Turks & Caicos Island Financial Services Commission
Guidelines Pursuant to Section 43 of the Financial Services Commission Ordinance 2007
Guideline for Credit Risk Management

1. Introduction

This Guideline is issued by the Turks & Caicos Islands Financial Services Commission (FSC) pursuant to Section 43 of the Financial Services Commission Ordinance 16.01 (2007) and in furtherance of its responsibility to regulate and supervise licensees under the Financial Services Commission Ordinance 16.01 (2007).

Credit risk is the potential adverse impact to earnings or capital arising from a borrower or counterparty failure to meet the terms of any contract or to perform as agreed. Loans are the largest and most obvious source of credit risk; however credit risk also stems from other financial instruments, both on and off balance sheet, such as interbank balances, bonds, equity, letters of credit and guarantees. The objective of credit risk management is to maximize the risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Credit risk management should be viewed as a component of a financial institution's comprehensive management strategy; thus licensees should address the interdependencies between credit risk and other types of risks (such as liquidity, market and operational).

The objective of this guideline is to promote the use of sound credit risk management by licensees. It represents the FSC's minimum requirements for credit risk management and should not be viewed as all encompassing. The FSC endorses and recommends the Basel Committee's "Principles for the Management of Credit Risk" (September 2000).

2. Application

This Guideline applies to licensees that engage in business activities which give rise to credit risk. However, given their heterogeneous structure and the diversity of credit business, it is recognized that the concepts and methods presented here may not have the same relevance to all credit institutions. Licensees are therefore advised to determine which of the concepts and methods are relevant for their respective business activities. In the case of low-risk transaction types, the Guideline may be implemented in a simplified manner appropriate for the nature, scope, complexity and level of risk.

3. Components of Credit Risk Management

A sound credit risk management system should include:

- An effective governance framework;
- Robust credit granting processes;
- Appropriate credit administration; and
- Adequate system and procedures to measure, monitor and control credit risk.

4. Governance Framework

An effective governance framework for credit risk management, should involve at a minimum the following:

4.1 Board of Directors' Oversight

The Board of Directors (Board) is generally responsible for approving an appropriate credit risk strategy and providing oversight of the credit risk management function. Depending on the institution's size, the Board may establish a credit committee, consisting of a cross section of members of the Board and senior management, to review credit related matters in greater depth. The Committee should be issued with documented terms of reference and report to the Board. The Board's responsibilities include the following:

a. Approving an appropriate credit risk strategy. The credit risk strategy is a forward-looking, written definition of risk parameters to be achieved by the credit institution. In formulating the strategy, the Board/Committee should consider the economic situation, the target market, desired portfolio mix, staff capacity, technical and organisational facilities;
b. Reviewing the risk strategy periodically (at least annually) to ensure its adequacy with the level of capital available, credit risk management expertise, relevance with changing economic conditions and the licensee's capability;
c. Ensuring that qualified and competent management is appointed to administer the credit risk management function;
d. Approving documented policies and procedures for the prudent management of credit risk;
e. Reviewing at least annually, credit policies, procedures, controls and information systems to ensure continued adequacy, relevance and effectiveness;
f. Deciding delegation of credit approving powers;
g. Ensuring through an independent credit review function adherence to policies, controls, and procedures;
h. Approving all large credit exposures as defined by FSC's guidelines, in relation to the institution's capital base;
i. Approving credits to, or guaranteed by related parties, and reviewing the licensee's policy related to such credits;
j. Reviewing periodic reports that are timely and contain detailed information to allow for a clear understanding of the licensee's overall credit risk exposure and performance of the credit portfolio, including information on concentration, classification of credits, the level of provisioning, delinquent and impaired assets and management's actions taken or contemplated for recovery;

k. Approving proposals for new types of business transactions, whether this be new products, new types of transaction or entry into new markets prior to implementation; and
l. Reviewing credits granted in conflict with credit policies, and approving action to ensure attainment and maintenance of compliance.

