STANDARDS OF SOUND BUSINESS PRACTICES

CAPITAL MANAGEMENT

Bank of Jamaica
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CAPITAL MANAGEMENT

A. PURPOSE

This document sets out the minimum policies and procedures that each licensee needs to have in place and apply within its capital management programme, and the minimum criteria it should use to ensure that it has adequate capital and effective plans to prudently manage its capital requirements.

Capital is one of a number of factors considered when assessing the safety and soundness of each financial institution. An adequate capital base acts as a safety net for the variety of risks that an institution is exposed to in the conduct of its business. It is available as a cushion to absorb possible losses and provides a basis for confidence in the institution by depositors, creditors and others.

The regulation of capital is commonly viewed as the most important tool available to financial institution regulators. It is the measure by which an institution's solvency is assessed.

B. DEFINITION

Capital is the investment in, or contribution to, the business of an institution that ranks behind depositors and other creditors as to entitlement to repayment or return on investment.

Capital provides a stable resource to absorb any losses and thus provide a measure of protection to depositors and other creditors in the event of liquidation.

C. CAPITAL MANAGEMENT PROGRAMME

Managing capital is the ongoing process of determining and maintaining the quantity and quality of capital appropriate for an institution. Managing capital adequacy requires a clear understanding of an institution's capital requirements and capital position related thereto. Capital management is an important component in the safe and sound management and the strategic planning of all institutions.

The objective of capital management is to ensure that, on the one hand, capital is, and will continue to be, adequate to maintain confidence in the safety and stability of the institution and that, on the other hand, the return on capital is sufficient to satisfy the expectations of investors.

Although the particulars of capital adequacy and capital management will differ among institutions, a comprehensive capital management programme requires:

- establishing and implementing sound and prudent policies governing the quantity and quality of capital required to support the institution; and

- developing and implementing appropriate and effective procedures to monitor, on an ongoing basis, the institution's capital requirements and capital position to ensure that the institution meets its capital requirements and will continue to meet its future capital requirements.

Capital Management Policies

Each licensee need to develop and implement capital management policies that will ensure the quantity of its capital is adequate, at a minimum, to meet all applicable regulatory requirements.

For regulatory purpose, the Bank of Jamaica shall specify the components of capital to meet regulatory requirements. Usually, permanent capital components have all, or a combination of, three important properties: permanence; freedom from mandatory fixed charges against earning; and legal subordination to the rights of depositors and other creditors.

Capital Management Procedures

Each licensee needs to develop and implement appropriate and effective procedures to manage its capital position. Such capital management procedures need to include, at a minimum:

- ongoing monitoring procedures to ensure that the institution's capital position meets its minimum capital requirements; and

- a process of capital planning to ensure that the institution will continue to meet its future requirements.

When measuring capital adequacy it is not sufficient to consider only the current capital position. The conditions on which any such judgement is based will change over time.

Therefore, each licensee needs to have in place a capital planning process in order to be prepared for changing conditions.

At a minimum, each institution should develop, at least annually, a plan for maintaining adequate capital.
A capital plan needs to :

- see section for adjustments;
- identify the underlying assumptions supporting the projection;
- identify the quantity, quality and sources of additional capital required, if any;
- assess the availability of any external sources identified; and
- estimate the financial impact of raising additional capital.

Anticipating the need for additional capital enables the institution and its major shareholders to take timely advantage of opportunities in the marketplace to raise capital on more favourable terms or to make other appropriate arrangements.

Factors that may necessitate capital additions include: changes in regulatory requirements; growth in assets and liabilities (both on- and off-balance sheet) including acquisitions; changes in the institution's risk profile; operating or investment losses; and the institution's dividend payout policy.

D. ROLE OF BOARD OF DIRECTORS

The Board of Directors of each institution is ultimately responsible for ensuring that the quantity and quality of capital maintained by the institution is adequate, at a minimum, to meet all applicable regulatory capital requirements.

In discharging this responsibility, a Board of Directors usually charges management with developing capital management policies for the board's approval, and developing and implementing procedures to monitor the institution's capital requirements and position and plan for its future capital needs.

A Board of Directors needs to have a means of ensuring compliance with the capital management programme. A Board of Directors generally ensures compliance through periodic reporting by management. The reports must provide sufficient information to satisfy the Board of Directors that the institution is complying with its capital requirements.

At a minimum, a Board of Directors should:

- review and approve the institution's capital management policies based on recommendations by the institution's management;

- define the content and frequency of capital adequacy reports from management to ensure compliance with capital adequacy requirements;

- review the reports and recommendations with respect to capital of management and, if any, of regulators; and

- review periodically, but a least once a year, the institution's capital plan.

E. ROLE OF MANAGEMENT

The management of each institution is responsible for ensuring that the institution maintains adequate capital in accordance with the policies established by the Board of Directors. Although specific capital management responsibilities will vary from one institution to another, management at each institution is responsible for:

- developing and recommending capital management policies for approval by the institution's Board of Directors;

- implementing the capital management policies approved by the institution's Board of Directors;

- monitoring, on an on-going basis, the capital position of the institution to ensure that the institution meets its capital requirements;

- reporting comprehensively on the adequacy of capital as frequently as required by the Board of Directors, the regulatory authorities; and

- developing, at least annually, a capital plan for review by the Board of Directors.