RESERVE BANK OF VANUATU

INTERNATIONAL BANK

PRUDENTIAL GUIDELINE NO. 8

RESTRICTIONS ON EXPOSURES GREATER THAN 25 PER CENT OF CAPITAL

1. The aim of this guideline is to clarify aspects of the International Banking Act in relation to restrictions on exposures greater than 25 per cent of capital (Section 30 of the Act) and to ensure that international banks 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. Banks should treat the 25 per cent limit as the upper limit for an exposure to a non-government, non-bank counterparty. The Reserve Bank expects banks 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 bank'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 bank's individual circumstances.

Risk Management of Credit Concentrations

4. The credit risk exposure of a bank is increased where it is concentrated in a few counterparties. A bank 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 the bank's financial position.

5. The board and management of a bank 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 bank'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, property, etc.)

that are commensurate with the bank'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 bank's Board or a board committee); and

   (c) the procedures for identifying, reviewing, controlling and reporting large exposures of the bank.

7. The Board and senior management of a bank should ensure that:

    (a) adequate systems and controls are in place to identify, measure, monitor and report large exposures and risk concentrations of the bank in a timely manner; and

    (b) large exposures of the bank are kept under regular review.

8. A bank 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 an exposure to an individual counterparty or a group of related counterparties, which exceeds 10 per cent of a bank's consolidated capital base (determined in accordance with Prudential Guideline 4 – Capital Adequacy: Measurement of Capital).

10. Exposures include claims and commitments recorded both on and off the balance sheet of a bank on a consolidated group basis. In addition to the requirements of Section 30(2) of the International Banking Act, a bank should treat counterparties as related where they are linked by cross guarantees, common ownership, ability to control, financial interdependency, or other connections which, in the bank's assessment, identify the counterparties as representing a single risk.

Prior Consultation Requirements for Large Exposures

11. Where a bank intends to enter into an exposure in excess of 20 per cent of its consolidated capital base, it must first consult with the Reserve Bank before committing to the exposure. The bank must be able to satisfy the Reserve Bank that the proposed exposure does not constitute an excessive risk to the consolidated group.

Concentrations of Large Exposures

12. A bank which has, on a consolidated group basis, a significant number of large exposures must be able to satisfy the Reserve Bank that excessive risks are not being undertaken. A bank with a high volume of large exposures is likely to be required to maintain a higher capital ratio.

Application to Foreign Bank Branches

13. This guideline does not apply to foreign bank branches 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 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 activities.

Reporting

14. Banks are required to report details of their large exposures as required in the quarterly statistical returns.