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THE FINANCIAL INSTITUTIONS ACT

THE FINANCIAL INSTITUTIONS (CAPITAL ADEQUACY) REGULATIONS, 2004

In exercise of the power conferred upon the Minister by section 38(1) of the Financial Institutions Act, the following Regulations are hereby made:—

PART I—*Preliminary*

1. These Regulations may be cited as the Financial Institutions (Capital Adequacy) Regulations, 2004.

2.—(1) In these Regulations—

"entity" includes a trust, partnership, pension or other fund or an unincorporated association or organization;

"financial institutions" means licensees and building societies;

"general provisions for loss" means all the accumulated provisions for loss which are prudential in nature and cannot be determined on an item-by-item basis and are

established in accordance with regulations made under the Act relating to credit classification, provisioning and non-accrual requirements;

"ordinary shares" means that class of shares in the capital of a licensee which are non-redeemable and are unsecured in which the rights of the holders thereof are equal in all respects, including the right to—

- (a) vote at all meetings of shareholders except where only shareholders of a specified class of shares are entitled to vote;
- (b) receive dividends declared on those shares; and
- (c) receive the remaining property of the licensee on liquidation;

"preference shares" means shares in the capital of a licensee other than ordinary shares which—

- (a) are preferred in matters relating to—
 - (i) the distribution of profits; and
 - (ii) payment of dividends; and
- (b) rank with respect to capital, in winding up proceedings and in such other matters and respects as the by-laws creating each such class of shares may provide;

"prescribed deductions" means the aggregate of—

- (a) a licensee's investments in its unconsolidated subsidiaries;
- (b) the licensee's substantial investment in any other unconsolidated entities or companies;
- (c) the licensee's proportionate share of the amount of accumulated losses of any unconsolidated subsidiary or any other unconsolidated entity or company in which the licensee has a Substantial investment;
- (d) one or more licensee, banks or building other facilities provided by the licensee that are treated as capital by unconsolidated subsidiaries and by any other unconsolidated entities or companies in which the licensee has a substantial investment;
- (e) new and existing capital issues between the licensee and societies that represent, either directly or indirectly, back-to-back placements;

"shareholders equity" means, in respect of a licensee—

- (a) its paid-up ordinary shares;
- (b) its paid-up preference shares;
- (c) capital paid in excess of par value of shares (share premium);

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- (d) capital raised by the licensee from an issue of its shares to a government agency or undertaking, pursuant to an arrangement for the provision of financial assistance to the licensee for the purpose of its restructuring;

“specific provisions for loss” means all the accumulated provisions, for loss on particular assets which are required to reduce the book values to realizable values in accordance with regulations made under the Act relating to the classification and provisioning for losses on credit facilities;

“subordinated debt” means an instrument evidencing a licensee’s indebtedness, whereby the indebtedness will, in the event of the insolvency or winding up of the licensee, be subordinated in right of payment to all deposit liabilities and all other liabilities of the licensee except those that, by their terms, rank equally with or are subordinate to such indebtedness;

“substantial investment” means—

- (a) a licensee’s investment in another company, which on its own or together with that of any connected person, amounts to twenty per cent or more of the voting rights or of total shareholder’s equity;
- (b) in the case of a licensee’s investment in an entity other than a company, the aggregate of the licensee’s ownership interests in the entity, however designated, whether held by the licensee solely or together with any connected person or any entity controlled by the licensee, which represents twenty per cent or more of all of the ownership interests into which the entity is divided;

“Tier 1 capital” means the aggregate of—

- (a) paid-up capital in the form of ordinary shares or stock;
- (b) qualifying paid-up capital in the form of non-redeemable, non-cumulative, preference shares;
- (c) qualifying paid-up share premium in respect of shares or stock under paragraphs (a) and (b);
- (d) capital raised by the licensee from an issue of its shares to a Government agency or company wholly owned by the Government in the circumstances specified in paragraph (2);
- (e) eligible reserves,

less the aggregate of—

- (f) any operating or other losses for the current year and any accumulated losses for previous years;
- (g) any net loss positions on revaluation reserves arising from fair value accounting for financial assets and liabilities; and

