



RESERVE BANK OF VANUATU

DOMESTIC BANK

Bank Supervision Policy Guideline 8

RESTRICTIONS ON EXPOSURES GREATER THAN 25 PER CENT OF CAPITAL

1. The aim of this Policy Guideline is to clarify aspects of the Financial Institutions Act in relation to restrictions on exposures greater than 25 per cent of capital as provided in Section 38 of the Financial Institutions Act, Chapter 254, (the Act) and to ensure that financial institutions implement prudent measures and limits to monitor and control the risk of credit concentrations in respect of large exposures to individual counterparties or groups of related counterparties on a consolidated basis.
2. Financial institutions should treat the 25 per cent limit as the upper limit for an exposure to a non-government, non-bank counterparty. The Reserve Bank of Vanuatu (the Reserve Bank) expects each financial institution to establish lower internal limits to any non-government, non-bank counterparty commensurate with their risk appetite.
3. Notwithstanding paragraph 1 above, the Reserve Bank may set specific limits on a financial institution's exposures to particular counterparties, groups of counterparties, industry sectors, countries or types of asset on a case-by-case basis, having regard to the financial institution's individual circumstances.

Risk Management of Credit Concentrations

4. The credit risk exposure of a financial institution is increased where it is concentrated in a few counterparties. A financial institution should maintain and implement appropriate policies, systems and internal controls to monitor and manage the risk of credit

concentrations on a consolidated group basis to ensure that it is not unduly exposed to a single or small number of counterparties such that their default would adversely affect its financial position.

5. The board and management of a financial institution should ensure that, as part of their responsibilities to maintain and implement an effective credit risk management system for monitoring credit risk exposures, adequate policies and procedures are in place to identify, measure, monitor and report large credit exposures of the consolidated group to individual counterparties or groups of related counterparties. The policy should place a limit on the size of individual exposures relative to the capital base of the consolidated group, and should provide for large credit exposures to be kept under regular review (at least annually).
6. A financial institution's large exposures policy should, as a minimum, cover the following:
 - (a) exposure limits for:
 - (i) various types of counterparties (e.g. governments, banks and foreign equivalents, corporate and individual borrowers);
 - (ii) a group of related counterparties;
 - (iii) individual industry sectors (where applicable);
 - (iv) individual countries (where applicable); and
 - (v) various types of investment (e.g. holdings of securities other than those issued by the Central Government of Vanuatu and the Reserve Bank of Vanuatu, property, etc.)that are commensurate with the financial institution's capital base and balance sheet size;
 - (b) the circumstances in which the above exposure limits may be exceeded and the authority required for approving such excesses (e.g. by the financial institution's Board or a board committee); and
 - (c) the procedures for identifying, reviewing, controlling and reporting large exposures of the financial institution.
7. The Board and senior management of a financial institution should ensure that:
 - (a) adequate systems and controls are in place to identify, measure, monitor and report large exposures and risk concentrations of the financial institution in a timely manner; and
 - (b) large exposures of the financial institution are kept under regular review.
8. A financial institution must inform the Reserve Bank immediately where it has concerns that its credit risk concentrations have the potential to impact materially upon its capital adequacy.

Definition of Large Exposures

9. The Reserve Bank defines a large exposure as the total direct and indirect exposures to an individual counterparty or a group of related counterparties, which exceeds 10 per cent of a financial institution's consolidated capital base

10. Exposures include claims and commitments (i.e., loans, overdrafts or credit given to a person on the basis of an obligation to repay or which is repayable from specific property pledged by or on behalf of a person) recorded both on and off the balance sheet of a financial institution on a consolidated basis. In addition to the requirements of Section 38(2) of the Act, counterparties linked by cross guarantees, common ownership, ability to control, financial interdependency, or other connections will be aggregated and treated as a single exposure for purposes of this Policy Guideline.

Definition of Capital Base

11. The Reserve Bank defines capital as used in Section 38 of the Act as the capital base determined in accordance with Prudential Guideline 4 – Capital Adequacy: Measurement of Capital.

Restrictions on Advances

12. The following limits shall apply:
 - (a) the total exposure at any time to an individual counterparty or group of related counterparties must not exceed 25 per cent of capital (defined as Capital Base determined in accordance with Prudential Guideline 4: Capital Adequacy – Measurement of Capital) unless otherwise exempted as provided in paragraph 13 of this Policy Guideline.
 - (b) the total of all large exposure as defined in paragraph 10 above at any time must not exceed 800% of capital (determined in accordance with Prudential Guideline 4 – Capital Adequacy – Measurement of Capital)

Exceptions to Restrictions

13. The following exposures will be exempt from the limits in paragraphs 12:
 - (a) exposures listed in Section 38(3) of the Act provided:
 - (i) any exposure guaranteed by the Government of Vanuatu must be in writing, unconditional and irrevocable as to the repayment of principal and interest;
 - (ii) any exposure that is fully secured by cash or a deposit, in addition to the requirements outlined in Section 38(3)(e), the cash or deposit:
 - (1) must be held by the lending financial institution in either an escrow account or a deposit at the lending financial institution; and
 - (2) if in a different currency than the exposure, then the amount of exposure exempt from the limits in paragraphs 12 above will be limited to 80 per cent the amount of the cash or deposit converted into the same currency as the exposure using the daily spot mid-rate of exchange (the average of the bid and offer rates for a currency as determined each day by the Reserve Bank).

