**SUPERVISORY AND REGULATORY GUIDELINES**
**Management of Credit Risk**
**Issued: 22 December 2015**
**Amended: 30 June 2017**

# GUIDELINES FOR THE MANAGEMENT OF CREDIT RISK FOR CREDIT UNIONS

## 1. INTRODUCTION

1.1 The Central Bank of The Bahamas ("the Central Bank") is responsible for the registration, regulation and supervision of all credit unions operating in and from within The Bahamas, pursuant to the Bahamas Co-Operative Credit Unions Act 2015 ("the Credit Unions Act"), and the Central Bank of The Bahamas (Amendment) Act, 2015 ("the CBA"). 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 credit union services.

1.2 The Central Bank recognizes that credit unions are not-for-profit organizations, and in this respect are different from other deposit-taking financial institutions. The Central Bank is aware that credit unions work as a co-operative, valuing volunteerism, co-operation and member participation. Therefore, the Central Bank is committed to ensuring the unique characteristics of credit unions are maintained, while still fulfilling its obligations to protect the interests of credit union members.

1.3 All registrants are expected to adhere to the Central Bank's registration and prudential requirements, ongoing supervisory programmes and regulatory reporting requirements. Registrants are also subject to periodic on-site examinations. Credit Unions are expected to conduct their affairs in conformity with all other relevant Bahamian legal requirements.

## 2. PURPOSE

2.1 The effective management of credit risk as a component of a comprehensive risk management program is fundamental to the safety and soundness of all credit unions and is critical to their long-term viability. These guidelines specifically address the management of the credit risk present in the business activities of credit unions. It prescribes best practices that credit unions should adopt within their overall corporate governance process and risk management program to address credit risks.

2.2 The Central Bank endorses the principles and best practices of the World Council of Credit Unions (WOCCU). Credit Unions are encouraged to refer to these principles and best practices on the WOCCU's website at http://www.woccu.org.

## 3. APPLICABILITY

3.1 These Guidelines apply to all credit unions which are registered under the Credit Unions Act or deemed, by virtue of section 126(1) to be registered under this Act.

## 4. CREDIT RISK POLICY

4.1 Every credit union is required to establish and implement a prudent lending policy. The board should review the policy periodically (at least annually) to ensure its adequacy and relevance given the changing operating circumstances, economic cycle, activities and risk that the credit union may face. At a minimum, lending policies must address major lending criteria including:

4.1.1 Acceptable limits and repayment terms for each authorized type of loan;

4.1.2 Acceptable types of tangible security;

4.1.3 Lending values for each type of tangible security;

4.1.4 Loan evaluation and documentation;

4.1.5 Loan approval processes;

4.1.6 Monitoring, evaluating and reporting of outstanding loans, including delinquent and impaired loans;

4.1.7 Lender approval limits; and

4.1.8 Write-offs.

4.2 Every credit union should 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 credit union's overall strategic objective. The credit risk policy should specify inter-alia:

4.2.1 Types of facilities to be offered, along with ceilings, pricing, profitability, maximum maturities and maximum debt-servicing ratios of borrowers for each type of lending;

4.2.2 A ceiling for the total loan portfolio ratios (i.e., loan-to-deposit ratio, maximum dollar amount or a percentage of capital base);

4.2.3 Limits, terms and conditions, approval and review procedures and records kept for connected lending;

4.2.4 The minimum information required from loan applicants (bearing in mind Anti-Money Laundering and Know Your Customer best practice and legal requirements).

4.3 Every credit union shall develop, and the board of directors shall adopt a policy on loans to directors, committee members, officers, employees and their associates, and such policy shall be compliant with the Credit Unions Act and the Bahamas Co-Operative Credit Unions Regulations, 2015.

## 5. CREDIT COMMITTEE

5.1 Section 48 of the Credit Unions Act requires that each credit union have a Credit Committee whose members are appointed by the Board and or in accordance with its Bye-laws.

