I. INTRODUCTION

The Central Bank of The Bahamas ("the Central Bank") is responsible for the licensing, regulation and supervision of banks and trust companies operating in and from within The Bahamas pursuant to The Banks and Trust Companies Regulation Act, 2000, and The Central Bank of The Bahamas Act, 2000. Additionally, The Central Bank has the duty, in collaboration with financial institutions, to promote and maintain high standards of conduct and management in the provision of banking and trust services.

All licensees are expected to adhere to the Central Bank’s licensing and prudential requirements and ongoing supervisory programmes, including periodic on-site inspections, and required regulatory reporting. Licensees are also expected to conduct their affairs in conformity with all other Bahamian legal requirements.

II. DEFINITIONS

Credit is the provision of funds on agreed terms and conditions to a debtor who is obliged to repay the amount borrowed (together with interest thereon). Credit may be extended, on a secured or unsecured basis, by way of instruments such as mortgages, bonds, consumer and corporate advances, financial derivatives and finance leases.

Credit risk is the risk of financial loss, despite realization of collateral, security or property, resulting from the failure of a debtor to honour its obligations to the licensee.

Credit risk management is the process of controlling the impact of credit risk-related events on the licensee. This management involves identification, understanding, and quantification of the degree of potential loss and the consequent taking of appropriate measures to minimise the risk of loss to the licensee.

III. PURPOSE

These Guidelines specifically address the management of the credit risk present in the business activities of licensees, within their overall corporate governance process and risk management programme. The effective management of credit risk as a component of a comprehensive risk management programme is fundamental to the safety and soundness
of every licensee and is critical to its long-term viability. These Guidelines should be read in conjunction with the “Guidelines for the Corporate Governance of Banks and Trust Companies Licensed to do Business Within and From Within The Bahamas” (“Corporate Governance Guidelines”) and the Guidelines for the Management of Large Exposures (“Large Exposures Guidelines”). Additionally, the Central Bank endorses the Basel Committee’s 17 Principles for Management of Credit Risk (September 2000) (See Appendix 1). Banks are encouraged to refer to the full Basel document at www.bis.org.

Experience indicates that adherence to sound credit granting policies and procedures goes hand in hand with financial soundness. Failure to adopt and adhere to sound credit policies and procedures is often a source of weakness in financial institutions. The major consequence, which arises from a weakening of the credit risk portfolio is the impairment of capital or liquidity, or both.

Credit risk management should be conducted within the context of a comprehensive business plan. Although these Guidelines focus on a licensee’s responsibility for managing and controlling its investments and loan portfolio and exposure to credit risk, it is not meant to imply that credit risk can be managed in isolation from other considerations such as asset/liability management considerations and the need to maintain adequate liquidity.

IV. APPLICABILITY

These Guidelines apply, as appropriate, to all licensees that engage in business activities that produce credit risk. They represent the Central Bank’s identification of accepted best practices for effective credit risk management in licensees. The Central Bank appreciates that the breadth of the credit risk management programme in each licensee will depend on the scope and sophistication of the activities of the licensee, the nature and complexity of its credit-related businesses, and the types and levels of the risks that it assumes. However, failure to adopt a satisfactory credit risk management programme appropriate to its business activities constitutes an unsafe and unsound practice and could subject the licensee to regulatory sanctions.

As part of its ongoing off-site supervision and on-site examination and analysis programmes, the Central Bank will periodically conduct an evaluation of each licensee’s strategies, policies, procedures and the management of the business activities that generate credit and related risks (i.e., the credit risk management programme). The Central Bank’s Regulations and Guidelines establish the standards against which each licensee’s credit risk management programme will be evaluated.
V. ESTABLISHING A CREDIT RISK ENVIRONMENT

Sound credit management involves establishing a credit risk philosophy, and policies and procedures for prudently managing the risk/reward relationship across a variety of dimensions, such as quality, concentration, maturity, currency, collateral security or property and type of credit facility.

1. Credit Risk Strategy and Policy

Licensees should have a written statement of their credit risk strategy and policy to implement the strategy. The strategy and policy should be approved by the board of directors and should be consistent with the licensee’s degree of risk tolerance, the level of capital available for credit activities and credit management expertise. The board should review the strategy and policy periodically (at least annually) to ensure their adequacy and relevance given the changing operating circumstances, economic cycles, activities and risks that the licensee may face.