4.2 Senior Management

The senior management is responsible for implementing the credit risk strategy approved by the Board. Senior management responsibilities include the following:

a. Developing and establishing credit policies and procedures as part of the overall credit risk management system for Board approval;
b. Disseminating the strategy, policy and procedures to all relevant staff employed in the credit function and personnel accountable for compliance with established policies and procedures;
c. Establishing and implementing adequate control functions such as limit setting, exposure and exception monitoring, reporting, custody and documentation over the credit risk function;
d. Monitoring the quality of the credit portfolio and ensuring that the portfolio is soundly and conservatively valued, uncollectible credits written off and probably losses adequately provided for;
e. Ensuring the implementation of an effective and independent credit review function to review and assess credit risk management activities;
f. Developing and implementing internal risk rating and management information systems that allows the financial institution to manage its credit risk;
g. Developing a written analysis of any new types of business transactions, be it new products, types of transactions or entry into new market for the Board's approval. This analysis shall include: an assessment of the risk level of the new type of business transactions, the effects on the processing of lending and loan processing, on risk management and risk control as well as on the risk strategy; and
h. Reporting to the Board on credit granted in conflict with policies and suggesting actions to ensure attainment and maintenance of compliance.

4.3 Credit Policy and Procedures

The credit policy[1] and procedures[2] establishes the framework under which the financial institution will conduct credit business. The credit policy and procedures should be written clearly and comprehensively, communicated to those involved in the credit function and reviewed periodically (at least annually) to ensure that it remains effective and flexible, and continues to meet the organization's objectives. Taking into account, the nature, complexity and risk level of the credit business, the credit policy and procedures should include:

a. A description of the credit risk strategy and philosophy of the financial institution;
b. Roles of the Board, senior management and units/staff involved in the management of credit;
c. Frequency, form and content of Board reporting;

[1] Policy represents plans, guiding principles, or course of actions designed to establish a framework for handling decisions relating to the credit function.
[2] Procedure is a set of established methods or steps for performing a task.

d. Specific reference to statutory provisions of the law in relation to credit and incorporates credit directives and guidelines issued by the FSC;
e. Appropriate segregation of duties within the credit risk management environment;
f. Credit approval authority at various hierarchy levels including authority for approval of exceptions;
g. The objectives and elements of the credit review function;
h. Limits or prohibitions on credit exposures including concentration;
i. Conditions for renewal, renegotiation and refinance of credits;
j. Policy on connected, related party and staff loans;
k. Evaluation criteria for assessing the credit worthiness of potential borrowers;
l. Types of credit to be extended, pricing and maturity guidelines and maximum debt service ratios for each type of credit facility;
m. Specify the type and range of financial information and evaluation required to assess various types of potential borrowers;
n. Types of collateral considered acceptable for securing a credit, loan-to-value ratios and criteria for accepting guarantees;
o. Credit documentation requirements, disbursement process and credit administration procedures;
p. Provide for the establishment and implementation of an internal credit risk rating system;
q. Provide for the establishment and implementation of information systems to record, retain and report accurate credit-related data/information;
r. The entity's provisioning methodology and guidelines for non-accrual and write-off; and
s. Procedural guidelines relating to the monitoring of the credit portfolio and management of problem credit.

4.4 Adequate Structures and Controls

Structures and controls for the credit risk function include:

a. Functional separation;
b. Delegation of Authority;
c. Risk mitigation techniques;
d. Independent review of the credit function; and
e. Prudential limits and standards;
    I. Large exposures and risk concentration
    II. Renegotiated credit
    III. Related party and staff loan

4.4.1 Functional Separation

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

4.4.2 Delegation of Authority

Licensees are required where applicable to delegate authority for credit approval. The Board is responsible for approving the overall lending authority structure and explicitly delegating credit approval authority to the credit committee and senior management. Lending authority assigned to officers should be commensurate with experience, ability and past adherence to the licensee's credit policy. Licensees should also develop risk based authorization structures where lending authority is linked to the risk rating of the obligor. Large financial institutions may develop multiple credit approvals as an enhanced system of check and balance.

4.4.3 Risk Mitigation

In controlling credit risk, licensees can utilise certain mitigation techniques including:

a. Accepting collateral, standby letters of credit and guarantees;
b. Maintaining compensating balances;
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 credits, credit derivatives and compensating balances are often employed after the credit is in place, or used to manage the overall portfolio risk.

When mitigation arrangements are in place they should be controlled. Licensees should have written policies, procedures and controls for the use of credit mitigation techniques.