(h) any goodwill, start-up expenses and other intangible assets;

"Tier 2 capital" means the aggregate of—

- (a) qualifying, paid-up capital in the form of non-redeemable, cumulative preference shares;
- (b) qualifying paid-up capital in the form of term preference shares with an original term to maturity of five years or more, subject to regulation 3(2);
- (c) paid up share premium in respect of shares under paragraphs (a) and (b);
- (d) subordinated debt issued to a Government agency or company wholly owned by the Government in the circumstances specified in paragraph (2);
- (e) general provisions for loss up to a maximum of one and one quarter per cent of the licensee's risk-weighted assets.

(2) The circumstances referred to in sub-paragraph (d) of the definitions of "Tier 1 capital" and "Tier 2 capital" in paragraph (1) are that the subordinated debt or shares have been issued pursuant to an arrangement for the provision of financial assistance to the licensee for the purpose of its restructuring.

(3) References in these Regulations to funds managed by a licensee are references to monies received by the licensee from clients for investment with written instructions as to the manner of investment, whether on a discretionary or non-discretionary basis, and which funds are subject to the Standards of Best Practice issued by the Bank of Jamaica or regulations made under the Bank of Jamaica Act.

PART II.—*Capital Base Requirements*

3.—(1) A licensee's capital base shall be measured by reference to the aggregate of all of the licensee's Tier 1 and Tier 2 capital, less prescribed deductions.

(2) In the calculation of Tier 2 capital, the capital value of term preference shares with an original term to maturity of five years or more shall be determined in accordance with the provisions of Schedule 6.

(3) Where any new shares are issued by a licensee after the coming into force of these Regulations, the licensee shall notify the Supervisor in writing of such issue—

- (a) within 21 days of the date of the resolution authorizing the share issue, or within such other period as may be agreed by the Supervisor; and
- (b) setting out full details of the issue, including the terms and conditions thereof and the classes of shares to be affected thereby.

(4) The Supervisor, may, after review of all of the terms and conditions applicable to any particular capital component used by a licensee in its calculation of Tier 1 or Tier

2 capital, determine that, notwithstanding that component's appellation or description, the component shall be excluded from the computation of the licensee's capital base, or included in a different Tier and such determination shall be final and binding.

(5) Irrespective of the standard risk-weight applying to any category of assets, the Supervisor may determine that a higher or lower risk-weight should be assigned to a particular asset where justified by the risk profile of that asset.

4. Each licensee shall maintain a capital base comprising not less than fifty per cent Tier 1 capital or such other percentage as the Supervisor may prescribe by notice published in the *Gazette*.

PART III.—*Capital Adequacy Ratio Requirements*

5.—(1) Subject to paragraph (2), a licensee shall maintain on a daily basis, the ratio between its capital base (the numerator) and the aggregate of its on-balance sheet assets, off-balance sheet items, and balances related to funds managed by the licensee and foreign exchange risk exposure (the denominator) at no less than ten percent or such other percentage as the Supervisor may prescribe by notice published in the *Gazette*.

(2) The Supervisor may, by notice in writing to a licensee, direct the licensee to vary the ratio between the licensee's capital base and the denominator to a level which is more consistent with that licensee's risk profile.

6.—(1) Each licensee shall have in place adequate systems and procedures satisfactory to the Supervisor to compute the capital adequacy ratio.

(2) In determining the adequacy of the systems and procedures, the Supervisor shall have regard to international standards of best practice, the risk profile of the licensee's areas of operations and the resources of the licensee.

7.—(1) Each licensee shall provide the Supervisor with computations of its capital adequacy ratio in the format prescribed by the Supervisor.

(2) The licensee shall calculate its capital adequacy ratio—

(a) with regard to its on-balance sheet assets, in accordance with the provisions of Schedule 1;

(b) with regard to off-balance sheet assets and funds managed by the licensee in accordance with the provisions of Schedule 2.

