



For Industry Consultation
Guidelines to the Prudential Regulations: 2002-__
Large Exposures Guidelines
9th August, 2002

GUIDELINES FOR THE MANAGEMENT OF LARGE EXPOSURES

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 onsite inspections, and required regulatory reporting. Licensees are also expected to conduct their affairs in conformity with all other Bahamian legal requirements.

II. PURPOSE

These Guidelines outline the minimum standards and requirements that licensees are expected to follow in relation to controls on large exposures and risk concentrations. These guidelines support The Banks and Trust Companies (Large Exposures)(No.1) Regulations, 2002. Additionally, the Central Bank endorses the Basel Committee’s document, “*Measuring and Controlling Large Exposures*” (January 1991).

III. APPLICABILITY

These Guidelines apply to all banks and bank and trust companies incorporated in The Bahamas. The Central Bank accepts that in the supervision of branches of foreign banks, account should be taken of the global large exposure management policies of the head office and the extent to which large exposures are supervised by the home supervisory authority. A separate guideline will be produced for the monitoring of large exposures by branches of foreign banks.

IV. REQUIREMENTS

1. Single Exposure Limit

A licensee may not incur an exposure to an individual counterparty or group of connected counterparties, which is equal to or which exceeds 25 percent of its capital base. A licensee may not hold investments in securities of an issuer which are equal to or which exceed 10 percent of the licensee's capital base.

2. Limit on Exposures to Related Parties

A licensee may not incur an exposure on an individual basis or incur exposures on an aggregate basis to its related parties of greater than 15 percent of its capital base. All exposures to related parties must be:

- a) fully collateralised throughout their tenure;
- b) negotiated on an arm's length basis for the clear commercial advantage of the licensee at market rates and without concessive terms;
- c) be specifically approved by the board of the directors of the licensee.

The Central Bank will closely monitor all exposures to related parties and deduct them from the capital base of the licensee if they are, in the opinion of the Central Bank, of the nature of a capital investment or made on particularly concessory terms.

3. Aggregate Limit on Large Exposures

A licensee may not incur large exposures (i.e. exposures which are equal to or which exceed 10 percent of capital base) which in aggregate exceed 800 percent of capital base.

4. Exemptions

Licensees shall at all times comply with the above limits. There are limited circumstances where a licensee may be allowed to incur an exposure to a counterparty which exceeds 25 percent of its capital base. These permitted exposures would include "exempt" exposures outlined below. However, these exposures must be notified to the Central Bank before the licensee becomes committed to the exposure. These "exempt" exposures fall into the following categories and are subject to the Large Exposures Policy Statement that the licensee submits to the Central Bank.

Exempt Exposures

- (a) Exposures to the Government of The Bahamas and non-commercial Bahamian governmental institutions.

- (b) Exposures to Bahamian and Zone A Central Governments with a Moody's rating above Baa2 for foreign currency debt;
- (c) Exposures to the Central Bank of The Bahamas and Zone A Central Banks;
- (d) Exposures secured by Bahamian and Zone A Central Government securities/guarantees above Baa2 for foreign currency debt;
- (e) Certain exposures which have been pre-notified to and approved by the Central Bank which are covered by a guarantee or acceptable letter of comfort from a bank acceptable to the Central Bank of The Bahamas.
- (f) Underwriting exposures which have been pre-notified to and approved by the Central Bank which do not exceed 90 days duration. Any residual holdings of securities, which are held for more than 90 days, are no longer "exempt" and are subject to the limits outlined in paragraphs one to three above.
- (g) Short-term (i.e. up to six months original maturity) interbank placements, which have been pre-notified to and approved by the Central Bank of The Bahamas. Unapproved exposures or longer-term exposures or holdings of securities issued by banks are not eligible for exemption and are subject to the limits outlined in sections 1 through 3 above.
- (h) Off-balance sheet exposures to banks acceptable to the Central Bank which have been pre-notified to and approved by the Central Bank.

5. Reporting of Large Exposures

Licensees must report (to the Inspector of Banks & Trust Companies) all large exposures (whether exempt or not) on a quarterly basis in the manner prescribed by the Central Bank. Licensees are required to adopt internal policies and internal limits which will ensure compliance with the exposure limits in paragraphs one to three above. For some licensees, the Central Bank may determine it prudent to set lower exposure limits than the limits set out in paragraphs one to three above by way of prudential norms. Should any licensee find that, for reasons outside its control or otherwise, it has an exposure which results in it exceeding any of the limits set out above, it should immediately report the exposure to the Central Bank and immediate action should be taken to bring the exposure back within applicable limits as soon as possible.