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

4.4.4 Independent Credit Review Function

Licensees should establish an independent credit review function as a process for detecting weaknesses in credit risk management and applying corrective measures. The credit review function of licensees is expected to differ based on their size, complexity, and management practices. The credit review function of licensees should address the following:

a. Qualification of credit review personnel. The credit review function should be staffed with skilled credit review personnel who are experienced in credit analysis and knowledgeable of sound lending operations;
b. Independence of credit review from the credit granting process. The nature of independence usually differs based on the size of licensees. Larger institutions typically establish a separate department/unit of credit review specialists however for smaller institutions, the responsibility for credit review may be assigned to Board members and management not directly involved in the lending function, internal audit or external consultants;
c. Frequency of credit review. Credit review should be performed at least annually however the frequency of reviews should depend on factors such as internal risk ratings, volatility of the operating environment and other market conditions;
d. Coverage of credit review. The credit portfolio review should cover at least 70% of the total amount of outstanding loans and advances. The review should cover all exposures significant to the licensee, past due, non-accruals, renewed and restructured loans; loans watch listed and or

designated a poor credit rating, insider loans, concentration of credits and a sample of smaller credits;

e. Scope of credit review. At a minimum, the credit review should assess credit quality, sufficiency of credit and collateral documentation, completeness and perfection of security, credit approval process, compliance with internal credit risk grading, appropriateness of pricing, adherence to loan agreements and covenants, compliance with laws, regulations, guidelines, internal policies and procedures and the appropriateness and timeliness of credit monitoring and particularly problem-credit identification and resolution;
f. Use of findings and follow-up actions. Findings should be reviewed with appropriate credit officers, department managers and senior management. Management's responses to all noted deficiencies and identified weaknesses should include existing or planned corrective actions and timeframes for correction. In subsequent review, the credit review function should follow up on whether the proposed corrective measures were implemented by management; and
g. Work papers and Reporting. Work papers for the credit review should be maintained and filed for future use whether by the licensee or external agents such as Auditors and Regulators. The credit review function should report directly to the Board or its designated committee.

4.4.5 Prudential Limits and Standards

Licensees should establish prudential controls and standards in relation to areas such as large exposures, credit renewals and related party lending. These should take into consideration any statutory requirements and prudential guidelines issued by the FSC. Examples of prudential controls and standards in relation to credit risk are as follows:

I. Large Exposure and Risk Concentration

An important element of credit risk management is to establish standards and limits to control exposures and other risk concentrations. Licensees are expected to develop their own standards and limits while adhering to the "Principles for Controlling Large Credit Exposures" issued by the FSC. Limits may be set for a single obligor, connected group of obligors, a specific industry, economic sector or geographical regions to avoid concentration risk.

II. Renegotiated Credit

Renegotiated loans and advances are credits which have been refinanced, rescheduled, rolled over or otherwise modified because of weaknesses in the borrower's financial position and or non-repayment of the debt as arranged. Licensees should address the conditions for renegotiating a credit facility which must be in accordance with the conditions for renegotiating credit stipulated by the FSC in the "Loan Classification and Provisioning Guidelines". Credit should only be renegotiated if:

a. The existing financial position of the borrower can service the debt under new conditions;
b. Loans classified as doubtful or loss receive an up-front cash payment or if there is an improvement in the security taken; and
c. The security for renegotiated loans, inclusive of capitalised interest, covers the full amount of the renegotiated loan.

Credits should not:

a. Be renegotiated more than twice over the life of the original loan (commercial loans) or more than twice in a five-year period (mortgage and personal loans); and
b. b. Be classified upward for a minimum of 1 year following renegotiation.

III. Related Party and Staff Loan

The legislation sets limits on unsecured lending to related party, directors and staff. In addition, licensees should ensure that all extensions of credit to related party and staff must be made on an arm's-length basis. In particular, credit to related party and staff 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.

5. Credit Granting Process

The credit granting process encompasses all steps up to provision of the credit facility. It involves gathering information on the applicant, evaluation of the credit proposal, approval and disbursement of funds. Licensees should have written policies and procedures on the credit granting process: ensuring that sufficient information is gathered, both financial and collateral, for evaluating loan applications. In addition, approval and disbursement should be made in accordance with written guidelines and any exception must reflect the appropriate level of approval and should be documented in writing.

Policies should provide for the following elements of a properly functioning credit granting process:

a. Credit decisions are made and approved by appropriate staff, with the appropriate authorization and accountability;
b. Credit follow a pre-established credit granting flow, which sets out the proper movement of credit applications within the financial institution;
c. Credit information and credit evaluation/analysis are properly documented on standardized forms;
d. Credit applications are evaluated against established credit criteria;
e. Credit funds are disbursed through proper channels, with proper safeguards against theft or fraud; and
f. Credit renewals are subject to the same criteria and credit evaluation process as when first approved making allowance for the borrower's history and perceived risk.

5.1 Credit Information

It is prudent for licensees to establish a policy outlining the minimum required credit information necessary for processing credit; this may be delineated by credit type. Credit application forms should be sufficiently detailed to permit gathering all relevant information required for credit evaluation. Licensees should have a checklist to ensure that all required information is collected.

