

Reserve Bank of Fiji
Banking Supervision Policy Statement No: 2

NOTICE TO INSTITUTIONS LICENSED UNDER THE BANKING ACT 1995

LARGE CREDIT EXPOSURES

1. Introduction

- 1.1. This Notice sets out the Banking Supervision policy and reporting requirements of the Reserve Bank of Fiji (“RBF”) in relation to Large Credit Exposures of licensed financial institutions, for which a limit of 25 % of Capital is imposed on each exposure in Section 24 (1) (a) of the Banking Act 1995. The Notice and Regulations (See Appendix I for Regulations) are issued under Sections 14, 26 and 78 of the Banking Act 1995 to form part of the rules for the conduct of banking business by licensed financial institutions in a safe and sound manner. The Banking Act limits apply at all times. The Regulations provide definitions and guidance on technical terms and definitions and set out the reporting format for monitoring compliance with the limits. The Notice and reporting requirements will take effect from quarter ending 31 March 1998. Minor changes were made to the provisioning terms in March 2009 due to changes in Banking Supervision Policy Statement No: 3 on Guidelines for Loan Classification and Provisioning for Impaired Assets.

2. Background and Outline of the Approach

- 2.1. The Reserve Bank expects each licensed financial institution's management and Board of Directors to understand and maintain effective control over the risks inherent in each aspect of its operations. A financial institution must take effective steps to identify, monitor and manage credit exposure risks within prudent policies and limits set by its board, having regard to the nature of its business, the capital supporting its operations and the applicable regulatory requirements.
- 2.2. Large credit exposures pose a particular risk of materially diminishing a financial institution's capital base if a single counterparty or group of related counterparties failed to meet its obligations as they fall due. The lack of effective limits on large credit exposures has historically contributed significantly to the failure or near failure of banking institutions in many countries including Fiji. In 1991, the Basle Supervisors Committee made recommendations on international best practice in relation to supervision and limitation on large credit exposures, including

recommended limits of not more than 25 percent of capital to a single borrower or borrower group.

- 2.3. The Notice and Regulations sets out the supervisory approach to be adopted by the Reserve Bank to be consistent with the Basle Committee's recommendations and in compliance with the 25 percent of Total Capital limitation in Section 24 (1) (a) of the Banking Act 1995.
- 2.4. The Reserve Bank has been obtaining quarterly reports from each institution on its 5 largest borrowers for some time under the previous legislation. The 1995 Act strengthened the information gathering powers, as noted in the Banking (Submission of Information) Regulations under Sections 14, 26 and 78 and made explicit reference in Section 27 to the confidentiality of information provided for the purpose of supervision under the Banking Act.
- 2.5. With the increased concentrations of risk exposures in some sectors of the economy and a heightened awareness that multiple exposures below the statutory limit may be a cause for concern, the Reserve Bank is introducing a new reporting form, attached as Schedule I to the Regulations, which will require quarterly details of the names and amounts of exposures to single borrowers or groups of related borrowers which exceed 10% of the Licensed Financial Institution's Total capital as defined. For institutions which have few or no exposures exceeding 10% of Total capital, the 15 largest exposures must be reported. The Reserve Bank may request additional information or vary the reporting requirements at its discretion, upon written advice to the institution(s) concerned.
- 2.6. Certain exposures are exempted from the 25% limit under Section 24 (1) (a) of the Act. Acting on the advice of the Reserve Bank of Fiji and consistent with the objectives of the Act, the Minister of Finance and Economic Development has issued a Ministerial Order (Attached as Appendix II) to exempt certain other exposures of licensed institutions from the 25% limit, so long as the exposures continue to represent a relatively low credit risk. Exposures which are exempt from the 25% limit under Section 24 (1) (a) of the Act include:
 - transactions between banks, or between branches of a bank
 - transactions for the purchase of telegraphic transfers
 - transactions for the purchase of bills of exchange or for export bills
 - exposures to Fiji Government, holdings of Government, or Government guaranteed Securities, Reserve Bank Securities,

