Financial Institutions

Cap. 324A.

FINANCIAL INSTITUTIONS (CAPITAL ADEQUACY) REGULATIONS, 1998

1998/110.

Authority: These Regulations were made on 12th August, 1998 by the Minister under sections 17 and 115*(a)* of the *Financial Institutions Act.*

Commencement: 27th August, 1998.

1. These Regulations may be cited as the *Financial Institutions (Capital Adequacy) Regulations, 1998.*

2. The capital adequacy ratio referred to in section 17 of the Act shall be a minimum of 8 per cent and shall be calculated in the manner set out in the *Schedule* to these Regulations. Schedule.

SCHEDULE

(Regulation 2)

CAPITAL ADEQUACY CALCULATION FOR FINANCIAL INSTITUTIONS

The following provisions apply:

(a) All assets recorded on the balance sheet of a financial institution as well as their off-balance sheet exposures shall be assigned to broad risk categories.

(b) The qualifying capital shall comprise Tier I or Core Capital and Tier II or Supplementary Capital.

(c) The ratio of capital (Tier I and Tier II) to risk-weighted shall be a minimum of eight per cent, of which the core element (Tier I) shall be at least four per cent.

The Constituents of Capital, the Risk Weights for On-Balance Sheet Assets and the Credit Conversion Factors for Off-Balance Sheet Items shall be as follows:

CONSTITUENTS OF CAPITAL

1. **Tier I Capital or Core Capital** shall consist of:

(a) *Equity and Disclosed Reserves*:

(i) issued and fully paid ordinary share or common stock and related surplus (share premium);

(ii) fully paid perpetual non-cumulative preference shares and related surplus. These are preferred shares which

(A) do not have a maturity date;

(B) cannot be redeemed at the option of the shareholder;

(C) give the issuer the legal right to defer or eliminate preferred dividends; and

(D) have no other provisions that will require future redemption of the issue;

(b) *Statutory Reserves* as required by section 18 of the Act;

(c) *Capital Reserves* excluding asset revaluation reserves;

(d) *General Reserves* excluding general reserves or provisions for losses on assets;

(e) *Retained Earnings* as stated in the audited financial statements.

2. **Tier II Capital Or Supplementary Capital** shall consist of:

(a) *Fixed Asset Revaluation Reserves* arising from a formal revaluation of the financial institution's real estate property but limited to one revaluation every five years and up to twenty per cent of Tier I capital;

(b) *Securities Revaluation Reserves* which arise from the practice of holding securities in the balance sheet valued at historic cost. The difference between the historic cost and the market value is discounted by fifty-five per cent;

(c) *General Provisions or General Reserves for losses on assets* i.e. provisions and reserves not ascribed to specific assets. General provisions or general loan loss reserves made for specific assets are not eligible for inclusion in capital. General provisions or general loan loss reserves which qualify for inclusion in Tier II do so subject to a limit of one point two five per cent of risk-weighted assets;

(d) *Hybrid debt capital instruments* i.e. a range of instruments that combine characteristics of equity capital and of debt (e.g. perpetual cumulative preference shares, long term preference shares, perpetual subordinated term debt and mandatory convertible debts instruments) which meet the following requirements:

(i) they may be unsecured, subordinated and fully paid;

(ii) they should not be redeemable at the discretion of the holder;

(iii) they should be available to absorb losses; and

(iv) service obligations attached to the instrument should be deferrable;

(e) *Subordinated debt* includes conventional unsecured subordinated debt capital instruments with a minimum original fixed term to maturity of over five years and limited life redeemable preference shares. Such instruments shall be subordinated to the claims of both depositors and general creditors and are limited to a maximum of fifty per cent of Tier I capital.

3. Deductions from Capital shall consist of**:**

(a) From Tier I: *goodwill* arising from the acquisition of assets;

(b) From Total Capital:

(i) *investments in subsidiaries* engaged in banking and financial activities which are not consolidated in national systems (deductions will be made against the total capital base and such investments would not be included in total assets); and

(ii) *other Intangible Assets* e.g. the capitalization of formation and other preliminary expenses.

RISK WEIGHTS FOR ON-BALANCE SHEET ASSETS

Risk weights shall be assigned to assets as shown on the balance sheet as follows:

1. **Zero Per Cent Risk Weight** shall consist of:

(a) local and foreign currency;

(b) deposits at the Central Bank i.e. reserve account balances and special deposits;

(c) treasury Bills and other securities issued or guaranteed by Central Government;

(d) claims on local governments, statutory boards and other public sector entities in CARICOM and approved foreign countries and loans to these entities, all guaranteed by the Central Government;

(e) claims on CARICOM and approved foreign Central Banks and Central Governments and other obligations fully guaranteed by these entities;

(f) claims fully secured by cash on deposits at the reporting institution or Central Government securities and guarantees.

2. **Twenty Per Cent Risk Weight** shall consist of:

(a) claims on domestic financial institutions and other financial institutions incorporated in CARICOM or approved foreign countries and loans guaranteed by such institutions;

(b) claims on multilateral development banks and claims guaranteed or collateralized by securities issued by such banks;

(c) bankers' acceptances held as part of an institution's investment portfolio;

(d) cash items in the process of collection.

3. **Fifty Per Cent Risk Weight** shall consist of loans fully secured by mortgages on residential properties that are or will be occupied by the borrower or that are rented.

4. **One Hundred Per Cent Risk Weight** shall consist of:

(a) claims on the private sector;

(b) other loans and advances;

(c) premises, plants and equipment and other fixed assets;

(d) real estate and equity investments;

(e) capital instruments issued by other financial institutions (unless deducted from capital); and

(f) all other assets.

CREDIT CONVERSION FACTORS FOR OFF-BALANCE SHEET ITEMS

The following credit conversion factors are to be multiplied by the weights applicable to the category of the counterpart for an on-balance sheet item:

1. **One Hundred Per Cent Conversion Factor** shall consist of:

(a) items which substitute for loans and advances e.g. financial guarantees, including standby letters of credit and bankers' acceptances;

(b) sale and repurchase agreements with recourse where the credit risk remains with the financial institution; and

(c) forward asset purchases, forward deposits and partly-paid shares and securities representing commitments with certain drawdown.

2. **Fifty Per Cent Conversion Factor** shall consist of:

(a) certain transaction-related contingent items e.g. performance bonds, warranties and standby letters of credit related to particular transactions;

(b) note-issuance facilities and revolving underwriting facilities; and

(c) other commitments (e.g. formal standby facilities and credit lines) with an original maturity of over one year.

3. **Twenty Per Cent Conversion Factor** shall consist of short-term self-liquidating trade-related contingencies (such as documentary credits collateralized by the underlying shipments).

4. **Zero Per Cent Conversion Factor** shall consist of other commitments e.g. (formal standby facilities and credit lines) with an original maturity of up to one year or which can be unconditionally cancelled at any time.