The credit risk strategy and policy should be clearly disseminated to, and understood by, all relevant staff.

2. Risk Tolerance and Portfolio Limits

Licensees should clearly articulate their credit risk tolerance, including how much, and what types of risk they are prepared to undertake. Risk tolerance should be compatible with the licensee’s overall strategic objectives.

The credit risk policy should specify, inter-alia:

(a) Types of facilities to be offered, along with pricing policies, profitability targets, maximum maturities and maximum debt-servicing ratios borrowers for each type of lending;
(b) A ceiling for the total loan portfolio ratios (i.e., for loan to deposit ratio, maximum dollar amount or a percentage of capital base);
(c) Portfolio limits for maximum aggregate exposures by country, industry, category of borrower/counterparty, individual credit product, groups of related parties and single borrowers, etc.;
(d) Limits, terms and conditions, approval and review procedures and records kept for connected lending;
(e) Types of acceptable collateral (e.g., charges, pledges, cash, securities, credit derivatives), loan-to-value ratios and the criteria for accepting guarantees; and
(f) The minimum information required from loan applicants (bearing in mind AML and KYC best practice and legal requirements).
3. **Risk Concentrations**

Licensees should establish internal controls and systems, endorsed by the board of directors, to measure, monitor and control large exposures and other risk concentrations in accordance with the Central Bank’s Large Exposures Regulations and Guidelines. Licensees should establish the proper mechanisms to ensure timely and accurate regulatory pre-notification and reporting.

4. **New Products**

Licensees should recognise and control the credit risk arising from their services and activities, including the risks associated with new products. Before licensees enter into new types of products, activities or markets, they should ensure that they understand and assess the impact of the possible risks to be undertaken with a view of minimizing the downside potential of the inherent risks associated with the introduction of the new product or service. They should decide whether such products, activities or markets are consistent with their strategy, and if so, they should establish appropriate credit risk policies, procedures and controls, which should be approved by the board of directors or its appropriate delegated committee. The required formal risk assessment of new products and activities should be documented.

5. **Delegated Credit Authority**

Credit authority should be clearly delegated by the board of directors and should be appropriate for the products or portfolios assigned to the Credit Committee or individual credit officers and should be commensurate with their credit experience and expertise. Licensees should ensure that credit authority is required and designated for all types of credit exposures, including the use of credit derivatives for hedging or income generation. Delegated credit authority should be subject to regular review to ensure that it remains appropriate to current market conditions and the levels of their credit officers’ performance and expertise.

Delegated credit authority may be absolute, incremental or a combination thereof and may also be individual, pooled, or shared within a committee. The delegation of authority needs to be clearly documented, and should include:

- The absolute and/or incremental approval authority being delegated;
- The officers, positions or committees to whom authority is being delegated;
- The ability of recipients to further delegate risk approval; and
- The restrictions, if any, placed on the use of delegated risk-approval.

Approval limits should relate to some combination of:

- Type of credit activity;
- Credit rating;
- Size;
- Credit concentration;
- Type of collateral security or property;
- Liquidity of investment; and
- Quality of covenant package.

6. Accountability

All staff should comply with credit polices and procedures and should be held accountable, ultimately to the board of directors through their reporting officers, for their decisions when discharging their responsibilities. A licensee’s remuneration policies should be consistent with its credit risk strategy. The policies should not encourage officers to generate short-term profits by taking an unacceptably high level of risk.

VI. PRUDENT PROCEDURES FOR APPROVING CREDIT, DOCUMENTATION AND COLLECTION

1. Documented Credit Approval Procedures

Licensees should have a written statement (credit manual) setting out the criteria and procedures for granting new credit, for approving extensions of existing credits and exceptions, for conducting periodic and independent reviews of credits granted and for maintaining the records of credits granted.

The credit manual should stipulate sound, well-defined criteria for granting credit, including a thorough understanding of the borrower or counterparty, the purpose and structure of the credit and its source of repayment. The same criteria should be applied to both advised and unadvised facilities.

Credit decisions should be supported by adequate evaluation of the borrower’s repayment ability based on reliable information. Sufficient and up-to-date information should continue to be available to enable effective monitoring of the account.