- short term exposures of credit institutions to banks,
 - exposures fully collateralised by cash deposits or Government/ Government guaranteed securities,
 - exposures guaranteed by Government or a bank are also exempt from the 25% limit under the Order; and
 - credit exposures where a binding right of set-off against accounts of the same counterparty, or group of related counterparties, with credit balances.
- 2.7. Gross credit exposures including to connected parties of the licensed financial institution are to be reported in the quarterly return, with the deduction of exempt exposures, and /or any individually assessed provisions allocated to the exposure shown separately. The 25% limit applies to (net) credit exposures after approved deductions. Where only part of an exposure is collateralised or guaranteed as outlined in paragraph 2.6, the unsupported portion of the exposure will be subject to the 25% limit under the Act.
- 2.8. While the Banking Act places a statutory limit of 25% of Total Capital on aggregated exposure to a single counterparty or group of related counterparties, each institution's management and Board of Directors should assess the appropriate levels of risk to be assumed in relation to the nature of its operations, and may in most cases wish to adopt in-house risk management policies which limit large exposures to a lower level than 25% of Capital.

3. Exposures to Connected Parties of the Institution

- 3.1. The 25% limit also applies to exposures to parties connected to a Licensed Financial Institution, to the extent that they are not exempt under the Act or Ministerial Order. Separate reporting of exposures to connected parties is required in the quarterly reports. This will also include full reporting of instances where, with the written approval of the Reserve Bank, exposures subject to a binding risk-layoff agreement with the institution's parent (bank or government) fall within the exemptions from the 25% limit.

4. Definitions of Terms Used in Large Credit Exposures Reporting to Reserve Bank of Fiji

- 4.1. The definitions of various terms used in reporting to the Reserve Bank are contained in Schedule II to the attached Regulations. Any further clarification can be obtained from the Banking Supervision Division of the Reserve Bank on request.

5. Application to Licensed Financial Institutions Incorporated Overseas

- 5.1. For those licensed financial institutions which are incorporated outside Fiji, the 25 percent limits on large exposures are to be calculated based on the latest paid up capital and published reserves of the global consolidated institution which holds the licence in Fiji, rather than being based on the capital held in Fiji to support the local operations.
- 5.2. In this regard, it is expected that effective supervision of the head office of the institution by the banking supervisory authority in the institution's country of incorporation, will include monitoring of and placing limits on the global aggregated credit exposures granted by the various entities within the supervised group to single borrowers or groups of related borrowers, consistent with the Basle Supervisors Committee's Minimum Standards for Cross-Border Supervision.
- 5.3. In most cases, the reporting requirements for branches of overseas incorporated banks will be for the largest 15 exposures in Fiji to be reported, using the same form as in Schedule I to the attached Regulations, and for reporting to connected parties.

6. Exposure Concentrations to Certain Economic Sectors or Industries

- 6.1. The Reserve Bank will monitor and discuss with each institution, any evidence of concentration of exposures to some types of industries or sectors which may, when taken together, pose an additional credit risk to lenders, for example, because of changes in economic, climatic or political circumstances which may adversely affect loan security values, income streams of borrowers and /or their ability to repay. Particular examples from overseas experience where sectoral concentrations have caused major problems for lenders include lending for: development and construction of commercial, industrial or speculative residential real estate; hotels and tourism-related investments; primary agriculture; energy or mining prospecting and development.

- 6.2. The Reserve Bank will expect institutions to have in-house limits and monitoring to avoid concentration of risks of this nature. Separate reporting requirements may be introduced from time to time where necessary to monitor developments closely.

