

FINANCIAL SUPERVISORY COMMISSION



Government of the Cook Islands

PRUDENTIAL STATEMENT

No. 02-2004

MINIMUM ELIGIBLE CAPITAL REQUIREMENT

1. Preamble

This Prudential Statement is issued by the Board of the Financial Supervisory Commission pursuant to Sections 24 and 25 of Banking Act 2003 on maintenance, computation and form of minimum capital. This Prudential Statement is applicable to all domestic and international bank licensees. Foreign licensees are not subject to this Prudential Statement; they are subject to the capital adequacy standards of their home country supervisor.

This Prudential Statement is intended to assure that each bank maintains a level of capital which (i) is adequate to protect its depositors and creditors, (ii) is commensurate with the risk activities and profile of the bank, and (iii) promotes public confidence as well as a good reputation in the international community for the Cook Islands. The Prudential Statement also provides for the submission of periodic reports by banks to monitor compliance with the minimum capital requirements, the persons responsible for ensuring the accuracy and timely submission of required reports, and the confidentiality of information submitted to the Financial Supervisory Commission.

The board of directors of each bank is responsible for ensuring compliance with the requirements of this Prudential Statement and for maintaining at all times an adequate level of capital. The capital requirements provided in this Prudential Statement are the minimum acceptable levels for banks considered fundamentally sound, well managed and which have no material financial or operational weaknesses. A bank with financial and operational weaknesses will be required, after due consultation with its management, to comply with additional requirements as may be prescribed by the Financial Supervisory Commission.

2. Definitions

As used in this Prudential Statement the following terms, unless otherwise clearly indicated by the context, have the meanings specified below:

“Capital impairments” means, in respect of the total capital and reserves of a bank:

- (1) the value of assets pledged to secure liabilities such that the pledged assets are not available for purposes of freely meeting liabilities and absorbing losses of the bank;
- (2) the book value of shares or other capital instruments held by a bank in another bank;
- (3) investments in non-consolidated subsidiaries of the bank.

“Cash deposit” means credit balances on accounts in the books of the bank over which the depositor has given the bank a formal written letter of cession as security or collateral for a loan or advance by the bank and which the bank at its discretion has transferred the amount of the cash deposit from the depositor’s account(s) to a specific or general cash collateral/security account(s).

“Subordinated term debt” means conventional unsecured subordinated debt capital instruments which have been approved by the Financial Supervisory Commission prior to issuance by a bank. With the prior written approval of the Financial Supervisory Commission subordinated term debt instruments, which by their terms meet all of the following requirements, qualify for inclusion as a Tier-2 capital component:

- (1) it must have an original term to maturity of over seven (7) years;
- (2) it must clearly state that the subordinated term debt is not a deposit of the bank and are not secured or collateralized by any asset of the bank;
- (3) it must clearly state that repayment is subordinated to the claims of depositors and other creditors of the bank.
- (4) it must be ineligible as security for a loan by the issuing bank;
- (5) it must provide that no repayment prior to maturity (other than regularly scheduled repayments stated in the subordinated term debt agreement) either pursuant to an acceleration in the event of default or otherwise may be made without the prior written approval of the Financial Supervisory Commission.
- (6) it must provide that once any scheduled repayments of principal begins, all payments shall be made at least annually and the amount of principal repaid each year shall be no less than in the prior year.

“Tier-1 capital” means capital representing a permanent commitment of funds by the shareholders of the bank which (i) is freely available to absorb losses, (ii) does not impose any unavoidable charge on the earnings of the bank, (iii) ranks below the claims of depositors and other creditors in the event of the liquidation or closure of the bank. Tier-1 capital consists of:

- (1) issued and fully paid shares;
- (2) paid-in premium or surplus;
- (3) retained earnings (losses) (prior years); and

- (4) income (loss) year-to-date;
- (5) LESS goodwill and other intangible assets.

