St. Vincent and the Grenadines

International Financial Services Authority

Statement of Guidance

Capital Adequacy

1. Statement of Objectives

To provide guidance to international banks on their obligations set out in Section 10(1) (c) of the International Banks Act.

1.2**. Importance of capital**

Capital adequacy is a key element of bank safety and soundness and ensuring confidence in the financial system. Due to its importance, capital adequacy is of interest to supervisors of financial institutions around the world. The importance of safety and soundness considerations must be factored in when deciding on the optimal level of capital by the shareholders, directors and management of the bank.

The 1988 Basel Accord explicitly considered credit risk and it required international banks to hold ***minimum total capital equal to eight percent (8%)*** of risk-adjusted assets. Therefore the greater the amount of loans and investments and hence credit risk in a bank's assets base, the more capital it is required to maintain. The Authority has adopted this 8% ratio or its reciprocal 12 times assets to capital as the maximum requirement of the amount of capital appropriate for an international bank. This guideline sets out the minimum capital adequacy standards and requirements for an international bank.

The purpose of this guideline is to:

i) Ensure that financial institutions have an adequate cushion of capital to absorb unexpected losses;
ii) Protect the interests of depositors, creditors and the interest of the public in general;
iii) Ensure that financial institutions maintain capital at internationally recognized standards;
iv) Promote self-discipline in the management of financial institutions; and
v) Promote public confidence in financial institutions and the financial system as a whole.

1.3 Initial Capital and Statutory Deposit

In order to obtain an international bank licence, a person shall provide evidence of the minimum initial capital requirement as required for a Class "A" Licence under Section 10 (1) of the International Banks Act (Act) and the statutory deposit as set out in Section10 (1)(b). The initial capital requirements for a Class "B" Licence are set out in Section 10 (2)(a) and Section 10 (2)(b) of the Act.

Such evidence should comprise a certified bank statement and an opening balance sheet certified by an approved auditor to the effect that the initial capital has been duly funded and meets the statutory requirement.

The statutory deposit should satisfy the following conditions:

i) Must be in the form of cash or other liquid form acceptable to the Authority and must be held in an approved commercial bank in St Vincent and the Grenadines.
ii) Must be derived from the shareholders' own funds.
iii) Must be in compliance with anti-money laundering laws and regulations.

1.4 Requirements for maintaining adequate capital

Every licensed financial institution shall maintain adequate capital in accordance with the following:

i) The provisions of Section 10 (Initial Capital) of the International Banks Act.
ii) The capital ratios as provided for under these Guidelines.

1.5 Total Regulatory Capital

"Total Regulatory Capital" means capital, which is approved for regulatory purposes. It comprises of ***Tier I Capital (Core Capital)*** and ***Tier II Capital (supplemental capital).***

1.6 Tier I or Core Capital means the aggregate of; -

i) Paid up ordinary share capital;
ii) Paid up ordinary share capital surplus
iii) Paid up perpetual non-cumulative preference shares;
iv) Paid up perpetual non-cumulative preference share surplus;
v) Statutory reserves; the amount set aside from the institution's annual profit;
vi) Capital reserves excluding asset revaluations;
vii) General reserves excluding reserve losses on assets;
viii) Retained Earnings as per the audited statements.

Less:

Current Year Losses;

i) Any net loss positions on revaluation reserves arising from fair value accounting for financial assets and liabilities;
ii) Bonus shares from capitalization of unrealised asset revaluation reserves;
iii) Goodwill, capitalized start-up expenses and other intangible assets.

Tier II or supplemental capital includes other types of reserves such as:

i) Fixed asset revaluation reserves (limited to 20 % of Tier I capital);
ii) General provisions and reserves for losses on asset (limited to 1.25% of total assets); specific reserves for loan losses are not eligible for inclusion in capital.
iii) Paid-up perpetual cumulative preference shares;
iv) Paid-up perpetual cumulative preference share surplus;
v) Bonus shares issued from capitalization of unrealized asset revaluation reserves;
vi) Unaudited undivided profits;
vii) Asset revaluation reserve
viii) Mandatory convertible debt instruments; that is all instruments which must be converted to shares as per the terms and conditions stipulated in the original document
ix) Subordinated term debt and limited life preference shares (limited to 50% of Tier I capital).
x) Other hybrid capital instruments with combined characteristics of equity and debt.

The following item must be deducted from the combined ***Tier I and Tier II Capital*** before arriving at **Total Regulatory Capital:**

i) Investments in financial subsidiaries not consolidated in the group.
ii) Each financial institution shall maintain a capital base comprising not ***less than 50 % Tier I capital***

1.7 Maximum capital adequacy ratio

Further to Section 10(c) of the International Banks Act, every international bank shall maintain a maximum leverage ratio of 12 times (assets including off-balance sheet items—the numerator divided by regulatory capital—the denominator).

Where one or more of the following conditions exists, the Authority may require a licensed financial institution to reduce the leverage ratio:

i) The ratio of unsatisfactory assets to Tier I capital is greater than 25%;
ii) Aggregate investments in equities exceed 5 % of total assets;
iii) Fixed assets exceed 25% of total capital;
iv) Risk management processes to identify, measure, monitor and control material risks are deemed unsatisfactory by the Authority and/or the external auditor and there is potential for unexpected losses to be incurred.

1.8. Compliance with the legislation and this guideline

i) Each financial institution shall have in place adequate systems and procedures satisfactory to the Authority to compute the capital adequacy ratio.
ii) The institution shall calculate its capital adequacy ratio –

With regard to its on-balance sheet assets, in accordance with Schedule II (a) Worksheet I of the Guidelines Instructions:

i) With regard to its off-balance sheet assets, in accordance with Schedule II (a) Worksheet II of the Guidelines Instructions;
ii) With regard to its capital computation, in accordance with Schedule II (b) Worksheet III of the Guidelines Instructions;

1.9 Financial institutions whose capital adequacy ratio falls below the minimum required amount shall employ one or a combination of the following strategies in order to achieve compliance:

Reduce the risk profile of its balance sheet by reducing its assets including off-balance sheet items;

i) Increase its total regulatory capital, by way of capital injection that must come from shareholders funds and adhere to AML guidelines.
ii) The capital position must be fully reconstituted within the time period specified by the Authority. Failure to reconstitute capital within the specified time period may cause the Authority to apply additional sanctions.

1.10 Sanctions and for non-compliance

Remedial Measures

i) When the Authority determines that a financial institution does not meet the capital adequacy requirement of these Guidelines and thus has a capital deficiency, it may take certain actions as specified under Section 20 of the International Banks Act.

ii) When the Authority determines that a bank’s capital deficiency is severe enough to have resulted in impaired capital and such capital impairment is judged to be detrimental to the interests of depositors, it may recommend to the Minister that the licence be revoked under Section 21 subsection (2) (a) of the International Banks Act.

Additional remedial measures

In addition to the remedial measures available as specified above, the Authority may, in accordance with provisions under section 20 (d) of the International Banks Act, issue any or all of the following directions to a bank encountering a capital deficiency:

i) Suspension of the establishment of new branches and/or expansion into new banking or financial activities;
ii) Prohibition from declaring and/or paying dividends;
iii) Suspension of the acceptance of new deposits;
iv) Suspension of acquisition of fixed assets;
v) Suspension of lending operations;

vi) Suspension of new investments.