**Reserve Bank of Fiji
Revised March 2009**

Attachments:

**Appendix I: Banking (Reporting of Large Credit Exposures) Regulations
1998**

Appendix II: Banking (Credit Exposures) Order 1998

BANKING ACT, 1995

BANKING (REPORTING OF LARGE CREDIT EXPOSURES) REGULATIONS, 1998

(Sections 14, 26 and 78)

PURSUANT to subsection (1) of Sections 14, 26 and 78 of the Banking Act, 1995, ("the Act"), the Reserve Bank of Fiji, with the approval of the Minister for Finance, has made the following Regulations:

Short title

1. These Regulations may be cited as the Banking (Reporting of Large Credit Exposures) Regulations, 1998.

Reports to the Reserve Bank of Fiji

2. Information to be submitted to the Reserve Bank of Fiji by licensed financial institutions pursuant to these Regulations shall contain such information and be furnished within such time as is specified in the First Schedule and shall be reported in accordance with the definitions set out in the Second Schedule.

Other information required

3. The Reserve Bank of Fiji may require a licensed financial institution to furnish such additional information relating to large credit exposures as the Reserve Bank of Fiji may specify by notice in writing to the licensed financial institution concerned.

Made this day of , 1998.

J. Y. KUBUABOLA
Governor
Reserve Bank of Fiji

BANKING ACT, 1995

BANKING (CREDIT EXPOSURES) ORDER, 1998 **(Section 79)**

PURSUANT to Section 79 of the Banking Act, 1995 (the Act) the Minister of Finance, acting on the advice of the Reserve Bank of Fiji (the Reserve Bank), has made the following Order:

Short Title

1. This Order may be cited as the Banking (Credit Exposures) Order, 1998.

Exemption of certain credit exposures

2. For the purposes of paragraph (a) of subsection (1) of Section 24, certain categories of credit exposures as set out in the Schedule shall be exempt from the definition of credit facilities and other exposures subject to the limit of 25 per cent of total capital (as determined by the Reserve Bank) of a licensed financial institution,

Exposures to subsidiaries

3. Where effective supervision of a licensed financial institution and its subsidiary companies operating in or from Fiji is able to be conducted by the Reserve Bank on a consolidated basis, exposures to a subsidiary of the licensed financial institution, may with the prior written approval of the Reserve Bank of Fiji, be excluded from the definition of credit exposures of the consolidated banking group in Fiji. Exposures to subsidiary companies will not be excluded from the definition of credit exposures of licensed financial institutions when measured on an unconsolidated basis.

Duration

4. This Order shall remain in force until varied, modified or revoked, or until such time as the Reserve Bank formally advises the Minister of Finance and each licensed financial institution that some or all of the specified exposures no longer represent a low degree of credit risk to licensed financial institutions.

Made this day of , 1998.

James M Ah Koy
Minister of Finance

SCHEDULE

EXEMPT CREDIT EXPOSURES OF LICENSED FINANCIAL INSTITUTIONS (from the limit of 25% of total capital in para (a), subsection 1 of Section 24 Banking Act 1995)

1. Short term exposures to licensed banks in Fiji, including call and demand deposits, and time deposits and short term loans with an original maturity of not more than 91 days.
2. Securities issued or guaranteed by the Government of Fiji, and loans to the Government of Fiji.
3. Notes and Bonds issued by the Reserve Bank of Fiji, and deposits held with Reserve Bank.
4. Exposures which are irrevocably secured by cash or collateral deposits lodged with the lending institution, or by securities issued or guaranteed by the Government of Fiji or the Reserve Bank of Fiji, except where repayments of principal or interest on those exposures are more than 90 days in arrears.
5. Exposures which have been covered by a legally binding and enforceable guarantee or risk lay-off agreement from the Government of Fiji, the Reserve Bank or a bank (or from any overseas central bank, central government or multilateral organisation which the Reserve Bank may specify in writing for this purpose). The nature of the guarantee or risk lay-off agreement will require prior written approval of the Reserve Bank before being acceptable for the purpose of these regulations.
6. Short term underwriting exposures for a total period not exceeding 42 days in any case.
7. Credit exposures where a binding right of set-off is held against accounts of the same counterparty, or group of related counterparties, with credit balances.