“Tier-2 capital” means capital other than Tier-1 that imparts strength to a bank, and includes such of the following elements as may be available to the bank:

- (1) the full extent of fixed asset revaluation reserves arising from the restatement of a bank’s premises where they are carried through to the balance sheet, provided the assets are revalued at least once every three (3) years by an independent qualified appraiser in a written appraisal report acceptable to the Financial Supervisory Commission.
- (2) revaluation reserves arising from the holding of equity securities at historical cost and not at market value, discounted fifty-five percent (55%) to reflect the potential volatility of this form of unrealized capital and the notional tax charge on it;
- (3) provisions for bad loans, limited to a maximum of one and one-quarter percent (1.25%) of risk-weighted assets;
- (4) the full extent of any subordinated term debt provided:
 - i. during the last five (5) years to maturity a cumulative discount (amortization) factor of twenty percent (20%) will be applied to reflect the diminishing value of these instruments as a continuing source of strength; and
 - ii. the total amount of subordinated term debt shall be limited to a maximum of fifty percent (50%) of Tier-1 capital;
- (5) hybrid (debt/equity) capital instruments as may be approved by the Financial Supervisory Commission such as cumulative preference shares which are unsecured and fully paid up in cash and available to meet losses;

Provided, the total of Tier-2 capital shall be limited to one hundred percent (100%) of Tier-1 capital.

“Total capital and reserves” means the net total of Tier-1 and Tier-2 capital after deducting any capital impairments. This amount shall be considered as Eligible Capital for purposes Sections 36, 37 and 39 of Banking Act 2003 pertaining to restrictions on advances and shareholdings in other companies. Any other reference to the term Eligible Capital in the Banking Act 2003, or other issuances by the Financial Supervisory Commission shall also mean “Total capital and reserves” as determined under this Prudential Statement.

3. Minimum Capital Ratio Requirements

Effective 1 March 2004, the following minimum capital ratios shall be applicable at any one time to all licences under the Banking Act 2003 on both a consolidated group and stand-alone basis, provided the Financial Supervisory Commission may require a bank to maintain higher minimum capital measures if it is pursuing or experiencing significant growth, has inadequate risk management systems, an inordinate level of risk, or less than satisfactory asset quality, management, earnings or liquidity:

- (1) a ratio of Tier-1 capital to total risk weighted assets of at least five percent (5%)

- (2) a ratio of total capital and reserves to total risk weighted assets of at least ten percent (10%).

4. Effectivity

Any bank which fails to comply with the minimum capital ratio requirements of this Prudential Statement shall submit to the Financial Supervisory Commission a detailed plan, acceptable to the Financial Supervisory Commission, describing the means and timetable by which the bank will achieve and thereafter comply with the required minimum capital ratios. Such plan must be submitted within sixty (60) days from the effective date of this Prudential Statement

If the eligible capital of a licensee is reduced below the minimum capital requirement, the licensee must within seven (7) days after becoming aware of the reduction advise the Financial Supervisory Commission in writing of the reduction, a detailed plan, acceptable to the Financial Supervisory Commission.

5. Computation of Total Risk Weighted Assets

- (a) The focus of the risk weights assigned by the Financial Supervisory Commission is credit risk, that is, the risk of default by a counter-party and country transfer risk.
- (b) Total risk weighted assets is the total of:
 - (1) on-balance sheet assets as reported by a bank in the Quarterly Statement of Assets and Liabilities, as of the end of each calendar quarter, less intangible assets, multiplied by the appropriate risk weight set out in Schedule I attached; and
 - (2) the different types of off-balance instruments and transactions reported by a bank in the Quarterly Statement of Assets and Liabilities, Commitments and Contingencies, as of the end of each calendar quarter, are:
 - i. multiplied by the corresponding credit conversion factor contained in Schedule II of this Prudential Statement to bring it to an on-balance sheet credit equivalent;
 - ii. the credit equivalent is then multiplied by the corresponding risk weight for the counter-party to the instrument or transaction contained in Schedule I.

6. Reporting Requirements

- (a) Every bank shall submit to the Financial Supervisory Commission not later than the close of business on the twentieth (20th) day following the end of each calendar quarter (31 March, 30 June, 30 September, and 31 December) the attached report on Minimum Capital and Risk Weighted Assets to Financial Supervisory Commission in such form as may be prescribed from time to time by the Financial Supervisory Commission giving an analysis of the banks' capital, risk assets, and ratios of Tier 1 and Total Capital to risk-weighted assets. Provided, banks may submit computer-generated reports in a format identical to that of the format as may be required by the Financial Supervisory Commission, including all captions, line items, columns and other identifying numbers.