- (b) exposures, or the portions thereof, with a maturity of not more than one year that are guaranteed by another bank as to the repayment of principal and interest will be exempt from the limits in paragraphs 12 above provided:
 - (i) the total of all exposures backed by guarantees issued by any one bank or related group of banks may not exceed 200 per cent of the lending financial institution's capital base at any time; and
 - (ii) the guaranteeing bank must not be related to the lending financial institution or if the guaranteeing bank is related to the lending financial institution the guaranteeing bank must not be rated lower than the three highest grades by an internationally recognized bank rating agency, and
 - (iii) the guarantee must be in writing, unconditional and irrevocable.
- (c) exposures, or the portion thereof, with a maturity of not more than one year secured by non-government securities and shares listed on a recognized exchange for which there are daily bid and ask price quotation, provide the amount of the exposure exempt from the limits in paragraphs 12 will be limited to 80 per cent of the market value of the securities or shares of stock determined as of the end of each working day.

14. Only those exposures which fully meet the exceptions listed in paragraphs 13 are permitted to exceed the restrictions on advances outlined in paragraphs 12. No further exceptions to the restrictions on advances as provided in paragraph 12 will be granted by the Reserve Bank under Section 38(1A) of the Act.

Loans Written Off

15. The limits in paragraphs 12 above apply to all exposures, including any exposure which has been written off in whole or in part. Exposures that have been discharged by a court or that are no longer legally enforceable will not be included in the total exposure of an individual counterparty or related group of counterparties for determining compliance with the limits in paragraphs 12 above.

Loan Participations and Syndications

- 16. Any exposure or portion thereof that has been sold as participation to another financial institution will not count against the limits in paragraphs 12 above. For this exception to apply, the participation must be covered by a written agreement which specifies that in the event of a default both banks will share in payments and recoveries on a pro rata basis according to their respective participation percentages at the time of default and the terms and conditions of the participations are not more favourable than the exposure.
- 17. When two or more financial institutions extend credit to a single counterparty under a single credit facility (e.g. a syndicated credit), the limits in paragraphs 12 above will apply only to each financial institution's respective exposure to the individual counterparty. For this exception to apply, the syndication agreement must be in writing

and must specify explicitly the terms and exposures of each financial institution in the syndicated credit.

Capitalized Interest

18. Accrued but uncollected interest is not subject to the limits in paragraphs 12 above unless the interest has been capitalized by adding to the principal of the loan with a corresponding entry to interest income.

Notification of Large Exposures

19. Where a financial institution enters into an exposure in excess of 20 per cent of its consolidated capital base, it must within 10 calendar days submit in writing to the Director, Financial Institutions Supervision Department, Reserve Bank, complete details of the exposure including, but not limited to:
- (i) the name of the individual counterparty and any related counterparties in the case of a related group;
 - (ii) the amount of the loan or other transaction which results in the total exposure to the individual counterparty or related group of counterparties exceeding 20 per cent of the financial institution's capital basis, and the terms and conditions of the loan or other transaction including, including the maturity date of the loan or other transaction, a description of any collateral securing the loan or transaction and the value of such collateral;
 - (iii) the outstanding balance of any other existing loans or other transactions to the individual counterparty and related counterparties;
 - (iv) any additional information as may be requested by the Director, Bank Supervision Department of the Reserve Bank.

Reporting

20. Each locally incorporated financial institution is required to report quarterly to the Reserve Bank (or more frequently if required by the Reserve Bank) details of its 5 largest bank (including foreign banks) and government counterparties and 5 largest exposures to non-bank, non-government counterparties.

Application to Foreign Bank Branches

21. This guideline does not apply to foreign bank branches in Vanuatu which are subject to the consolidated supervision by their home country supervisors in respect of credit concentrations and large exposure limits. However, as part of its prudential oversight of the Vanuatu operations of a foreign bank, the Reserve Bank may discuss with the foreign bank's home supervisor any undue credit risk concentrations associated with the branch's Vanuatu activities.
22. Foreign banks are required to report quarterly to the Reserve Bank (or more frequently if required by the Reserve Bank) details of its 5 largest bank (including foreign banks)

and government counterparties and 5 largest exposures to non-bank, non-government counterparties.

Enforcement and Corrective Measures

23. If a financial institution fails to strictly comply with the requirements of this Policy Guideline, as determined by the Reserve Bank based on an examination of the financial institution or other credible information, the Reserve Bank may pursue any or all corrective measures as provided in the Act to enforce the provisions of this Policy Guideline including:
- (a) issuance of a directive ordering the financial institution to cease and desist from the unsound and unsafe practices as provided in Section 45 and to take additional steps as may be determined by the Reserve Bank to ensure the financial institution's future compliance with the Policy Guideline;
 - (b) pursuit of money penalties as provided in Section 38.