



Turks & Caicos Islands Financial Services Commission

Guideline on Large Exposures and Credit Risk Concentration for Banks

Last Amended: 21 September 2015

1. Introduction

- 1.1 This Guideline is issued by the Turks & Caicos Islands Financial Services Commission (“the Commission”) pursuant to Section 43 of the Financial Services Commission Ordinance 16.01 (2007) (the “FSC Ordinance”) in furtherance of its responsibility to regulate and supervise licensees under the FSC Ordinance, and monitor compliance with relevant Ordinances. Section 43(4) of the FSC Ordinance provides that the Commission may take into account any failure to follow guidelines in determining whether there has been a contravention of that Ordinance, any other financial services Ordinance or of any Code issued under the FSC Ordinance.
- 1.2 As part of its overall supervision of banks, the Commission is responsible to review and assess bank licensees’ systems and determine on the adequacy of policies and procedures in place to control and mitigate risk concentrations and large exposures. This Guideline is issued further to that charge, and the guidance set out herein is consistent with the Basel Committee on Banking Supervision’s (BCBS) recommendations regarding supervisory oversight and establishment of prudential limits on large exposures and credit risk concentrations.
- 1.3 This Guideline will be subject to periodic review.

2. Rationale for supervisory monitoring of risk concentrations

- 2.1 Banks, by virtue of their core business of granting credit, are exposed to various credit risk concentrations which, if not closely monitored, pose potential threat to their financial strength, stability and ongoing viability. While credit concentration risks constitute an inherent element of banking and cannot be wholly eliminated, banks have a responsibility to effect diversification and risk management strategies to limit both the likelihood and impact of loss events. As such, the Commission has a duty to assess whether its bank licensees have adequate policies and procedures to identify, measure and control these concentrations, as well as to set and monitor compliance with prudential limits in relation to these exposures.
- 2.2 The objective of supervisory monitoring of large exposures, in particular – that is, to limit disproportionately large losses stemming from the failure of one, or a group of related counterparties – is a cornerstone of prudential supervision and is critical to the protection of depositors. It bears emphasis that

in addition to monitoring large exposures, banking supervisors have also found it necessary to require banks to closely monitor the performance of pools of individual transactions which, because of common characteristics or common sensitivity to certain market or business developments, may collectively perform like a single large exposure and present a concentration risk, posing a threat to earnings and capital even where individual transactions within the pool are soundly underwritten.

3. Legal Basis

3.1 The Turks and Caicos Islands Banking Ordinance 1979 as revised (the “Banking Ordinance”) prescribes limits on large exposures within banks, for the control of exposures and risk concentrations.

Specifically:

- Section 21(1) provides that “a licensed financial institution shall not grant a financial concession to a person or related persons except as may be prescribed or as may be agreed with the Commission.”

Banking Regulation 13 further sets out that a licensed financial institution may grant financial concessions to related persons for the purposes of Section 21(1) where—

- (a) “the value of the financial concessions granted would not exceed **twenty-five per cent of the paid up capital** of the financial institution;
- (b) granting the financial concession would not increase the total value of all the concessions granted to the related persons before that time to an amount exceeding **twenty-five per cent of the paid up capital** of the institution; or
- (c) the licensed financial institution has obtained approval from the Commission to grant the concessions.”

3.2 This Guideline sets out further guidance to the Commission’s bank licensees regarding the specific treatment and reporting of large exposures and the general management of credit risk concentrations. The Commission will assess conformity with this Guideline by *inter alia*, reviewing the effectiveness of credit risk management and oversight arrangements within each bank. To that end, this Guideline should be read in conjunction with other guidance issued by the Commission on credit, risk management and governance.

3.3 This Guideline is applicable, without exception, to all banks operating in and from within the Islands, including subsidiaries and branches of foreign banks licensed by the Commission to conduct banking business. The Commission expects banks to comply at all times with the exposure limits established in this Guideline, unless granted express, written approval by the Commission to act otherwise.

3.4 Banks should also ensure compliance with other relevant sections of law, including Sections 24(1) and 27 of the Banking Ordinance, which restrict intergroup lending by banks and acquisitions of share capital in companies and other major acquisitions and investments, respectively.

4. Definitions

4.1 For the purposes of measuring exposures and consistent with the provisions of Section 21(1), a “counterparty” will generally be considered to be the borrower (client/customer), or the individual/entity standing as guarantor.