- (b) The Financial Supervisory Commission may from time to time request additional information for the purpose of enforcing the provisions of the Banking Act 2003 or this Prudential Statement. Provided, any such requests by the Financial Supervisory Commission must be made in writing to a bank. The bank shall be provided at least fifteen (15) days after the receipt of such written request to submit such information to the Financial Supervisory Commission.

7. Persons Responsible for Submission of Report

The accuracy and correctness of the information required to be submitted under this Prudential Statement shall be attested to by the chief executive officer of the bank, or such other person by whatever title with responsibility for the overall daily management of the affairs of the bank and the implementation of policies by the bank's board of directors, and the chief accountant of the bank, or such other person by whatever title with responsibility for maintaining the books, ledgers and accounts of the bank on a day-to-day basis.

8. Review and Approval by Board of Directors

Information required to be submitted by a bank pursuant to Paragraph 6 of this Prudential Statement shall be reviewed and approved by the reporting bank's board of directors at the next regularly scheduled meeting of the board following the submission of the report. The board of directors' review and approval of the report as required to be submitted under Paragraph 6 of this Prudential Statement shall be detailed in minutes of the appropriate board meeting.

9. Record Keeping Requirements

Each financial institution shall maintain adequate records in support of any information submitted in reports as required under Paragraph 6 of this Prudential Statement and it shall preserve every such record for a period of at least six (6) years.

10. Transition

Existing banks shall have until 30 June 2004 to bring itself into compliance with the requirements of this Prudential Statement. Existing banks, therefore, must rectify any deficiency in the minimum eligible capital requirement within the transition period unless otherwise approved by the Financial Supervisory Commission.

11. Enforcement and Corrective Measures

If a bank fails to comply with the requirements contained in this Financial Supervisory Commission in a flagrant manner which results, or threatens to result, in an unsafe or unsound condition, or submits statistical or other reports to the Financial Supervisory Commission which are materially inaccurate, the Financial Supervisory Commission may pursue any or all corrective actions as provided under pertinent sections of the Banking Act 2003 or as may be prescribed by subsequent regulations or issuances of the Financial Supervisory Commission. Directives or conditions that may also be imposed by the Financial

Supervisory Commission on the operation of the bank may include but need not be limited to:

- i. prohibition from engaging in new activities or from expanding existing activities;
- ii. suspension of lending, investment and credit extension activities;
- iii. prohibition from acquiring, through purchase or lease, additional fixed assets;
- iv. prohibition from accepting further deposits or other liabilities for borrowed money;
- v. prohibition from declaring or paying dividends or bonuses, salary incentives, severance packages, management fees or other discretionary compensation to directors, managers and officers.

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5 FEBRUARY 2004

SCHEDULE I

Risk Weight	On-Balance Sheet Asset Category
0%	(a) Cash (notes and coin) held in own vault (b) Claims ¹ on and loans guaranteed ² by the Government of the Cook Islands and OECD ³ central government and central banks (c) Claims secured by cash deposit
20%	(a) Claims on banks, excluding loans guaranteed by affiliated banks, incorporated in OECD countries and Cook Islands (b) Claims on banks, excluding loans guaranteed by affiliated banks, incorporated in countries outside the OECD and Cook Islands with a residual maturity of up to twelve (12) months (c) Cash items in process of collection
50%	(a) Loans secured by first lien on real estate that is occupied by the borrower solely for residential purposes or that is intended to be rented solely for residential purposes, which are repayable in monthly installments and where the monthly installments of such loans are not past due more than three (3) months
100%	(a) Claims on banks incorporated in countries outside the OECD and Cook Islands, with a residual maturity of more than twelve (12) months (b) Claims on the private sector (c) Claims on commercial companies owned by the public sector (d) Claims on central governments outside the OECD and Cook Islands (e) Capital instruments issued by other financial institutions (but excluding banks) (f) Fixed assets, office furniture and equipment (including premises) (g) All other assets (including other real estate as may be defined by the Financial Supervisory Commission)

¹Loans guaranteed or collateralized by securities issued by the Government of the Cook Islands will attract equivalent low weights on that part of the loan which is covered by the guarantee or the current market value of the security provided the security instrument is held by the bank in safekeeping.