5.2 The Credit Committee shall perform such duties as are prescribed in the Credit Unions Act, the regulations and the bye-laws of the co-operative credit union. These duties include inter-alia:

5.2.1 Making decisions on applications for loans; and

5.2.2 Fixing to time the rate of interest to be charged on loans to members from time.

5.3 Section 78 of the Credit Unions Act imposes a statutory responsibility on the Credit Committee to maintain books and records for the necessary and prudent recording of its credit functions. The Central Bank shall have unlimited access to all records of the Credit Committee.

5.4 The board of directors must ensure that the Credit Committee complies with its statutory obligations.

## 6. RISK CONCENTRATION AND LOAN LIMITS

6.1 Credit risk concentration may arise from excessive exposures to individual counterparties, related counterparties (inclusive of consanguinity), and a group(s) of connected counterparties with similar characteristics (e.g. counterparties in specific geographical locations, economic or industry sectors). The Central Bank is concerned about credit risk concentration because if these exposures cannot be recovered, the financial condition of the credit union could be adversely affected.

6.2 Credit Unions should establish internal controls and systems, endorsed by the board of directors, to measure, monitor and control credit risk concentration and large exposures and other risk concentrations in accordance with these Guidelines. Safe guarding against credit risk concentrations should form an important component of a financial credit union's risk management system.

6.3 Subject to the Credit Unions Act, every loan granted by a credit union must be approved in accordance with the policies established by the board of directors before any funds are advanced.

6.4 In addition, the bye-laws of every credit union shall provide for limits on the amounts of loans to any one member or as to the type of loans which may be granted.

6.5 Section 70 of the Credit Unions Act requires that loans may be made only to members.

## 7. DELEGATED CREDIT AUTHORITY

7.1 Credit authority should be clearly delegated by the Board of Directors ("the Board") 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.

7.2 It is important to note that while the Board can delegate authority for certain credit functions, as set out above, it cannot delegate responsibility or accountability in relation to these functions.

## 8. LOAN APPROVAL

8.1 All loans should be approved in the manner prescribed under Sections 66 and 68 of the Credit Unions Act.

### Authorized Loan Types

8.2 Credit unions may only grant the following classes of loans:

- 8.2.1 Personal loans (maximum of 7 years)
- 8.2.2 Mortgage loans (maximum of 30 years)
- 8.2.3 Agricultural loans (maximum of 7 years)
- 8.2.4 Small and Micro Enterprise loans (maximum of 7 years)

### Lending Values of Security

8.3 The credit union's credit policy must address the maximum lending values for each type of loan.

8.4 Subject to any restrictions that may be prescribed in its bye-laws, a credit union may take any security for loans that it considers advisable in keeping with sound business practices. The level of security required in respect of a loan application should reflect the size and risk profile of the proposed loan.

8.5 Approved types of security and circumstances in which the security should be taken, should be clearly set out in the credit policy.

## 9. IMPAIRED LOANS

9.1 The calculation and circumstances under which impaired loans should be measured and/or assessed by credit unions is established in Regulations (7) thru (12) of the Bahamas Co-Operative Credit Unions Regulations, 2015 (“the Regulations”).

9.2 An impaired loan as defined in the Regulations, refers to a loan in respect of which, it is probable that a co-operative credit union will be unable to collect, on time, the full amount of principal or interest due according to the contractual terms of the loan agreement. An asset is impaired if the estimated recoverable amount of an asset is less than its carrying amount shown in the books of the credit union.

9.3 Interest income on impaired loans should be treated in accordance with Regulation 4 of these Regulations.

## 10. PAST DUE LOANS

10.1 Loans that are not paid as agreed are considered delinquent the day after the first missed payment. Immediate action should be taken to control delinquency and collect when a loan is reported past due.

10.2 A loan is considered ‘past due’ when the contracted payment (principal and interest) has not been met when due or it is otherwise outside contracted arrangements. To measure the total percentage of delinquency in the loan portfolio of the credit union, the criterion is as follows:

a. Sum of all delinquent loan balances
b. Total (Gross) Loan Portfolio Outstanding

**Criteria:** $\frac{a}{b} = < 5\%$

10.3 Loans past due more than 30 days, should comprise less than 5% of the total loan portfolio. When a loan becomes delinquent, the credit union should not grant new loans to pay off the outstanding capital and interest for the same borrower.