SECOND SCHEDULE

DEFINITIONS FOR REPORTING OF LARGE CREDIT EXPOSURES

Gross Credit Exposure

1. A Gross Credit Exposure is defined as the Gross amount at risk arising from loans and advances made, securities held, deposits placed and other credit facilities, financial guarantees and other off-balance sheet exposures or contingent liabilities incurred; and shall further include all items set out in Annex II of the Banking Supervision Policy Statement No. 1 entitled Capital Adequacy Requirements for Licensed Financial Institutions issued by the Reserve Bank of Fiji in May 1996, as revised and advised in writing by the Reserve Bank from time to time.
2. The Gross amount at risk will be taken as the full amount of the licensed financial institution's claims and contingent liabilities, and potential claims and liabilities in the case of undrawn facilities, unless stated otherwise in the detailed reporting instructions issued by the Reserve Bank for the completion of the large credit exposures returns or as set out below. In general, exposures should be reported on a gross basis, so that credit balances should not be offset against debit balances. Acceptable risk reduction mechanisms such as cash collateral and bank or Government guarantees will be reported as deductions from the Gross Credit Exposure.
3. The amount at risk arising from interest rate contracts, foreign exchange rate contracts (including forward foreign exchange contracts etc) is not the nominal amount of a contract but rather a credit equivalent amount. The method for calculating the credit equivalent amount is the same as that used in the calculation of the capital adequacy ratio requirement (ie the replacement cost or original exposure method set out in Annex III to the Banking Supervision Policy Statement No. 1).
4. Risks arising from the settlement of transactions are generally not included within the scope of the Large Credit Exposures reports; in particular, claims arising in the course of settlement of a foreign exchange transaction on a counterparty where the reporting institution has paid away its side of the transaction but has not received the countervalue, for a period of up to two working days after payment was made. (After this period such claims will constitute an exposure.) However, the control of such exposures needs to be carefully considered by institutions since inadequate controls could be a cause of substantial loss. The Reserve Bank will therefore pay

particular attention during the course of its supervision to how individual banks control such risks.

Credit Exposure

5. A Credit Exposure is derived after deducting from Gross Credit Exposure:
 - (i) the amount of any exempt credit exposures as defined in the Banking (Credit Exposures) Order 1998 or otherwise exempt by virtue of the proviso to paragraph (a) of Subsection (1) of Section 24 of the Act (see also paragraphs 18 and 19 of this Schedule); and
 - (ii) any individually assessed provisions for doubtful debts allocated by the reporting institution against the Gross Credit exposure.

Large Credit Exposures

6. Large credit exposures are defined as credit exposures to counterparties or groups of closely related counterparties which are greater than or equal to 10% of the licensed financial institution's Total Capital. (For reporting purposes only, if there are few or no exposures in excess of 10% of Total Capital as defined, the 15 largest credit exposures of the institution in Fiji should be reported in the large credit exposures return.)

Capital Base

7. The capital base used as the basis for monitoring and controlling large exposures of licensed financial institutions incorporated in Fiji should be Total Capital in Fiji as calculated each quarter according to the method set out in the Reserve Bank's Policy Statement No. 1 (ie. the same as that used in the calculation of the capital adequacy ratio in the quarterly Capital Ratio Return). The licensed financial institution must however, adjust this figure for new issues of capital during the course of the quarter and take account of other significant changes to the capital base, either upwards or downwards. In such circumstance the amended figure should be advised to the Reserve Bank in writing as soon as the capital adjustment is made.
8. For the licensed financial institutions incorporated outside Fiji and operating as a branch only in Fiji, Total Capital is the latest published consolidated issued paidup capital and published reserves of the institution, which amount should be converted to Fiji dollar equivalent and advised to the Reserve Bank annually.

An Individual Counterparty and a Group of Closely Related Counterparties

9. Credit exposures are required to be reported and controlled according to the nature of the counterparty. For example, exposures to bank and non-bank counterparties will be treated differently. Furthermore, exposures to a group of closely related counterparties must be aggregated and treated as if they were exposures to a single counterparty.