6. Policy Statements

Each licensee must set out its policy on large exposures, including limits for differing types of exposures to individual counterparties, countries and market sectors in a policy statement, which must be approved by its board of directors. Licensees must review their existing large exposures policy statements on an annual basis (commencing January 2003). Licensees must not implement significant changes to these policies without prior

notification to the Central Bank of The Bahamas. The policy document should identify the licensee's "related parties" and its policies towards lending to and investing in these parties.

The Central Bank will not apply common maximum percentages for licensees' sectoral or market/country exposures but will monitor such exposures on an individual and general basis. Licensees must specify how they define economic and market sectors. The board of directors should review exposures and limits for sectors at least quarterly.

As a minimum, licensees' policy statements on large exposures should cover the following:-

- (a) A general statement of the board's adoption of the Central Bank's Large Exposure Regulations and Guidelines including the definitions of an "exposure" contained therein.
- (b) The maximum individual exposure considered acceptable to counterparties categorized as follows:
 - (i) Banks (and banks and trust companies), Zone A and other;
 - (ii) Non bank counterparties (individuals and corporates);
 - (iii) Governments (Zone A and other);
 - (iv) Economic Sectors; and
 - (v) Country/Geographical limits.
- (c) The maximum number of large exposures (i.e. equal to or greater than 10% of capital base) considered acceptable to the board.
- (d) The internal procedures/policies by which counterparty limits are determined and reviewed (including various levels or authority).
- (e) Details of the procedures by which exposures are measured, monitored and controlled (in relation to limits).
- (f) The circumstances in which limits may be exceeded, and the authorization process for limit excesses.
- (g) The policy on related party exposures and intra-group lending. The board should, as part of this exercise, identify the licensee's related parties and its procedures and limits for exposures to related parties.
- (h) Any differentiation in policies between secured and unsecured exposures, together with descriptions of permissible forms of security.

- (i) The allocation of responsibility for large exposures reporting and pre-notification to the Central Bank.

The Central Bank is aware that some licensees operate within policies and limits set by their parent bank. Licensees should describe where this is the case.

7. The Measure of “Exposure”

For large exposures reporting purposes, the measure of exposure should reflect the maximum loss that will arise should a counterparty fail. The measure of “exposure” should include the amount at risk arising from a licensee’s:

- i) Claims on a counterparty including actual claims and potential claims which would arise from the drawing down in full of undrawn advised facilities (whether revocable, irrevocable, conditional or unconditional), which the licensee has committed itself to provide and claims which the licensee has committed itself to purchase or underwrite. In the case of undrawn advised overdraft facilities, the advised limit must be reported after deduction of any provisions. In the case of loans, the net outstanding balance as shown in the books of the licensee should be reported after deduction of any provisions.
- ii) Contingent liabilities arising in the normal course of business and liabilities that would arise from the drawing down of undrawn advised facilities. In the case of undrawn trade finance or similar facilities, the advised limit should be reported.
- iii) Holdings of equity capital, bonds, bills or other financial instruments. In the case of financial instruments, the current fair value (as shown in the books of the licensee) should be reported.
- iv) Any other assets that constitute a claim on a counterparty by the licensee and which are not included in i), ii) or iii) above.

As a general rule, exposures should be reported on a gross basis (i.e. no offsets). However, debit balances on accounts for a counterparty may be offset against credit balances on other accounts with the licensee if:

- i) a legally enforceable right of set off exists in all cases (as confirmed by a legal opinion addressed to the licensee);
- ii) the debit and credit balances relate to the same counterparty or group of connected counterparties;
- iii) the licensee intends to settle on a net basis or to realize the debit balances and settle the credit balances simultaneously. For a group facility a full

cross guarantee structure must also exist before debit balances on accounts may be offset.

8. Calculations of Large Exposures

Large exposures are calculated using the sum of nominal amounts before the application of any risk weighting and credit conversion factors for on-balance sheet claims and off-balance sheet instruments (e.g. trade finance). For derivative contracts only, the amount at risk is taken to be the credit equivalent amount (as defined in the BSD I and II instructions).

A licensee's exposure arising from its securities trading operations is calculated as its "net long position" in a particular security. A short position in one security issue may not be offset against a long position in another issue made by the same party. A licensee's "net long position" in a security refers to its commitment(s) to buy the security plus its current holdings of the security less any commitments to sell the same security.

9. Identity of Counterparty

For the purpose of measuring exposures, a counterparty is generally the borrower (customer), the person guaranteed, the issuer of a security in the case of an investment in a security, or the party with whom the contract is made in the case of a derivative contract. Where a third party has guaranteed an exposure (the guarantee must be explicit, unconditional, irrevocable and direct) and subject to the licensee's large exposures policy statement not stating otherwise, the guaranteed licensee may elect to report the exposure as being to the guarantor rather than the counterparty.