4.2 In the context of this Guideline, the Commission considers an “exposure” to be the amount of risk arising from the loan, advance, or extension of credit, which represents the maximum loss which may be incurred through a counterparty’s failure to honour an obligation or other diminution in value at realization due to changes in asset or off-balance sheet positions. This definition includes:

- (i) claims on counterparties including actual and potential claims which would arise from the drawing down of advised facilities (whether revocable or irrevocable, conditional or unconditional) which the financial institution has committed itself to grant, provide, purchase or underwrite; and
- (ii) contingent facilities arising in the normal course of business, and which would arise from the drawing down of advised facilities (whether revocable or irrevocable, conditional or unconditional) which the financial institution has committed itself to provide.

Common types of exposures include, but are not limited to:

- loans and advances
- lines of credit
- commitment letters
- standby facilities
- participations
- guarantees
- promissory notes, loan stocks and similar papers
- letters of credit
- other transactions with recourse and
- other contingent liabilities, notably credit commitments.

4.3 For the purposes of this Guideline, a “large exposure” is any exposure to a single counterparty or group of related counterparties, which is equal to or greater than twenty-five per cent (25%) of a bank’s paid up capital.

In the case of those licensees which maintain assigned capital pursuant to BO, Section 12, exposures are measured against assigned capital such that a large exposure is also any exposure to a single counterparty or group of related counterparties, which is equal to or greater than twenty-five per cent (25%) of a bank’s assigned capital.

4.4 Consistent with Section 21(1) of the Banking Ordinance, a bank grants a “financial concession” where it—

- (i) grants an advance or credit facility;

- (ii) gives a financial guarantee on behalf of a person or group of related persons; or
- (iii) incurs any other liability on behalf of a person or group of related persons whether such advance, credit facility, financial guarantee or other liability is granted to, given on behalf of or incurred on behalf of that person or these related persons singly or jointly with any other person or persons or is obtained by or on account of that person or these related persons singly or jointly with any other person or persons.

4.5 The term “related person” in this context refers to a natural or legal person who is related to the person receiving financial concessions. For a person to be considered “related” it must be clearly established that either:

(a) the related person:

- (i) is the proprietor or beneficial owner of the entity receiving concessions;
- (ii) is a partner, director, manager or beneficial owner of the person or entity receiving concessions;
- (iii) controls a twenty per cent (20%) or greater interest in the shares, or controls twenty per cent (20%) or more of the assets in any related or connected body corporate, whether by holding shares outright or through influence;

or

(b) while there is no relationship of control between the borrower and the other person(s), they constitute a single risk by virtue of their financial and economic interdependence, such that if one were to experience changes in funding or difficulties repaying, the other(s) would likely encounter similar difficulties.

5. Board and Management’s Responsibility to Monitor Credit Concentrations

5.1 The Commission expects each bank to formulate and implement an appropriate framework of policies, procedures and controls to allow for timely and accurate identification, measurement, reporting and control of credit risk concentrations, as well as monitoring of compliance with approved policies. Board and management should ensure that policies, at minimum, address:

(a) establishment of exposure limits in respect of, *inter alia*:

- various types of counterparties, including governments as well as those within the same industry, economic sector or geographic region or whose financial health and performance depends on the same activity or commodity;
- groups of related counterparties;
- off-balance sheet exposures (including guarantees and other commitments);
- collateral or other credit protection provided either by a single counterparty or by related counterparties within a group; and
- market and other risk factors which may expose the bank to particular asset classes, products,

collateral or currencies,

which are commensurate with the bank's capital position and balance sheet posture.

(b) the specific circumstances in which the above-mentioned exposure limits may be exceeded, and the nature and level(s) of authorization required for extraordinary approvals; and

(c) minimum procedures for identifying, reviewing, controlling and reporting large exposures.

Policies should also take cognizance of credit risk concentrations which may arise from less direct, situation-specific factors such as exposure to a particular industry which may be impacted by contagion from other industries with which there are close economic linkages.

