

# **BANKING (CAPITAL) REGULATIONS 2003**

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## BANKING (CAPITAL) REGULATIONS 2003

*(Legal Notice of 2003)*

**MADE** by the Governor under sections 8A(1), 8B, 8C, 8D, 8E and 8F of the Banking Ordinance.

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| Citation and commencement  | <b>1.</b> These Regulations may be cited as the Banking (Capital) Regulations 2003.  |
| Interpretation             | <b>2.</b> In these Regulations references to numbered sections are to sections as so numbered in the Banking Ordinance.  |
| Paid up share capital      | <b>3.</b> The amount of paid up share capital to be retained under section 8A(1) shall be three million United States dollars.   |
| Amount of guarantee        | <b>4.</b> The amount of the guarantee under section 8B shall be three million United States dollars.   |
| Amount of assigned capital | <b>5.</b> The amount of assigned capital under section 8C shall be three million United States dollars.  |
| Capital adequacy ratio     | <b>6.</b> The amount prescribed under section 8D(1) shall be eight per cent.   |
| Risk weighting of assets   | <b>7.</b> A licensed financial institution's assets listed in column (1) of the table below shall be weighted for risk by deducting from their value the percentage of that value listed opposite and in relation to the assets in column (2) for the purposes of the definition of risk weighted assets in section 2 and of section 8D(1) and of regulation 10(c)(iii) of these regulations - |

	(1)	(2)
	(On –Balance Sheet Assets)	(Risk Weights)
1. Local and foreign currency.		0%
2. (a) Treasury bills and other securities issued or guaranteed by the Government.		
(b) Claims on statutory boards, other public sector entities and countries outside the Islands and approved by the licensing committee and loans to entities guaranteed by the Government.		10%
(c) Claims fully secured by cash on deposits at the institution which reports to the Financial Services Commission under the Banking Ordinance or Government securities and guarantees.		

3. (a) Claims on financial institutions licensed by the Financial Services Commission and financial institutions in countries outside the Islands and approved by the licensing committee and loans guaranteed by institutions.	20%
(b) Claims on multilateral developments and claims related to multilateral developments and guaranteed or collateralised by securities issued by banks approved by the licensing committee.	
(c) Bankers' acceptances held as part of a licensed institution's portfolio.	
(d) Cash items in the process of collection.	
4. Loans fully secured by mortgages on residential properties whether these properties are occupied by their owners or rented.	50%
5. (a) Claims on the private sector.	
(b) Loans and advances other than those in paragraph 4.	
(c) Premises, plant and equipment and other fixed assets.	100%
(d) Real estate and equity investments.	
(e) Capital instruments issued by financial institutions outside the Islands and approved by the licensing committee, unless deducted from capital under section 8D(3).	
(f) Assets other than those listed in paragraphs 1 to 5(e).	

8. The off- balance sheet exposure of a licensed financial institution shall be weighted for risk for the purposes of the definition of risk weighted assets, by the nominal principal amounts of a licensed financial institution's off-balance sheet engagements or activities listed in column (1) of the table below –

Risk weighting of off-balance sheet exposure

- (a) being multiplied by the credit conversion factor listed opposite and in relation to them in column (2); and

(b) the resulting amount being weighted for risk according to the nature of the counterparty under regulation 10:

(1) (Off- Balance Sheet Items)	(2) (Credit Conversion Factor)
1. (a) Instruments which are substitutes for loans and advances including general guarantees of indebtedness, standby letters of credit other than those mentioned in paragraphs 2 and 4 and bank acceptance guarantees.	100%
(b) Sales and purchase agreements with recourse where the credit risk remains with the licensed financial institution.	
(c) Forward assets purchases, forward deposits and partly-paid shares and securities representing commitments with certain draw-down.	
2. (a) Certain transaction-related contingent items including performance bonds, warranties and standby letters of credit related to particular transactions.	50%
(b) Note issuance facilities and revolving underwriting facilities.	50%
(c) Other commitments including formal standby facilities and credit lines, with an original maturity of over one year.	
3. Short-term self liquidating trade related contingencies including documentary credits collateralised by the underlying shipments.	20%
4. Commitments other than those listed in paragraphs 1 to 3 including formal standby facilities and credit lines -	0%
(a) with an original maturity of up to one year; or	

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(b) which can be unconditionally cancelled at any time.

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9. A licensed financial institution's capital and the amount of that capital for the purposes of subsection (2)(a) and subsection (3)(a) respectively of section 8D shall be -

Share capital and disclosed reserves

- (a) its shares at their nominal paid up value where fully paid up;
- (b) the amount received in excess of the nominal value;
- (c) where shares are partly paid up, the amount paid;
- (d) perpetual non-cumulative preference shares where issued and fully paid up;
- (e) perpetual non-cumulative preference shares convertible into ordinary shares including those redeemable at the option of the issuer with the Superintendent of Banking's consent, where the shares have been issued and fully paid up;
- (f) disclosed reserves under the Banking Ordinance;
- (g) disclosed reserves including –
  - (i) the undistributed balances on the profit and loss account attributable to previous years;
  - (ii) reserves created or increased by appropriations of retained earnings or other surplus e.g. share premiums, retained profits, general reserves and legal reserves;
  - (iii) general funds (such as a fund for general banking risks in certain EC countries) of the same quality that meet the following criteria –
    - (A) allocations to the funds must be made out of post-tax retained earning or out of pre-tax earnings adjusted for all potential tax liabilities;
    - (B) the funds and movements into or out of them must be disclosed separately in the bank's published accounts;
    - (C) the funds must be available to a bank to meet losses for unrestricted and immediate use as soon as they occur;
    - (D) losses cannot be charged directly to the funds but must be taken through the profit and loss account; and
    - (E) in the case of consolidated accounts, minority interest in the equity of the subsidiaries which are less than wholly owned.