5.2 Credit Evaluation

The credit policy should document key evaluation criteria; setting general requirements to evaluate a borrower's character, cash flow, capital and collateral/security and conditions.

The evaluation criteria will of necessity vary between corporate and personal credit applicants. Corporate credit applicants should be required to provide up to date audited financial statements, and management accounts where necessary, in support of their applications. At a minimum, the evaluation criteria for corporate credit should focus on

a. Amount requested and purpose for credit;
b. Sources of repayment;
c. Applicant's integrity as well as legal capacity to assume credit obligation;
d. Risk profile of the applicant and the sensitivity of the applicable industry sector to economic fluctuations;
e. Performance of the applicant in any credit previously granted by the financial institution and other institutions;
f. The applicant's capacity to repay based on the business plan and projected cash flows;
g. Cumulative exposure of the applicant to different institutions;
h. Physical inspection of the applicant's business premises as well as the asset that is the subject of the proposed financing;
i. Applicant's business expertise and managerial capacity;
j. Adequacy, marketability and enforceability of collateral or guarantees, taking into account the existence of any previous charges of other institutions on the collateral;
k. Current and forecast operating environment of the borrower; and
l. Background information on shareholders, directors and beneficial owners.

5.3 Collateral Evaluation

Collateral should not be substituted for a licensee's evaluation of a borrower's credit worthiness. It is meant to serve as a credit risk mitigation technique; to ensure that the licensee's interest is protected in the event of a borrower's default, to act as a secondary source of repayment. Licensees should ensure that assets accepted as collateral satisfy, at minimum, the following criteria:

a. Is secured by a legal claim which is enforceable and without impediment;
b. The market value of the asset can be reasonably established and verified;
c. There exists a secondary market for disposing of the asset;
d. The useful or economic life of the asset is longer than the maturity of the facility for which it is used as collateral; and
e. Control over the asset can be secured if necessary.

The credit policy should establish the types of collateral required for various types of loans and advances and appropriate advance rates (collateral value/loan balance) for different types of collateral. When establishing advance rates, management should take into consideration factors such as the liquidity and marketability of the collateral. The legislation prohibits the granting of any advance by a licensee against the security of its own shares. Examples of acceptable collateral are referenced in Appendix 1.

The collateral value should be determined at the time the loan or advance is placed on the books and should be regularly revaluated. The appropriate frequency of revaluation depends on the nature of the collateral and current market conditions. The FSC reserves the right to prescribe how often collateral should be revaluated.

Licensees should not regard unsupported guarantees as collateral and the portion of the facilities covered by them should be regarded as unsecured. Exceptions to this rule are guarantees issued by the TCI

Government in support of any financial exposure to the TCI Government or to a statutory corporation. Licensees should ensure guarantees: represent a direct claim on the guarantor, are unconditional and irrevocable; are properly documented and legally enforceable; remain continuously effective until the facility covered by the guarantee is fully repaid or settled; and are based on a thorough assessment of the financial strength of the guarantor to adequately discharge the obligation under the guarantee.

Board approved policies should document the maximum amount of unsecured credit allowed. Generally, unsecured credit should only be considered for short-term loans and for applicants with the highest credit rating who have a previous and satisfactory credit history at the financial institution.

5.4 Credit Documentation

Prior to the approval and disbursement of funds, all credit documentation should be completed, received and reviewed. Incomplete, unenforceable or inaccurate documentation has been a major source of historical loss for financial institutions.

The credit policy should establish what information should be required prior to approval and disbursement and what information the borrower will be required to submit while the credit remains outstanding. Part of the underwriting process, may include loan covenants in the loan agreements, requiring businesses to submit periodic financial statements and provide other needed information. The credit file is the central instrument of documentation. It should include all documents and decisions relevant for credit approval so that it is possible to review the credit approval at any time and to monitor and evaluate the credit during its life. The credit policy should require that credit documentation include inter alia:

a. Borrower identification, occupation and other Know your customer and anti-money laundering statutory requirements;
b. The borrower's past and current financial condition;
c. The purposes of all credit granted to the borrower, the sources of repayment, and the repayment programs;
d. Identification of the collateral, its value and the source of its valuation; and
e. Evidence of follow up of any problem situations.

Credit files should include all financial statements, credit reports, collateral-inspection documents, reference letters, past loan applications, memoranda, correspondence and appraisals.