²To qualify for risk weighting purposes, a guarantee must be affirmed in writing and be unconditional as to the payment of principal and interest.

³OECD comprise countries which are full members of the Organization for Economic Cooperation and Development or which have concluded special lending arrangements with the International Monetary Fund associated with the International Monetary Fund's General Arrangements to Borrower. These are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Saudi Arabia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States of America. Provided that the Financial Supervisory Commission may, by notice to the principal place of business of each bank amend the list from time to time.

SCHEDULE II

Credit Conversion Factor	Off-Balance Sheet Items
100%	Bills endorsed and rediscounted (including Bankers' Acceptances)
100% 50%	Indemnities and Guarantee (a) Lending related (including standby letters of credit serving as financial guarantees for loans) (b) Performance related (e.g. performance bonds, bid bonds, warranties, and standby letter of credit).
20%	Documentary credits fully collateralized by readily marketable ¹ commodities ²
50% 0%	Unutilized stand-by facilities, credit lines and commitments to make loans which: (a) cannot be unconditionally cancelled at any time by the issuing financial institution; (b) can be unconditionally cancelled at any time by the issuing financial institution.
50%	Underwriting exposures
0.5% 1.0% 1.0%	Interest Rate Contracts (Gross) (a) Over seven (7) days and less than one (1) year (b) One (1) year and less than two (2) years (c) For each additional year
2.0% 5.0% 3.0%	Exchange Rate Contracts (Gross) (a) Over seven (7) days and less than one (1) year (b) One (1) year and less than two (2) years (c) For each additional year
100%	All other commitments and contingent liabilities

¹ "readily marketable" means convertible to cash within four (4) business days at a fair market value determined by established international markets for which there are recognized daily price quotes.

² "commodities" means agricultural or mining commodities such as coffee, tea, sugar, mineral ores, etc. which are traded on established international markets.

FINANCIAL SUPERVISORY COMMISSION



Government of the Cook Islands

QUARTERLY REPORT OF CAPITAL AND RISK WEIGHTED ASSETS (FSCForm-BKC)

(Name of Reporting Bank)

As of:

(Date of Report)

CERTIFICATION OF ACCURACY

I/We, the undersigned officer(s), do hereby declare that this Quarterly Report of Capital and Risk Weighted Assets has been prepared in conformance with official instructions issued by the Financial Supervisory Commission and is true to the best of my/our knowledge and belief.

<i>Signature of Chief Executive Officer:</i>	Date Signed:
Print Name and Title of Person Signing Report:	Telephone Number:
<i>Signature of Chief Accountant:</i>	Date Signed:
Print Name and Title of Person Signing Report:	Telephone Number:

QUARTERLY REPORT OF CAPITAL AND RISK WEIGHTED ASSETS ¹

Name of Bank: _____

PART A: CALCULATION OF CAPITAL AND RESERVES

TIER-1 CAPITAL COMPUTATION:		
1. Issued and Fully Paid Common Stock		
2. Paid-in Premium		
3. Retained Earnings (Prior Years)		
4. Income (Loss) Year-to-date		
5. LESS: Goodwill and Other Intangible Assets		
6. Sub-total TIER-1 CAPITAL (Total Lines 1 through 4, Less Line 5)		
TIER-2 CAPITAL COMPUTATION:		
7. Provisions for Bad Loans		
8. Maximum Eligible Provisions for Bad Loans (Enter 1.25% of Line 24)		
9. Allowable Provisions for Bad Loans (Enter lesser of Line 7 or Line 8)		
10. Hybrid (debt/equity) Capital Instruments (Attach Complete Description):		
11. Subordinated Term Debt (Discounted 20% per year during last five years to maturity)		
12. Maximum Eligible Subordinated Term Debt (Enter 50% Line 6)		
13. Allowable Subordinated Term Debt (Enter lesser of Line 11 or Line 12)		
14. Revaluation Reserves (Attach Complete Description)		
15. Sub-total Tier-2 Capital (Add Lines 9, 10, 13, and 14)		
16. Maximum Eligible Tier-2 Capital (Enter amount from Line 6)		
17. Allowable Tier-2 Capital (Enter lesser of Line 15 or Line 16)		
18. LESS: Assets Lodged/Pledged to Secure Liabilities (Attach Complete Description)		
19. LESS: Investment in Capital of Other Financial Institutions (Attach Complete Description)		
20. LESS: Investment in Non-consolidated Subsidiaries (Attach Complete Description)		
21. TOTAL CAPITAL AND RESERVES (Add Lines 6 and 17, Less Lines 18, 19, 20)		