All credit should be granted on an arm’s length basis. Credit to related borrowers should be monitored carefully and steps should be taken to control or reduce the risks of connected lending (see Large Exposures Regulations and Guidelines).

Licensees should not over-rely on collateral or guarantees. While these can provide secondary protection to the lender if the borrower defaults, the primary consideration should be the borrower’s debt-servicing capacity.
2. Legal Documentation


Licensees should take measures to minimize the possibility of loss through legal risk. All new draft loan documentation, and documentation for all other credit products should be subject to (independent) legal review and approval for enforceability and compliance with relevant domestic and international law.

Prior to release of funds, all completed documentation and supporting documents (such as mortgages, guarantees, charges, bills of lading, etc.) should be received, independently reviewed and approved by the licensee’s authorized parties. This requirement applies equally to rescheduled facilities. Incomplete, unenforceable or inaccurate documentation has been another major historical source of loss for financial institutions.

VII. EFFECTIVE SYSTEMS FOR CREDIT ADMINISTRATION, MEASUREMENT AND MONITORING

1. Credit Administration

Licensees should have in place systems for administering their credit portfolio, including keeping the credit files current, obtaining up-to-date financial information on borrowers and other counterparties, and safe custody of important documents (such as title deeds etc.).

Additionally, licensees should conduct a review of all facilities, at least annually, to ensure that the terms and conditions continue to be complied with and that the rationale for the original facility continues to be reflective of the borrower’s capacity to repay the loan. (Consumer loans repayable by instalment need not be reviewed if current).

Failure to establish adequate procedures to effectively monitor and control the credit function within established guidelines can result in significant other costs, in addition to credit losses. Compromising credit policies and procedures is a major cause of servicing costs and credit losses.

Accordingly, each licensee needs to develop and implement procedures to identify, monitor and control the characteristics and quality of its credit portfolio. These procedures need to define prudent criteria for identifying and reporting potential problem credit exposures to ensure that they are identified for more frequent review, followed up
with appropriate corrective action, classified as below standard where appropriate, and that provisions are made where necessary.

Categorization of the credit portfolio by type of credit activity, credit rating, regular review of individual and groups of credits within the portfolio and internal credit audits are integral elements of effective and prudent portfolio monitoring and control and should include current relevant information about the collateral, the borrower, and all other parties which support the credit.

Regular review of ratings and the rating system can also provide an effective tool for monitoring the level and trends in the quality of individual credits and the credit portfolio by highlighting credits or segments of the portfolio that warrant special attention.

2. Measuring and Monitoring of Credit Risk

Licensees should maintain comprehensive procedures and adequate information systems for measuring credit risk (including measuring credit risk inherent in off-balance sheet products such as guarantees issued and received, derivatives in credit equivalent terms, etc.) and for monitoring the condition of individual credits to facilitate identification of problem credits and determination of the adequacy of provisions and reserves. The complexity of the credit risk measurement tools will depend on the nature and degree of the inherent risks of the products involved. These should be flexible to help licensees identify risk concentrations. To achieve this, a licensee’s monitoring system should be capable of analysing its credit portfolio by the following characteristics:

(a) Size of exposure;
(b) Exposure to groups of connected parties;
(c) Individual product lines;
(d) Sectors (geographic, industrial);
(e) Borrowers’ demographic profiles;
(f) Account performance;
(g) Internal credit ratings;
(h) Outstanding versus undrawn commitments;
(i) Types and coverage of collateral; and
(j) Interest rate sensitivity (i.e. fixed or floating), etc.

Licensees should have in place a system for monitoring the overall quality of their credit risk exposures under normal and stress conditions.

There should also be a reporting system which alerts management to aggregate exposures approaching various pre-set portfolio limits.

Licensees should be conscious of business and economic cycles and regularly stress-test their portfolios against adverse market scenarios.
Adequate contingency planning should be developed in conjunction with stress-testing.

3. **Asset Classification**

Licensees are required to develop and use credit risk grading systems in managing credit risk. The grading system should be consistent with the nature, size and complexity of the licensee’s activities.