5.2 The Commission expects Board and management, to jointly:

- ensure that the framework established to monitor and control credit concentrations is supported by effective risk management, loan review and audit oversight functions;
- ensure that concentration risk policies and procedures take sufficient cognizance of the potential impact on earnings and capital posed by exposure concentrations under both normal and under stressed market conditions;
- develop appropriate policies and control procedures to treat specifically with large exposures, paying particular emphasis to their approval and monitoring;
- ensure that appropriate systems, including information systems, are in place and sufficiently robust to facilitate timely and accurate identification and aggregation of large exposure and risk concentration data, and that this information is regularly reviewed and reported to the Board.

5.3 The Commission further expects that the Board of each bank would ensure:

- that approved concentration limits are clearly set out in writing, and that these reflect and are commensurate with the bank's articulated risk appetite, risk profile and capital strength; and ensure that these limits are effectively communicated by management, and are understood and enforced across the bank; and
- regular, adequate internal and/or external audit coverage of the quality of large exposures and of the controls in place to safeguard against risk concentrations.

6. Notification and Regulatory Reporting

6.1 The Commission expects banks to report all credit exposures, whether to individual or related counterparties, which amount to ten per cent (10%) or greater of paid up/assigned capital in the format prescribed by the Commission, to commence in the quarter following issuance of this Guideline.

6.2 Reporting further to 6.1 above will be required on exposures held by each bank's solo operations, as well as on exposures held by financial subsidiaries owned by banks, where applicable.

6.3 Amounts should be reported gross, that is:

- before provisions and credit risk mitigation (including adjustments for collateral held); and
- inclusive of accrued interest (taking cognizance of the Commission's requirements for accrual of interest as set out in the Guideline on Loan Classification and Provisioning).

7. Exposure Limits

▪ Individual Exposures

7.1 As outlined at Paragraph 3.1 above, the Banking Ordinance establishes the maximum threshold for granting financial concessions to a single counterparty or group of related counterparties at twenty-five per cent (25%) of a bank's paid up capital. In the case of licensees which maintain assigned capital, the applicable limit is twenty-five per cent (25%) of assigned capital. Banks must apply to the Commission and receive formal written approval to extend financial concessions beyond these limits. Applications for regulatory approval should be submitted in the format prescribed by the Commission.

7.2 For prudence, the Commission expects that banks would apply the twenty-five per cent (25%) threshold to **all exposures** which meet the definition provided under Paragraph 4.3, whether to a single counterparty or group of related counterparties.

▪ Aggregate Exposures

7.3 As a backstop, for the further containment of risk, the Commission also expects that banks would observe an aggregate exposure limit over their portfolios of large exposures, such that they would not incur large exposures, which in aggregate, exceed **five hundred per cent (500%) of paid up / assigned capital**.

8. Exempt Exposures

Unless otherwise advised, the following are exempt from the exposure limits set out above and will not be counted as large exposures:

- (i) amounts representing transactions entered into by a bank where it acts as a trustee;
- (ii) transactions between banks or between branches of the same bank; and
- (iii) in the case where an asset is traded, claims on the counterparty to the transaction, during the course of settlement¹.

9. Breaches

9.1 Non-adherence to the statutory limits established under Section 21 of the Banking Ordinance and Banking Regulation 13 may result in enforcement action, pursuant to Section 33 of the FSC Ordinance and the Financial Services (Financial Penalties) Regulations. Other non-compliance with the provisions of this

¹ Amounts which have not been settled within five (5) working days after the due date should however be included, where applicable, in the computation and reporting of large exposures.

Guideline may also result in enforcement action pursuant to Section 33 of the FSC Ordinance.

- 9.2 In the event that a bank becomes aware of a breach of the statutory large exposure limit or other non-compliance with this Guideline, the Commission expects that management would immediately notify the Commission of the breach and advise of a timetable to bring the exposure within agreed limits as soon as practicable. Such notification should specify the nature of and reason(s) for the breach or non-compliance, and outline ameliorative plans.
- 9.3 Where a breach is identified, in addition to initiating enforcement action, the Commission may require a bank to take other measures, determined by the specific case. These may range from requiring the bank to increase capital, to taking steps to limit further business expansion.
- 9.4 Breaches of statutory limits or other non-compliance with the provisions of this Guideline may be viewed by the Commission as indication that a bank does not have adequate systems in place to control risk exposures, or may call into question the Board and management's commitment and/or competence to operate the bank in a safe and prudent manner.

Turks and Caicos Islands Financial Services Commission, 2015