Ideally, it is recommended that collateral documentation such as appraisals be maintained in a separate file. Both collateral and credit files should be stored in a fire-proof environment. Negotiable security should be subject to dual control. All files should be culled on a regular and periodic basis by the appropriate credit officer to ensure their continuing validity.

It is recommended that in each credit file, a credit checklist be included, summarizing the various steps that have been taken to properly establish a new credit. The credit checklist should be completed by the credit officer responsible for the loan or by a designated credit committee member, where applicable. It should be reviewed and initialled by the credit manager or his designate to ensure the credit and collateral files are in order prior to those files being stored.

5.5 Disbursements Process

Every licensee should establish a standardized credit processing flow and document this process in operational procedures in order to ensure that the prerequisites for disbursements are met. The credit processing flow is particularly to check whether the specified decision-making hierarchy has been adhered to and whether the requirements and/or conditions set forth in the credit agreement were met prior to disbursement. Licensees should ensure that the following minimum elements are included in the credit processing flow:

a. The credit approval and disbursement functions should be performed by two separate individuals; and
b. The accounting and disbursement functions should be performed by two independent individuals.

Licensees should closely monitor the loan disbursement function. Individuals who have lending authority must not be assigned unilateral disbursement authority due to the conflict of interest this situation may create. It is generally recommended that an independent employee acts as funds disbursement officer, empowered to release funds upon evidence of at least two other authorizing signatures. The disbursement of funds should not be authorized until all required security is in place.

6. Credit Administration

Administration of the credit portfolio is an essential part of the credit process. Once a credit is approved, it is the responsibility of those with responsibility for credit administration to ensure that the credit is properly maintained. A financial institution's credit administration should at a minimum ensure the following:

a. Credit agreements are prepared and credit facilities disbursed only after all contractual terms and obligations have been met and all required documentation received;
b. Collateral documents are duly executed (perfected) and in fire proof safe under dual control;
c. Credit files are neatly organized and up to date and contain sufficient information necessary to assess the financial health of the borrower and repayment performance;
d. Credit related information such as current financial information are obtained and current;
e. The terms and conditions (interest rate, maturity, payment amount) of credits are accurate;
f. Funds disbursed under the credit agreement are allocated for the purpose for which they were granted;
g. Credit facilities are reviewed, at least annually, to ensure that the terms and conditions continue to be met;
h. Regular contact with the borrowers/counterparties and proper monitoring of credit facilities;
i. Credit ratings are assigned to individual credits in accordance with the internally developed rating system and ratings are consistent across the loan portfolio;
j. Management is provided with timely information to allow for adequate assessment of the quality of the credit portfolio;
k. Management policies and procedures, applicable laws and regulations are complied with; and
l. Collateral valuations are up to date.

7. Measurement and Monitoring of Credit Risk

Licensees should have in place adequate internal risk rating classification and management information systems for measuring and monitoring credit risk.

7.1 Internal Risk Rating Classification System

Licensees are required to develop and implement a meaningful risk rating classification system for initial and on-going assessment of credit risk and particularly for assignment of borrowers to various classifications taking into account gradations in risks. The rating system should be consistent with the nature, size and complexity of the licensee's activities.

The FSC does not wish to standardize its credit risk rating system however risk rating systems developed by licensees should be capable of being reconciled to the five-grade classification system employed for regulatory reporting as set out in the Classification and Provisioning Guidelines. Licensees must ensure that internal risk grades can be mapped to the 5 grade classification under FSC Regulations. Additionally, the system should allow licensees to track the migration of individual credits in loan portfolios, facilitate the early identification of deteriorating credits, and thus allow for implementation of corrective actions to minimise potential credit losses. Licensees should ensure that assigned risk grades cover both on and off balance sheet credit exposures of customers.

The initial ratings assigned to borrowers or counterparties must be reviewed on a periodic basis and new ratings assigned when conditions either improve or deteriorate. The responsibility for confirming credit risk ratings should be independent of the credit origination function and may reside with the credit review function. In addition, the consistency and accuracy of the overall credit risk rating system should be examined periodically by the credit review function.

Licensees should utilize the internal risk rating system as an important tool in monitoring and controlling credit risk. For instance, credits with deteriorating ratings should be subject to additional oversight and monitoring, through more frequent visits from the credit officer and inclusion on a watch list that is regularly reviewed by senior management.