Individual Non-Bank Counterparty

10. An 'individual non-bank counterparty' comprises natural and legal persons and includes individual trusts, corporations, unincorporated businesses (whether as sole traders or partnerships) and non-profit making bodies other than licensed banks in Fiji and international banks of good standing acceptable to the Reserve Bank.

Bank Counterparty

11. A bank counterparty includes licensed banks in Fiji and international banks of good standing acceptable to the Reserve Bank of Fiji, other than the parent or branches of a reporting bank.

Closely Related Counterparties

12. A group of closely related counterparties exists where:
 - (i) unless it can be shown otherwise, two or more individual counterparties constitute a single risk because one of them has, directly or indirectly, the power to exercise control or influence over the other or others [in terms of paragraph (a) of Subsection (2) of Section 24]; or
 - (ii) individual counterparties are connected in such a way that the financial soundness of any of them may affect the financial soundness of the other or others or the same factors may affect the financial soundness of both or all of them. Particular examples include linkages by way of cross guarantees or companies with common guarantors, and common ownership which collectively has the power to control or influence both companies.

In such cases, the exposure to these individual counterparties should be aggregated and considered as a single exposure to a group of closely related counterparties.

13. Where there is doubt in a particular case whether a number of individual counterparties constitute a group of closely related counterparties or where, notwithstanding that the relationship between a number of counterparties identified in the reporting instructions exist, the counterparties do not appear to share a common risk, the circumstances should be discussed with the Banking Supervision Division to determine how the exposure(s) should be reported.

A Connected Counterparty

14. Parties connected to the reporting licensed financial institution comprise:-
- (i) any person who holds or has the power to vote a minimum of 51% of the voting shares of the licensed financial institution, or may otherwise exercise factual control or influence over the policies of the licensed financial institution;
 - (ii) any persons over who the licensed financial institution holds or has the power to vote a minimum of 51% of the voting shares or the licensed financial institution may otherwise exercise factual control or influence over the policies of that person;
 - (iii) non-group companies with which the reporting institution's directors and other persons who are able to exercise control or influence over the licensed financial institution are individually or collectively able to exercise control or influence (as defined in Subsection 2 of Section 24 of the Banking Act) over the non-group companies.
 - (iv) The Reserve Bank may, by written notice to a licensed financial institution, direct that connected counterparties shall also include persons falling within the definition of 'associated persons' in subsection (2) of Section (2) of the Act.
15. For exposures to connected counterparties other than parent, subsidiary or sister companies of the licensed financial institution, where the lending institution is able to demonstrate to the Reserve Bank's satisfaction that, notwithstanding that a connection with a counterparty exists, the lender's relationship with that counterparty is at arm's length, its exposure to that counterparty will not be considered as an exposure to a counterparty connected to the lending institution.

LIMITS

Single Credit Exposure Limit

16. A Large Credit exposure to an individual counterparty (after deducting any exempt credit exposure in terms of the Banking (Credit Exposures) Order 1998 and individually assessed provisions) may not exceed 25% of Total Capital in accordance with Section 24(1)(a) of the Act.

Aggregate Limit

17. Aggregate large credit exposures to all counterparties (after deducting exempt credit exposures) may not exceed 800% of Total Capital.

Connected Counterparty Limit

18. Aggregate credit exposure to counterparties connected to the reporting licensed financial institution (other than exempt credit exposures) may not exceed 25% of Total Capital.