## 11. PROVISIONING FOR DOUBTFUL LOANS

11.1 Every co-operative credit union shall determine and disclose the monthly provision for doubtful loans as prescribed under Regulation 7 of the Regulations.

11.2 Income recognition in the case of write-offs and recoveries of impaired loans should be maintained in accordance with Regulation 11 of the Regulations.

11.3 The Central Bank will require that credit unions retain on file sufficient documentation of their data and management's judgment on the credit union's provisioning methodology, and the board of directors' support for their estimates of impairment.

## 12. ADEQUATE CONTROLS OVER CREDIT RISK

12.1 The Credit Unions Act grants general direction and control of the affairs of the credit union, including the proper and profitable conduct of credit union operations, the safety of credit union assets, and the accuracy and adequacy of the annual reports to the board of directors. The Board retains overall responsibility for the affairs of the credit union. As part of that responsibility, the board should establish internal controls, which include among other things, organizational plans, policies, and operating procedures to maintain control over the duties delegated to paid employees.

## 13. INVESTMENTS

13.1 Given the inherent risk that certain investments present, credit unions are required to seek the prior approval of the Central Bank for all financial investments with exception of securities issued or guaranteed by Government as prescribed under Section 61 of the Credit Unions Act. Credit Unions are also prohibited from investing in non-financial assets.

## 14. ACCOUNTABILITY

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

## 15. SEGREGATION OF DUTIES

15.1 Credit unions should aim to keep the following functions as separate as possible:

15.1.1 Credit initiation;

15.1.2 Approval;

15.1.3 Review and Administration; and

15.1.4 Payments and Work-out.

15.2 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 available to various levels of management on a timely basis.

## 16. RISK MITIGATION

16.1 In controlling credit risk, credit unions can utilize certain mitigation techniques. Generally, these may include:

16.1.1 Accepting collateral;

16.1.2 Entering into netting arrangements;

16.1.3 Setting strict loan covenants; and

16.1.4 Prudential underwriting practices.

16.2 When the mitigation arrangements are in place they should be controlled. Therefore, credit unions 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.

16.3 Credit unions should revalue their collateral and mitigation instruments on a regular basis.

## 17. INDEPENDENT AUDITS

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

17.2 Credit audits should be conducted to assess individual credits on a sampling basis and the overall quality of the credit portfolio. Such audits are considered useful for evaluating the effectiveness of the credit process.

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

## 18. REPORTING REQUIREMENTS

18.1 In accordance with Section 71 of the Credit Unions Act, where a co-operative credit union is reporting loans on the balance sheet in its annual financial statements, it shall report the loans at their net estimated value after deducting an allowance for doubtful loans, or in any other format as may be prescribed by the Central Bank.

18.2 In addition, the submission of the Excel Reporting System (ERS) is a requirement of all credit unions, and must be completed on a monthly basis, for large credit unions.

# Appendix A
## *Definitions*

**Associate** means:

(a) a person who is related by consanguinity to a director committee member, officer or employee of a credit union; or

(b) a partnership, company, trust or other entity in which a person who is related by consanguinity to a director, committee member, officer or employee of a credit union, has a controlling interest.

**Consanguinity** means a relationship by descent and for the purposes of this Guideline; the degrees of consanguinity are as follows:

(i) a relationship within the first degree by consanguinity means a spouse, child or parent;

(ii) a relationship within the second degree by consanguinity means a sibling, half-brother, half-sister, grandchild or grandparent.

**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 registrant.

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

**Doubtful loan** means a loan which is impaired, the repayment of which is in doubt.

**Fully secured loan** is a loan which is fully secured by cash, charges on real property such as land and buildings, or security interest in personal property such as an automobile or securities where the fair value of the security or estimated net realizable amount is sufficient to discharge the outstanding principal and interest in full.

**Impaired loan/asset** means a loan/asset in respect of which it is probable that a co-operative credit union will be unable to collect, on time, the full amount of principal or interest due according to the contractual terms of the loan agreement.

**END**