For deteriorating ratings, particularly credits for which a loss event has occurred and is recognized; loan loss provisioning must be established. The Classification and Provisioning Guidelines details FSC's provisioning policy however it is recognized that a variety of methodologies may be appropriate for determining a licensee's specific and general provisions. Where the provisioning methodology differs to that of the FSC, licensees are required to justify the basis of estimated losses and to demonstrate that their policy is in line with industry best practice. In addition, where a licensee's provisions are below those based on the FSC's Classification and Provisioning Guidelines, the licensee is required to account for the residual balance which would ensure regulatory compliance, through an additional reserve account. Licensees should also prepare a report which reconciles provisions based on the methodology employed with that based on FSC Guidelines for submission to the FSC upon request.

7.2 Management Information System

Whether computerized or manual, the management information system is an important tool for monitoring and controlling credit risk. The management information system of licensees must readily, accurately and routinely provide the following types of information:

a. The evolving performance of a credit, regularity of payments, borrower's financial condition, type and value of the security, and other attributes of the credit;
b. Total loans and commitments, both on and off balance sheet;
c. Classification of credit portfolio based on internal credit ratings;

d. Manipulation of the credit portfolio by characteristics such as groups of borrowers, types of credit facilities, product lines, maturity and industry sectors;
e. Large credits and or those in excess of existing credit limits;
f. Volume of loans secured versus unsecured;
g. New extensions of credit, credit renewals, and restructured credits;
h. Listing of delinquent, impaired and non-accrual loans;
i. Credits which have been watch listed or those requiring special attention;
j. Credit to related parties; and
k. Credit not in compliance with policies, laws, or regulations.

7.3 Monitoring of Credit Risk

Credit monitoring refers to the continuous review of individual credits including off-balance sheet exposures as well as the credit portfolio. The normal practice is for each credit officer to be assigned a number of borrowers and the Credit Manager to assume responsibility for the credit portfolio. Licensees are required to establish a system to monitor the quality of the credit portfolio on a regular basis and to take remedial measures when there are signs of deterioration.

Credit monitoring procedures, at a minimum should specify the following:

a. The roles and responsibilities of individuals responsible for credit risk monitoring;
b. The assessment procedures and analysis techniques (for individual credit and the overall credit portfolio. This should include ascertaining whether credits are being serviced as per contractual terms, understanding the current financial condition of borrowers or counterparty, monitoring compliance with existing covenants, identifying any contractual deficiencies and reviewing the adequacy of provisions ;
c. The frequency of monitoring. Monitoring of the credit portfolio should be part of routine activity however the frequency of monitoring for individual credits should depend on risk ratings and other signs of deterioration of credit quality;
d. The periodic examination of collaterals and assessment of collateral coverage;
e. The frequency of site visits; and
f. The identification of problem credit and allocation for prompt remedial actions.

Senior management has the responsibility to put procedures in place to monitor the overall quality of the portfolio and take corrective actions to address any weaknesses identified. A summary of credit monitoring should be reported to senior management in a timely manner to enable them to adequately assess the quality of the credit portfolio and take corrective measures.

7.3.1 Managing Problem Credit

The licensee’s monitoring system supported by the credit review function should identify weakened and problem credits early in the process. Early detection is important as this presents the licensee with more options for remedial measures to avoid further deterioration.

The licensee’s policy should clearly set out the procedures for managing problem credits. For financial institutions with significant credit-related problems, it is recommended that a dedicated unit/function be established to handle the recovery and workout of problem loans. The workout unit/function should be independent of the credit granting function and be adequately staffed with the required resources and expertise to facilitate speedy resolution.

8. Role of the FSC

As part of its supervisory approach, the FSC will assess the credit risk management systems of licensees against the concepts and methods detailed in this Guideline; being cognizant of the need for such systems to be commensurate with the size, complexity and diversity of a licensee's activities which give rise to credit risk. The FSC's supervisory approach will involve an assessment of the credit risk governance framework, credit granting process, credit administration, measurement tools and monitoring systems, as well as credit risk related prudential reports.

The FSC will determine whether a licensee's credit risk management systems and practices are appropriate for effectively managing and controlling its credit risk exposure. Where deficiencies are identified, licensees will be required to take appropriate actions to promptly improve their credit risk management processes.

APPENDIX 1

Examples of Acceptable Forms of Collateral for Loan Exposures

1. Cash
2. Bill of Sale
3. Debenture over the Fixed and Floating assets
4. First Legal Mortgage
5. Second Legal Mortgage
6. Guarantee, which is supported by Assignment of Assets
7. Government Guarantee
8. Security such as publicly traded shares, bonds and commercial paper may be considered collateral, provided that appropriate haircuts are applied.