EXEMPT CREDIT EXPOSURES

19. The following types of exempt credit exposures as listed in the Banking (Credit Exposures) Order 1998 may be deducted from the amount of Gross credit exposure for the purpose of the limit on Large Credit Exposures and credit exposures to connected parties.
 - Short term exposures to licensed banks in Fiji, including call and demand deposits, and time deposits and short term loans with an original maturity of not more than 91 days. (Exposures of licensed credit institutions to banks with maturity of over 91 days should be treated the same way as individual exposures to non-bank counterparties and are subject to the limits on large credit exposures.)
 - Securities issued or guaranteed by the Government of Fiji and loans to the Government of Fiji.
 - Notes and Bonds issued by the Reserve Bank of Fiji, and deposits held with Reserve Bank.
 - Exposures which are irrevocably secured by cash or collateral deposits lodged with the lending institution, or by securities issued or guaranteed by the Government of Fiji or the Reserve Bank of Fiji, except where repayments of principal or interest on those exposures are more than 90 days in arrears.
 - Exposures which have been covered by a legally binding and enforceable guarantee or risk lay-off agreement from the Government of Fiji, the Reserve Bank or a bank (or from any overseas central bank, central government or multi-lateral organisation which the Reserve Bank may specify in writing for this

- purpose). The nature of the guarantee or risk lay-off agreement will require prior written approval of the Reserve Bank before being acceptable for the purpose of these regulations.
- Short term underwriting exposures for a total period not exceeding 42 days in any case.
 - Exposures to a subsidiary of the licensed financial institution, where the prior written agreement of the Reserve Bank of Fiji has been obtained to the exclusion and where effective supervision is able to be conducted by the Reserve Bank on a consolidated basis for the group operating in or from Fiji.
 - Credit exposures where a binding right of set-off is held against accounts of the same counterparty, or group of related counterparties, with credit balances.
20. Also exempt by virtue of the proviso to Section 24(1)(a) of the Act are:
- all exposures from one bank to another, or between the branches of a bank;
 - exposures relating to the purchase of telegraphic transfers, or to the purchase of bills of exchange or documents of title to goods where the holder of those bills or documents is entitled to payment outside Fiji for exports from Fiji, or to advances made against those transfers, bills or documents.

Treatment of Credit Exposures to Government Entities

21. Credit exposures to quasi-government counterparties such as Statutory Corporations and Government-owned trading companies are subject to the single exposure limit unless they have been exempt, for example, because legally binding and enforceable guarantees exist from the Government of Fiji.
22. In general, the relationships with or between such entities should only be categorised as a group of closely related counterparties or as a connected counterparty of the licensed financial institution respectively where those definitions would be met even if there was no Government ownership or control of the entity concerned. Therefore, a Government-owned trading company and its subsidiaries will normally form a group of closely related counterparties for the purposes of the single exposure limit of 25% of Total Capital. On the other hand, for example, two statutory corporations operating in the finance industry and reporting to the same Cabinet Minister, but with separate Boards of Directors, and governing legislations and profit or income sources which provide for de-facto independence in operational and policy matters, would not normally be regarded as connected counterparties of a Government-owned bank, or required to be grouped as closely related counterparties.

CONSOLIDATED SUPERVISION

23. Licensed financial institutions are required to aggregate credit exposures of the licensed institution and all its subsidiary companies to the same individual counterparty for the purposes of limiting and reporting large credit exposures. Agreement should be reached with the Reserve Bank on the extent to which consolidated supervision and monitoring should also encompass other associated persons (as defined in Subsection 2 of Section 2 of the Act) of the licensed financial institution, on a case by case basis to determine whether there are any situations where exposures of other associated persons to the same individual counterparty should be aggregated with those of the licensed financial institution and its subsidiaries.

MONITORING AND REPORTING REQUIREMENTS

24. Large credit exposures and connected credit exposures must be reported to the Reserve Bank on a quarterly basis on the form contained in Schedule 1 including the names of the counterparties and exempt credit exposures as defined. Reporting of exempt exposures to the Fiji Government, Reserve Bank of Fiji and Statutory Corporations which are fully guaranteed by Government, and exempt exposures to Banks in Fiji, will **not** be required.
25. Any breach of the limits set out above (single, aggregate or to connected counterparties) must be reported to the Reserve Bank immediately with written advice of the action being taken to redress the situation. Penalties and sanctions for breaches of the Act may be imposed by the Reserve Bank.