The Central Bank of The Bahamas does not wish to impose a standard credit risk grading system for all licensees. Rather, the Central Bank, during the course of the onsite examination programme, will rely upon the system adopted by each licensee. The following factors should be considered when developing these systems:

(a) Coverage should extend to as much of a licensee’s portfolio as possible, including off-balance sheet exposures;

(b) For applicable exposures, the system should cover both performing and non-performing assets to provide for the migration of an exposure from fully performing to loss status;

(c) Connected parties should generally be classified on a group basis;

(d) A regular independent review function to provide assurances about the integrity of the grading process should be established;

(e) Arrangements for the periodic validation of the grading model to ensure that it continues to deliver reliable information and adequately distinguishes between exposures of varying credit quality;

(f) A sufficient number of risk grades to ensure that the system adequately captures gradation of risk; and

(g) Poorer quality facilities should at least include four categories along the lines indicated in Appendix 2. However, comparable ratings systems may also be used.

4. **Provisioning Policy**

Licensees should establish policies on provisioning which ensure that exposures are prudently provided for on a timely basis. Experience has demonstrated that there is a period between when a loss event occurs – that is, an event that results in a borrower’s
inability to repay interest and/or principal – and when management is able to identify such an event. Accordingly, loan loss provisions, including both specific and general provisions for credit risk, must be established to recognize (1) the losses that management estimates to have occurred in the portfolio at the balance-sheet date, and (2) impaired loans or credits that, may not yet have been, or not yet specifically identified as being impaired.

Historical evidence indicates that problem credits often originate in periods of economic growth. Typically, as a business/economic cycle peaks and begins to decline, more loans are likely to become impaired. However, many problem credits will not become specifically identified as impaired until some time later when the evidence of impairment becomes more explicit.

Although a variety of methodologies may be appropriate for determining a licensee’s specific and general provisions (see example footnote 1 below), it is important to recognize these dynamics when establishing the methodology most appropriate for each licensee. Specific provisions must be reflective of the expected loss on any loan facility while the general provision account is expected to increase to reflect portfolio growth and/or evidence of deterioration in credit quality through the economic cycle.

General provisions are not a substitute for specific provisions. Accordingly, as individual assets can be identified as impaired, specific provisions are to be established. Licensees should provide specifically for credits where losses are certain or likely. The percentages to be provided will depend on the particular circumstances.

Licensees should maintain general provisions based on historical loss experience and their assessment of future economic trends in the markets in which they operate. As general and specific allowances are related, it is necessary to review and assess regularly the adequacy of specific and general allowances in light of the developments within the portfolio, and to be able to demonstrate that the level of both general and specific allowances is adequate.

Whilst the level of provisions is normally a matter for a licensee to determine in consultation with its external auditors, the Central Bank may exercise its discretion to intervene where in its opinion the licensee is being insufficiently prudent in its approach to its own provisioning policies or is seriously out of line with industry best practice provisioning policies.

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1 The following is an example of a common provisioning benchmark system:

(a) Satisfactory – 0
(b) Special mention – 0%
(c) Substandard – 15-25%
(d) Doubtful – 50-75%
(e) Loss – 100%
(a) **Measurement Guidance**

Loans that are not specifically identified as impaired should be grouped into pools of loans with common risk characteristics. To capture the extent of impairment fully, the general allowance must reflect exposures across all portfolios/categories that give rise to credit risk including, but not limited to, the unimpaired portion of the loan portfolio, undrawn commitments, letters of credit, guarantees and bankers acceptances, credit derivatives and loan substitutes.

(b) **Components of Collective Loan Impairment**

The assessment of impairment for pools of loans should be based on all available and relevant information. Licensees are likely to identify multiple components of collective loan impairment.

Components of collective loan impairment may relate to:

- Historical loss experience;
- Current environmental conditions;
- Attributes specific to a defined group of borrowers; and,
- Other characteristics directly affecting the collectability of a pool or portfolio of loans, and that are unique to a defined group of borrowers within a pool or portfolio.

Each identified component should be assessed individually and should be supported by data developed by the licensee demonstrating how the data supports their estimates. Although the appropriate level of specific and general allowances will normally lie within a range of estimates, The Central Bank of The Bahamas believes the level chosen should be conservative, reflecting such factors as the imprecise nature of the estimates.