PART B: CALCULATION OF TOTAL RISK WEIGHTED ASSETS

22. Total On-Balance Sheet Risk-Weighted Assets (from Line 46)		
23. Total Off-Balance Sheet Risk-Weighted Items (from Line 54)		
24. Gross Risk-Weighted Assets (Add Lines 22 and 23)		
25. Less Ineligible Portion of Provisions for Bad Loans (enter excess of Line 7 over Line 8)		
26. TOTAL RISK-WEIGHTED ASSETS (Line 24 Less Line 25)		

¹ Form for Prudential Statement No.2, to be represented in thousands of dollars (indicating currency used) as of the last day of each calendar quarter.

PART C: CALCULATION OF CAPITAL RATIOS

(Report all ratios to two decimal points, e.g. 10.49%)

27. TIER-1 CAPITAL TO TOTAL RISK-WEIGHTED ASSETS (Line 6 divided by Line 26)	%
28. TOTAL CAPITAL AND RESERVES TO RISK-WEIGHTED ASSETS (Line 21 divided by Line 26)	%

PART D: COMPUTATION OF ON-BALANCE SHEET RISK-WEIGHTED ASSETS

	AMOUNT (A)	RISK WEIGHT (B)	TOTAL (A) X (B) = (C)
29. Cash (notes and coin) in own vault		0%	
30. Claims on and loans guaranteed by the Government of the Cook Islands and OECD central governments and central banks		0%	
31. Claims secured by cash deposit		0%	
32. Claims on banks, excluding loans guaranteed by affiliated banks, incorporated in OECD countries and Cook Islands		20%	
33. Claims on banks, excluding loans guaranteed by affiliated banks, incorporated in countries outside the OECD and Cook Islands with a residual maturity of up to twelve (12) months		20%	
34. Cash items in process of collection		20%	
35. Claims on banks incorporated in countries outside the OECD and Cook Islands, with a residual maturity of more than twelve (12) months		50%	
36. Claims on international banks and other banks in non OECD countries		100%	
37. Claims on the private sector		100%	
38. Claims on commercial companies owned by the public sector		100%	
39. Claims on central governments outside the OECD		100%	
40. Capital instruments issued by other financial institutions (excluding banks)		100%	
41. Fixed assets, office furniture and equipment (including premises)		100%	
42. Other real estate owned		100%	
43. All other assets		100%	
44. LESS: Provisions for Bad Loans			
45. Total On-Balance-Sheet Assets			
46. TOTAL ON-BALANCE SHEET RISK-WEIGHTED ASSETS			

PART E: COMPUTATION OF OFF-BALANCE SHEET RISK-WEIGHTED ITEMS

	NOTIONAL AMOUNT ¹ (A)	CREDIT CONVERSION (B)	CREDIT EQUIVALENT (A) X (B) = (C)	RISK-WEIGHT ¹ (D)	TOTAL (C) X (D) = (E)
47. Bills endorsed and rediscounted (including Bankers' Acceptances)		100%			
48. Indemnities and Guarantees: (a) Lending related (including stand-by letters of credit serving as financial guarantees for loans) with counter-parties (b) Performance related (e.g. performance bonds, bid bonds, warranties and stand-by letters of credit)		100% 50%			
49. Documentary credits fully collateralized by readily marketable commodities with counter-parties:		20%			
50. Unutilized stand-by facilities, credit lines and commitments to make loans (a) with an original maturity of twelve (12) months or more which cannot be unconditionally canceled at any time (b) with an original maturity of less than twelve (12) months or which are unconditionally cancelable at any time		50% 0%			
51. Underwriting exposures		50%			
52. All other commitments and contingent liabilities		100%			
53. Total Notional Amount (Must equal total of the amounts recorded for each off-balance sheet item as at reporting date.					
54. TOTAL OFF-BALANCE SHEET RISK-WEIGHTED ITEMS					

¹ Insert appropriate on-balance sheet risk weight based on the counter-party to the respective off-balance sheet item.