, banks that could not meet the thresholds, such as Opportunity Bank, ABC Capital Bank, and Guaranty Trust Bank, opted to downgrade. The reforms are accelerating consolidation, favouring institutions with access to deep shareholder capital while narrowing the space for mid-sized domestic banks.

Finance Trust Bank's path to downgrading

Finance Trust Bank (FTB) was among the commercial banks required to meet the revised capital timelines. Its board sought a grace period from the Central Bank, within which the bank was expected to restructure its assets and liabilities to meet the thresholds. One option considered was a merger and acquisition.

On 18 January 2024, FTB announced that Access Bank PLC would be acquiring 80% of its shareholding, and that the agreement was awaiting approval from the Central Bank. This arrangement was expected to enable FTB to meet the regulator's requirements.

However, the deal did not materialise. Access Bank PLC instead opted to acquire National Bank of Kenya from the KCB Group. This effectively ended FTB's prospects of maintaining its commercial bank licence through that transaction. With limited options remaining, FTB faced a choice: downgrade or collapse. The board chose the former.

In other words, FTB's downgrade was not necessarily a result of internal mismanagement, but rather its inability to meet the revised capital requirements set by the regulator.

What FTB's downgrade means for its customers.

Following the BoU's approval of its Tier II credit institution licence effective 1 April 2026, Bank of Uganda granted FTB three months to restructure its assets, liabilities, and products to meet both the capital requirements and the product/service framework applicable to Tier II credit institutions.

FTB subsequently issued a notice to its customers, which largely appeared to be aimed at public relations management rather than clearly explaining how the downgrade may affect customers' banking relationships going forward.

The downgrade from a Tier I to a Tier II licence has significant operational implications. The revised minimum capital requirement for Tier II (non-banks) is capped at UGX 25,000,000,000. This means FTB will no longer be able to offer several products typically associated with commercial banking.

Tier II credit institutions can accept deposits and provide lending services, such as savings and fixed deposit accounts and loans. However, they cannot offer certain services commonly offered by commercial banks, including checking/current accounts that allow easy access through cheques or direct debits, foreign exchange trading, and full trade finance services such as issuing letters of credit.

As a result, customers who benefit from or require such services may no longer be supported under FTB's new structure and may need to change their account arrangements or migrate to another commercial bank that can meet their needs. That

said, the bank is expected to continue offering deposit-taking, lending, agency banking, money transfer services, and other permitted services.

Conclusion

With the increasing need to ensure a stable banking sector that can absorb financial shocks, the Central Bank is likely to continue demanding more from financial institutions in terms of capital strength and corporate governance.

Going forward, commercial banks must remain ahead of the curve. The sector may experience further downgrades as global regulatory standards evolve, including the proposed Basel IV reforms, which are in the later stages of ratification. Among the notable changes is the so-called "output floor", which ties the output of banks' internal risk calculations to the standardised risk approach by setting a floor of 72.5%. This means the maximum benefit a bank can obtain from using internal models is limited to 27.5% of risk-weighted assets.

In short, commercial banks that are well-capitalised, compliant, and supported by strong corporate governance structures are more likely to endure. The performance of the economy is heavily dependent on the strength of its banking sector. Whereas the revised capital requirements and associated compliance obligations may be burdensome to industry players, they remain necessary for the long-term stability of the financial system and the economy.

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