(3) Subject to regulation 3 (5), the respective standard risk-weights to be applied to a licensee's on-balance sheet assets shall be those specified in Schedule 3.

(4) The credit conversion factors to be applied to a licensee's off-balance sheet assets shall be those specified in Schedule 4.

(5) In making the calculations specified in this regulation and regulation 5, each licensee shall calculate, in accordance with the provisions of Schedule 5, the foreign exchange risk exposure attaching to all on and off-balance sheet assets denominated in foreign currency.

(6) Each licensee shall submit the calculations required under this Part in such form as the Supervisor may specify, as at the last day of each calendar month or such other date as the Supervisor may specify, provided that the calculations shall be submitted to the Supervisor within twelve working days thereafter.

PART IV.—*Primary Ratio Requirements*

8. A licensee shall maintain, on a daily basis, the ratio between its capital base and the total of its assets at no less than six percent or such other percentage as the Supervisor may specify by notice published in the *Gazette*.

PART V.—*Transitional, Repeal*

9. Each licensee shall meet the capital adequacy ratio prescribed by regulation 5 by the date of commencement of these Regulations.

10. A licensee which, at the date of the coming into effect of these Regulations, does not meet at least the capital adequacy ratio requirement shall, within one month of that date, provide a plan acceptable to the Supervisor for the timely achievement of the capital adequacy ratio:

Provided that the licensee shall achieve compliance in any event not later than six months after the coming into operation of these Regulations.

11. The Financial Institution (Capital Base) Regulations, 1997 are hereby repealed.

SCHEDULE 1

(Regulation 7(2))

*Capital Adequacy Ratio Calculations—On-Balance Sheet
Assets*

1. To derive the denominator of the capital adequacy ratio prescribed by regulation 5, the assets of a licensee (and credit equivalent amounts for off-balance sheet items and managed fund portfolios) shall be classified in one of four broad risk-weighting categories, namely, zero per cent (0%); twenty per cent (20%); fifty per cent (50%) and one hundred per cent (100%).

2. Classification shall be dependent on the Supervisors assessment of—

- (a) the nature of the counter-party; or
- (b) where applicable, the guarantor or the collateral.

3. Amounts classified in each category shall be multiplied by the applicable risk-weighting, with the resulting weighted values added together to arrive at total risk-weighted assets.

4. The amount of the licensee's assets deducted in computing its capital base (such as goodwill, investments in unconsolidated subsidiaries, or back-to-back securities) shall be risk-weighted at zero per cent (0%).

SCHEDULE 1, *contd.*

5. Asset balances subject to risk weighting must be reported net of specific provisions for loss.
6. Recognition of collateral in reducing the credit risk of claims shall be limited to cash or securities issued by the Government of Jamaica and other central governments, central banks and public sector entities of the G10 and CARICOM countries and specified multilateral development banks or lending agencies approved by the Supervisor. That portion of a claim that is covered by such approved collateral will be assigned the risk-weight given to the collateral (namely 0% to 20%).
7. Loans or other exposures unconditionally guaranteed by the Government of Jamaica and other central governments, central banks and public sector entities of the G-10 and CARICOM countries, by approved multilateral development banks or lending agencies and by banks or supervised deposit-taking institutions incorporated in the G-10 and CARICOM countries approved by the Supervisor, shall attract the weight assigned to a direct claim on the guarantor.

SCHEDULE 2

(Regulation 7(2))

*Capital Adequacy Ratio Calculation of Off-Balance
Sheet Assets*

1. With the exception of commitments which are unconditionally cancellable by the licensee, all off balance sheet items shall be assigned a 100% credit conversion factor to determine an on-balance sheet credit equivalent amount. The on-balance sheet equivalent amount is calculated by multiplying the respective off-balance sheet item by the relevant credit conversion factor.
2. The credit equivalent amount will then be treated as an on-balance sheet item and assigned a risk-weight appropriate to the counter-party or, if relevant, the weight assigned to the guarantor or the nature of the collateral.
3. At any time when funds are managed by the licensee, capital adequacy requirements shall apply to such funds, in recognition of the risks (reputational, contagion and others) which accrue to the licensee as a result of involvement in this area of business.
4. Where funds are managed by the licensee on a specifically non-discretionary basis, no capital adequacy requirements will apply.
5. Where funds are managed by the licensee on a discretionary basis, such portfolios shall be assigned a conversion factor of 25% to determine an on-balance sheet equivalent for the purposes of assigning risk-weights.
6. The on-balance sheet equivalents will then be assigned a risk-weight appropriate to the counter-party or the nature of the collateral as specified under Schedule 1.
7. These Regulations shall not be deemed to grant to a licensee any power or right regarding the management or investment of customers' funds which is