(c) **Changes to the Allowance for Loan Loss Provisions**

The levels of allowances are expected to fluctuate in accordance with the nature and composition of the licensee’s portfolio, shifts in the economic cycle and the effectiveness of the licensee’s own credit risk policies and procedures. Management, with close oversight of the board of directors, must closely monitor changing conditions and resulting impairments and reflect such changes through increases or decreases in general and specific allowances as appropriate.

Amounts will flow from general to specific allowances. In normal circumstances, transfers occur as specific allowances are established to recognize impairment on an individual loan basis. A transfer from the general to the specific is appropriate only to the extent that the individual exposure can be identified with the categories/subgroups of risk for which the general provision has been established. The level of the residual provision must continue to be maintained at a reasonable level as supported by the licensee’s methodology to establish the general provision.
The methodology for establishing general and specific allowances must be supported by appropriate observable data. This data must be assessed periodically as circumstances change or as new data that are more relevant and directly representative of loss become available.

Where the condition/composition of an underlying portfolio has materially changed, it will be appropriate for the licensee to review the components of impairment; this may, in turn, result in reassessment/recalibration of a portion of the general allowance. The Central Bank of The Bahamas must be notified prior to a material adjustment of this type. The licensee would be expected to demonstrate that:

- The circumstances under which a licensee has previously established its level of general and specific provisions have undergone material change;

- The residual general provision is sufficient to meet any minimum level that the Central Bank of The Bahamas may establish for either the licensee or the industry; and,

- The adjustment is justified by the licensee’s methodology to establish the level of provisions.

The methodology for establishing provisions for loan losses should include a threshold, or minimum level of general provision that is reflective of the probability of loss in a licensee’s performing risk portfolio. Given the industry’s historical loss experience, the Central Bank of The Bahamas would not normally expect general provisions to represent less than **1.00 percent** of a licensee’s on and off balance sheet credit risk portfolio. Any recommended variances to the recommended threshold must have Central Bank of The Bahamas approval prior to implementation.

The Central Bank of The Bahamas will require that licensees retain on file sufficient documentation of their data and management judgment and board of directors support for their estimates of impairment.

### VIII. ADEQUATE CONTROLS OVER CREDIT RISK

#### 1. Segregation of duties

Licensees should keep the functions of credit initiation, approval, review, administration, payments and work-out as separate as possible.

Licensees should establish and enforce internal controls and practices so that deviations from policies, procedures, limits and prudential guidelines are promptly reported to the appropriate level of management.
A timely, accurate and in-depth management information system should be supported by a framework whereby relevant reports on the credit portfolio are generated and made available to various levels of management on a timely basis.

2. Risk Mitigation

In controlling credit risk, licensees can utilize certain mitigation techniques. Normally, they include:

(a) Accepting collateral, standby letters of credit and guarantees;
(b) Entering into netting arrangements;
(c) Setting strict loan covenants; and
(d) Using credit derivatives and other hedging instruments.

While mitigation through collateral and guarantee is usually dealt with at the time of granting of credits, credit derivatives and netting are often employed after the credit is in place, or used to manage the overall portfolio risk.

When the mitigation arrangements are in place they should be controlled. Licensees should have written policies, procedures and controls for the use of credit mitigation techniques. They should also ensure adequate systems are in place to manage these activities.

Licensees should revalue their collateral and mitigation instruments on a regular basis. The method and frequency of revaluation depends on the nature of the mitigation and the products involved.

3. Managing Problem Credits

It is recommended that licensees establish a dedicated resource to handle the recovery and work-out of problem loans with appropriate policies in place. Licensees should have a well defined credit collection and arrears management process.

4. Independent Audits

Licensees should establish a system of regular independent credit and compliance audits. These audits should be performed by independent parties (i.e. Internal Audit and Compliance, which report to the Board or the Audit Committee).

Credit audits should be conducted to assess individual credits on a sampling basis and the overall quality of the credit portfolio. Such audits are useful for evaluating the performance of account officers and the effectiveness of the credit process.
Compliance audits should be performed to test compliance with established credit policies and procedures, in particular credit approval, internal credit risk grading, the appropriateness of pricing, adequacy of provisioning and adherence to limits, statutory restrictions and operating procedures. Such audits should also be used to identify credit control or process weaknesses, irregularities and exceptions and to test whether the reporting of credits to senior management is accurate as regards composition, credit quality and value of the portfolio.

