REGISTRY OF CO-OPERATIVE SOCIETIES
Ministry of Culture, Community and Youth

RCS SF70.1.4

29 June 2016

WRITTEN DIRECTION TO CREDIT SOCIETIES
CO-OPERATIVE SOCIETIES ACT (CAP. 62)

CAPITAL ADEQUACY AND RESTRICTION ON DIVIDEND

1. This Written Direction is issued pursuant to section 93(2) of the Co-operative Societies Act (Cap. 62) (hereinafter referred to as “the Act”) and applies to all credit societies which receive deposits. This Written Direction takes effect from **1 July 2016**, and supersedes the Written Direction on Capital Adequacy and Restriction on Dividend issued on 21 April 2011 (reference: RCS SF70.1.4).

Definitions

2. In this Written Direction, unless the context otherwise requires —

“capital adequacy ratio” or “CAR”, in relation to a credit society, means the credit society’s institutional capital expressed as a percentage of its total assets, based on the most recent audited financial statements of the credit society, calculated as set out in paragraph 4;

“institutional capital”, in relation to a credit society, means the aggregate of the following:
(a) the credit society’s accumulated surplus/deficit or unappropriated surplus;
(b) the credit society’s general reserves or general funds (excluding reserves and funds established for specific purposes, such as, common good, scholarship, fair value or revaluation, loan default, or provisions for bad and doubtful loans);
(c) cash donations.

3. In this Written Direction, all expressions used shall, except where expressly defined in this Written Direction or where the context otherwise requires, have the same meanings as in the Act.

Capital Adequacy

4. Capital Adequacy Ratio or “CAR” is to be calculated as follows:

$$\text{CAR (\%)} = \frac{institutional\ capital}{total\ assets} \times 100$$

5. **From 30 June 2011 to 30 June 2020 (both dates inclusive)**, a credit society which receives deposits shall maintain, at all times, a CAR of **at least 8%**.

6. **From 1 July 2020**, a credit society which receives deposits shall maintain, at all times, a CAR of **at least 10%**.

7. A credit society shall notify the Registrar immediately if at any time, its management or audited accounts show that it is unable to meet the applicable CAR requirement.

Restriction on Dividend

8. A credit society with a CAR lower than the applicable CAR requirement as set out in paragraphs 5 and 6 as at the financial year end and which intends to distribute dividends from that year’s surplus shall seek the Registrar’s written approval for the proposed dividends.

Power to Vary the CAR Requirement and Restriction on Dividend

9. The Registrar may, if he considers it appropriate in the circumstances of a particular credit society or class of credit societies, vary the CAR requirement or restriction on dividend applicable to that credit society or class of credit societies.

Non-compliance

10. The Registrar may from time to time conduct or commission audits to ensure compliance with this Written Direction.

11. The Registrar may from time to time require a credit society or class of credit societies to submit returns on the CAR, and supporting documents where necessary or appropriate.

12. Under Section 100 of the Act, any failure to comply with this Written Direction amounts to an offence. The offence is punishable on conviction with a fine not exceeding $10,000 and, in the case of a continuing offence, with a further fine not exceeding $500 for every day or part thereof during which the offence continues after conviction.

Frequently Asked Questions (‘FAQs’)

Please note that the FAQs below are provided for the sole purpose of offering additional information regarding the Written Direction. It is not part of the Written Direction.

Q1. Why does a credit society need to maintain CAR?

The CAR requirement ensures that a credit society which receives deposits from its depositors has sufficient institutional capital at any given time to serve as a buffer to absorb unanticipated losses which may arise from its operations or investments.

A long lead time has been provided for the increase of the CAR requirement from 8% to 10% so that credit societies have sufficient time to build their institutional capital.

Q2. How can a credit society improve its CAR?

A credit society can seek to increase its institutional capital and/or manage its total assets base by considering the suggestions below:

a) To increase the institutional capital: The credit society can build up its accumulated surplus though improved profitability, for instance, by implementing measures to increase revenue or to cut costs. It can also build up the accumulated surplus by reducing or postponing declaration of dividends to members. The credit society may also receive cash donations which can be included in its institutional capital. The credit society should also be prudent in distributing its surplus to reserves and funds established for specific purposes.

b) To manage its total assets base: The credit society can place a cap on the amount of deposits per depositor, reduce its deposit rates or return deposits to depositors.

To facilitate the monitoring of the CAR, a credit society should compute the CAR based on the monthly or quarterly balance sheet statements, which should be reported to the Committee of Management in a timely manner.

Q3. If a credit society’s CAR is less than the applicable requirement, can it still distribute dividends from that year’s surplus?

The credit society should notify the Registrar once it is aware that it may not meet the applicable CAR requirement at the financial year end, and shall seek the Registrar’s written approval for the proposed dividends. This allows the Registrar to analyse the credit society’s situation and provide guidance on appropriate actions to improve the CAR.

The credit society should also make its own assessment on whether it is justifiable to distribute dividends if the CAR is significantly lower than the applicable CAR requirement. By appropriating funds for dividend payment, a credit society will have less funds for institutional capital and thus it will take longer for the credit society to meet the applicable CAR requirement.

In general, the Registrar is not likely to support a dividend rate of more than 1%. In assessing the application, the Registrar will consider, amongst others, the credit society's efforts in monitoring the CAR, improving its institutional capital and managing its total assets.

Q4. Before the Co-operative Societies Act was amended in 2008, co-operative societies were required to maintain a reserve fund and make contributions based on the prescribed percentage of the operating surplus. If it is important to build up the general reserve fund for CAR purpose, why was the mandatory contribution removed?

This was to give co-operative societies flexibility in deciding the amount of monies to contribute to their reserve funds.

All co-operative societies are strongly encouraged to maintain and make yearly contributions to their general reserves or general funds as this will help absorb unanticipated losses which may arise from their operations and investments.

Q5. Is the Registrar's approval required if a co-operative society wishes to transfer its Statutory Reserve Fund to an existing General Reserve Fund or reclassify their Statutory Reserve Fund as General Reserve Fund?

No, there is no need to seek the Registrar's approval for such matters.

Q6. Why are specific funds (for example common good fund) not counted as institutional capital?

Specific funds are funds established for specific purposes and needs. Thus, they should <u>not</u> be treated as a buffer to absorb unanticipated losses which may arise from operations or investments. Only funds that are not marked for any specific purposes (for example, general reserves or accumulated surplus) should be considered in computing the institutional capital, as recommended by the World Council of Credit Unions.

We note that there may be instances where a credit society no longer utilises certain specific funds. For such instances, the credit society may redistribute the funds to the general reserves or general funds, so as to improve its CAR.