SCHEDULE 2, *contd.*

inconsistent with the provisions of any regulations under the Bank of Jamaica Act or Standards of Best Practices issued by the Bank of Jamaica on the investment of customer's funds.

SCHEDULE 3

(Regulation 7(3))

On Balance Sheet Assets—Risk-Weight Categories

1. 0% Risk-Weight

- (a) cash (denominated in domestic and foreign currency) on hand;
- (b) deposits with and other claims on the Bank of Jamaica, including cash reserves (domestic and foreign currency) and current account balances;
- (c) Government of Jamaica debt securities denominated in Jamaican currency;
- (d) loans granted to, or which are guaranteed by, the Government of Jamaica;
- (e) debt securities which are issued by statutory bodies or companies owned or controlled by the Government of Jamaica, or an agency of the Government of Jamaica, and are also guaranteed by the Government of Jamaica;
- (f) debt securities issued by governments and central banks of the United States of America, Canada or United Kingdom and other governments and central banks of the G-10 countries approved by the Supervisor from time to time, and denominated in the issuer's national currency and funded in that currency;
- (g) debt securities issued by public sector entities or agencies of the governments of the United States of America, Canada or the United Kingdom and other governments of G-10 and CARICOM countries as approved by the Supervisor from time to time, that carry the full guarantee of the respective governments;
- (h) debt securities issued by CARICOM country governments and central banks as approved by the Supervisor from time to time and denominated in the issuer's national currency;
- (i) claims fully secured by cash or Government of Jamaica securities.

2. 20% Risk-Weight

- (a) claims on banks, licensees and other licensed deposit taking institutions specified under the Bank of Jamaica Act. Such claims (other than capital instruments) shall include deposits/ loans, cheques' and other items in transit, and loans guaranteed by such banks and licensees or other licensed deposit-taking institutions;

SCHEDULE 3, *contd.*

- (b) claims (other than capital instruments) with residual maturity of less than twelve months on deposit-taking financial institutions incorporated in and supervised by the appropriate banking supervisory or monetary authority of the United States, Canada, United Kingdom or CARICOM country, as approved by the Supervisor from time to time;
 - (c) claims (other than capital instruments) with residual maturity of less than twelve months on banks and deposit taking financial institutions incorporated in and supervised by the appropriate banking supervisory or monetary authority of any other country as approved by the Supervisor from time to time;
 - (d) Government of Jamaica debt securities denominated in foreign currency;
 - (e) debt securities issued by—
 - (i) governments and central bank of CARICOM countries;
 - (ii) governments and central banks of the United States of America, Canada or the United Kingdom; and
 - (iii) other governments and central banks of the G-10 countries, approved by the Supervisor from time to time and denominated in a currency other than the issuer's national currency;
 - (f) debt securities denominated in foreign currency which are issued by statutory bodies or companies owned or controlled by the Government of Jamaica or an agency of the Government and are also guaranteed by the Government;
 - (g) claims on, including claims guaranteed or collateralized by securities issued by, other governments, central banks and multilateral development banks or lending agencies as approved by the Supervisor from time to time;
 - (h) debt securities issued by public sector entities or agencies of the Governments of the United States of America, Canada or the United Kingdom and other governments of the G-10 and CARICOM countries as approved by the Supervisor from time to time, that are not guaranteed by their respective governments.
3. 50% Risk-Weight
- First legal mortgages to owner-occupiers fully secured on their residences (except for those where the arrears on the mortgage exceed three (3) months, in which case, the mortgage is assigned a 100% risk-weight).
4. 100% Risk-Weight
- (a) other claims, loans and mortgages not otherwise classified in this Schedule;

SCHEDULE 3, *contd.*

- (b) holding of ordinary and preference shares;
- (c) other securities not otherwise classified in this Schedule;
- (d) fixed assets, including land, buildings and equipment net of depreciation, used or held, or both by the licensee in the conduct of its business;
- (e) all other assets.