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Undisclosed reserves and their amounts

**10.** A licensed financial institution's reserves other than its disclosed reserves and the disclosed reserves' amounts for the purposes of subsection (2)(b) and subsection (3)(b) respectively of section 8D shall be -

- (a) undisclosed reserves which have been created out of the institution's profit and loss account and which are accepted by the Superintendent;
- (b) reserves created by revaluation of assets subject to-
  - (i) the assets being considered by the Superintendent to be prudently valued, reflecting the possibility of price fluctuations and forced sale; and
  - (ii) in the case of revaluation of long term holdings of equity, a discount of fifty five per cent of the difference between their historic cost book value and their market value, being made;
- (c) general provisions or general loan-loss reserves which -
  - (i) are created against the possibility of losses not yet identified;
  - (ii) do not reflect a known deterioration in the valuation of identified assets; and
  - (iii) do not exceed one and a quarter per cent of the risk weighted assets;
- (d) instruments which combine characteristics of equity and debt, known as "hybrid debt capital instruments" and which meet the following requirements -
  - (i) they are unsecured, subordinated and fully paid-up;
  - (ii) they are not redeemable at the initiative of the holder or without the prior consent of the Superintendent;
  - (iii) they are available to participate in losses without the licensed financial institution being obliged to cease trading; and
  - (iv) they allow service obligations to be deferred where the profitability of the licensed financial institution would not support payment; and
- (e) other subordinated term debt including -
  - (i) conventional unsecured subordinated debt capital instruments with a minimum original fixed term to maturity of over five years; and
  - (ii) limited life redeemable preference shares, after amortisation and not exceeding 50% of the capital calculated under section 8D(3)(a).



## EXPLANTORY NOTE

*(This note is not part of the Regulations)*

The Banking (Capital) Regulations 2003 seek to make provisions in respect of capital amounts for the purposes of section 8A to 8F of the Banking Ordinance.

**Regulation 3** seeks to provide that the amount of paid up share capital which must be retained under section 8A(1) is three million dollars.

**Regulation 4** seeks to provide that the amount of guarantee which must be maintained under section 8B is three million dollars.

**Regulation 5** seeks to provide that the amount of assigned capital which must be maintained under section 8C is three million dollars.

Section 8D(1) provides that a licensed financial institution must maintain a capital adequately ratio of such amounts as may be prescribed plus three per cent. **Regulation 6** seeks to prescribe that amount as eight per cent, which is the minimum figure recommended by the International Convergence of Capital Measurement and Capital Standards of 1998. Therefore the capital adequacy ratio at present is eleven per cent.

**Regulation 7** sets out the risk weighting assets for the purpose of calculating the capital adequacy ratio under section 8D(1) of the Banking Ordinance and regulation 10(c)(iii). The Basle Committee considers that a weighted risk ratio in which capital is related to different categories of assets or off-balance-sheet exposure, weighted according to broad categories of relative riskiness, is the preferred method for assessing the capital adequacy of banks.

**Regulation 8** seeks to provide the framework for calculating the risk weighting of off-balance-sheet exposures by applying the credit conversion factor to the different types of off-balance-sheet instrument or transaction. With the exception of foreign exchange and interest rate-related contingencies, the credit factors are set out in the table in the regulation. They are derived from the estimated size and likely occurrence of the credit exposure, as well as the relative degree of credit risk as identified in the Basle Committee's paper "The management of banks' off-balance-sheet exposure: a supervisory perspective" of 1986.

The credit conversions factors would be multiplied by the weights applicable to the category of the counterparty for an on-balance-sheet transaction under regulation 7.

Section 8D(2)(a) and (3)(a) states that regulations will prescribe what is meant by capital and the amount of that capital. Paragraphs (a) to (e) of **regulation 9** seek to provide the share content of capital. The emphasis is on the actual amount of cash received. Paragraphs (f) and (g) of the regulation seek to prescribe the disclosed reserves which include the undistributed balance on the profit and loss account attributable to previous

years, reserves created or increased by appropriations of retained earnings or other surplus e.g. share premium, retained profits, general reserves and legal reserves ect.

Section 8D(2)(b) and 3(b)(i) states that regulations will prescribe what the undisclosed reserves will consist of and their amounts.

**Regulation 10** seeks to set out the details and the amount.

**Regulation 11** seeks to provide that the ratio of guaranteed risk weighed assets which must be maintained under section 8E is 11%.

**Regulation 12** seeks to provide that the ratio of assigned capital risk weight asset which must be maintained under section 8F is 11%.

**Regulation 13** seeks to provide the conditions under which a licensed financial institution can grant financial concession to related persons.

**Regulation 14** seeks to provide the conditions under which a licensed financial institution can grant financial concession to a connected counterparty.