The findings of these audits should be reported to the Board or the Audit Committee on a timely basis, and appropriate remedial actions should be taken to address any concerns and weakness raised.

IX. CENTRAL BANK OF THE BAHAMAS’ ASSESSMENT PROCESS

The Central Bank of The Bahamas’ assessment of a licensee’s compliance with these Guidelines will be conducted in two ways:

(1) The Central Bank will assess licensees’ credit risk management policies, specific and general provisioning policy and associated methodologies against the assessment criteria identified in this Guideline. Emphasis will be placed on the understanding and degree of oversight of the provisioning process applied by senior management and the board of directors of each licensee; and

(2) The Central Bank will assess the overall reasonableness of the level of specific and general allowances.

Licensees having a credit risk management methodology and/or level of provisioning (specific and general allowances) that is assessed as “Not Acceptable” will be required to submit an action plan and timeline for compliance with the Guideline. Until such time as the licensee achieves an “Acceptable” or better rating the licensee may be subject to enhanced monitoring of its risk management processes. Also, licensees that do not achieve an “Acceptable” rating for the level of provisioning may be expected to provide an additional level of capital or equivalent to minimize the adverse effects of not having a sufficient level of provisioning.
Appendix 1: Principles for the Management of Credit Risk

Basel Committee on Banking Supervision (September 2000)

(a) Establishing an Appropriate Credit Risk Environment

1. The board of directors should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the licensee. The strategy should reflect the licensee’s tolerance for risk and the level of profitability the licensee expects to achieve for incurring various credit risks.

2. Senior management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the licensee’s activities and at both the individual credit and portfolio levels.

3. Licensees should identify and manage credit risk inherent in all products and activities. Licensees should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls before being introduced or undertaken, and approved in advance by the board of directors or its appropriate committee.

(b) Enforcing Prudent Procedures for Approving Credits

4. Licensees must operate within sound, well-defined credit-granting criteria. These criteria should include a clear indication of the licensee’s target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment.

5. Licensees should establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

7. Licensees should have a clearly-established process in place for approving new credits as well as the amendments, renewal and re-financing of existing credits.

8. All extensions of credit must be made on an arm’s-length basis. In particular, credit to related companies and individuals must be authorised on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm’s length lending.

(c) Maintaining Effective Systems

9. Licensees should have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

10. Licensees must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.
11. Licensees are encouraged to develop and utilize an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of the licensee’s activities.

12. Licensees must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system should provide adequate information on the composition of the credit portfolio, including identification of and concentrations of risk.

13. Licensees must have in place a system for monitoring the overall composition and quality of the credit portfolio.

14. Licensees should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions.

(d) Ensuring Adequate Controls Over Credit Risk

15. Licensees must establish a system of independent, ongoing assessment of the institution’s credit risk management process and the results of such reviews should be communicated directly to the board of directors and senior management.

16. Licensees must ensure that the credit-granting function is being properly managed and that credit exposures are within levels consistent with prudential standards and internal limits. Licensees should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

17. Licensees must have system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

(e) The Role of Supervisors

18. Supervisors should require that banks have an effective system in place to identify, measure, monitor and control credit risk as part of an overall approach to risk management. Supervisors should conduct an independent evaluation of a bank’s strategies, policies, procedures and practices related to the granting of credit and the on-going management of the portfolio. Supervisors should consider setting prudential limits to restrict bank exposures to single borrowers or groups of connected counterparties.
Appendix 2 – Asset Classification Ratings System

- **Special Mention**, where a credit which is has potential weakness that deserve management’s close attention. If left uncorrected, these potential weaknesses may, at some future date, result in the deterioration of the repayment prospects for the credit or the institution’s credit positions. Special mention credits are not considered as part of the classified extensions of credit category and do not expose the licensee to sufficient risk to warrant classification;

- **Substandard**, where well identified and defined weakness are evident which could jeopardize repayment, particularly of interest. The bank will sustain some loss if the deficiencies are not corrected. The credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged or guarantee(s) given, if any.

- **Doubtful**, where the situation has deteriorated to such a degree that collection of the facility amount in full is improbable and the licensee expects to sustain a loss; and

- **Loss**, where facilities are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the credit has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future