SCHEDULE 4

(Regulation 7(4))

*Credit Conversion Factors for Off-Balance
Sheet Assets*

100% Conversion Factor

- (a) Guarantees given on behalf of customers to stand behind the financial obligations of the customer and to satisfy those obligations should the customer fail to do so.
- (b) Standby letters of credit or other equivalent irrevocable obligations serving as financial guarantees, such as letters of credit supporting the issue of commercial paper.
- (c) Participations in bankers' acceptances and participations in financial letters of credit. Participations constitute guarantees by the participating bank or licensee such that if there is a default by the underlying obligor, they will indemnify the selling entity for the full principal and interest attributable to them.
- (d) Securities lending transactions where the lending entity is liable to its customer for any failure to recover the securities lent.
- (e) Contractual obligations to purchase assets, including financing facilities with certain draw-down.
- (f) Transaction related contingencies (such as bid bonds, performance bonds, warranties, and standby letters of credit related to a particular transaction).
- (g) Commitments including underwriting commitments and commercial credit lines.
- (h) Note Issuance/Revolving Underwriting Facilities whereby a borrower may issue short-term notes, typically three to six months in maturity, up to a prescribed limit over an extended period of time, commonly by means of repeated offerings to a tender panel. If at any time the notes are not sold by the tender at an acceptable price, an underwriter (or group of underwriters) undertakes to buy them at a prescribed price.

SCHEDULE 4, *contd.*

- (i) Trade related contingencies (e.g. short-term, self-liquidating trade related items, such as commercial and documentary letters of credit issued by the licensee that are, or are to be, collateralized by the underlying shipment).
- (j) All other commitments other than those to which a 0% conversion factor has been designated under these Regulations.

0% Conversion Factor

Commitments that are unconditionally cancellable by the licensee at any time without prior notice.

SCHEDULE 5

(Regulation 7(5))

Foreign Exchange Risk

1. Two processes are needed to calculate the capital requirement for foreign exchange risk as follows—

- (a) firstly the measurement of the licensee's exposure or its net open position in a single currency; and
- (b) secondly, the measurement of the risks inherent in the licensee's mix of long and short positions in different currencies.

2. The licensee's exposure in a single currency or its net open position in a single currency shall be the aggregate of—

- (a) the net spot position (namely all asset items less all liability items, including accrued interest, denominated in the currency in question);
- (b) the net forward position (namely all amounts to be received less all amounts to be paid under forward foreign exchange transactions);
- (c) guarantees (and similar transactions) that are certain to be called and are likely to be irrecoverable;
- (d) any other item representing a profit or loss (such as accrued interest or expense) in foreign currencies.

3. To measure the exposure in the mix of long and short positions, the nominal amount (or net present value) of the net position in each foreign currency is converted at spot rates into Jamaican dollars. The overall net open position is measured by aggregating separately the individual net short positions and the individual net long positions. The greater of the two sums represents the overall foreign exchange risk position which is to be included in the denominator of the capital adequacy ratio.

SCHEDULE 6 .

(Regulation 3(2))

Tier 2 capital calculations—determination of capital value of term preference shares with an original term to maturity of five years or more

<i>Remaining term to maturity</i>	<i>% of value for inclusion in Tier 2 capital</i>
5 years or more	100%
4 years or more and less than 5 years	80%
3 years or more and less than 4 years	60%
2 years or more and less than 3 years	40%
1 year or more and less than 2 years	20%
Less than 1 year	0%

Dated this 8th day of March, 2004.

OMAR DAVIES,
Minister of Finance and Planning.