



Bangko Sentral ng Pilipinas

OFFICE OF THE GOVERNOR

CIRCULAR NO. 414 Series of 2004

The Monetary Board, in its Resolution No. 1846 dated December 18, 2003, approved the following guidelines for managing large exposures and credit risk concentrations in line with its objective of strengthening risk management in the banking system.

SECTION 1. GENERAL PRINCIPLES

A. PRINCIPLES FOR MANAGING LARGE EXPOSURES AND CREDIT RISK CONCENTRATIONS

1. A bank can be exposed to various forms of credit risk concentration which if not properly managed may cause significant losses that could threaten its financial strength and undermine public confidence in the bank.
2. Credit risk concentrations may arise from excessive exposures to individual counterparties, groups of related counterparties and groups of counterparties with similar characteristics (e.g. counterparties in specific geographical locations, economic or industry sectors).
3. Diversification of risk is essential in banking. Many past bank failures have been due to credit risk concentrations of some kind. It is essential for banks to prevent undue credit risk concentrations from excessive exposures to particular counterparties, industries, economic sectors, regions or countries.
4. While concentration of credit risks are inherent in banking and cannot be totally eliminated, they can be limited and reduced by adopting proper risk control and diversification strategies. Safeguarding against credit risk concentrations should form an important component of a bank's risk management system.
5. The board of directors of a bank shall be responsible for establishing and monitoring compliance with policies governing large exposures and credit risk concentrations of the bank. The board should review these policies regularly (at least annually) to ensure that they remain adequate and appropriate for the bank. Subsequent changes to the established policies must be approved by the board.

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6. The policy on large exposures and credit risk concentrations shall, at a minimum, cover the following:
 - a. Exposure limits that are reasonable in relation to capital and resources for –
 - i. Various types of borrowers/counterparties (e.g. government, banks and other financial institutions, corporate and individual borrowers);
 - ii. A group of related borrowers/counterparties;
 - iii. Individual industry sectors;
 - iv. Individual countries; and
 - v. Various types of investments.
 - b. The circumstances in which the above limits can be exceeded and the party authorized to approve such excesses, e.g. the bank's board of directors or credit committee with delegated authority from the board.
 - c. The delegation of credit authority within the bank for approving large exposures;
 - d. The procedures for identifying, reviewing, managing and reporting large exposures of the bank;
 - e. The definition of exposure. Banks should take into account the nature of their business and the complexity of their products. In any case, a bank's exposures to a counterparty should include its on and off-balance sheet exposures and indirect exposures; and
 - f. The criteria to be used for identifying a group of related persons;
7. The board and senior management of a bank should ensure that:
 - a. Adequate systems and controls are in place to identify, measure, monitor and report large exposures and credit risk concentrations of the bank in a timely manner; and
 - b. Large exposures of the bank are kept under regular review. Large exposures shall refer to exposures to a counterparty or a group of related counterparties equal or greater than 5% of bank's qualifying capital as defined under Circular No. 280 dated March 29, 2001.

8. A bank should, where appropriate, conduct stress testing and scenario analysis of its large exposures to assess the impact of changes in market conditions or key risk factors (e.g. economic cycles, interest rate, liquidity conditions or other market movements) on its profile and earnings.
9. It is expected that banks would generally observe a lower internal single borrower's limit than the prescribed limit of twenty-five percent (25%) as a matter of sound practice.

B. MONITORING OF LARGE EXPOSURES

1. Banks should have a central liability record (preferably based on automated system) for each loan exposure. Banks should be able to monitor such exposures against prescribed and internal limits on a daily basis.
2. Every bank should have adequate management information and reporting systems that enable management to identify credit risk concentrations within the asset portfolio of the bank or of the group (including subsidiaries and overseas branches) on a timely basis. If a concentration does exist, banks should reduce it in accordance with their prescribed policies. Large exposures shall be subject to more intensive monitoring.
3. Banks should ensure that their internal or external auditors conduct at least an annual review of the quality of large exposures and controls to safeguard against credit risk concentrations. Their review should ascertain whether:
 - a. The bank's relevant policies, limits and procedures are complied with; and
 - b. The existing policies and controls remain adequate and appropriate for the bank's business.
4. Management should take prompt corrective action to address concerns and exceptions raised.
5. There should also be an independent compliance function to ensure that all relevant internal and prescribed requirements and limits are complied with. Breaches of prescribed requirements and deviations from established policies and limits should be reported to senior management in a timely manner.

C. UNSAFE AND UNSOUND PRACTICE

Non-observance of the principles and the requirements of Section 1.A and 1.B above may be a ground for a finding of unsafe and unsound practice under Section 56 of the General Banking Law of 2000, and may be subject to appropriate sanction as may be determined by the Monetary Board.

D. NOTIFICATION REQUIREMENTS

A bank must inform BSP immediately where it has concerns that its large exposures or credit risk concentrations have the potential to impact materially upon its capital adequacy, along with proposed measures to address these concerns.

E. REPORTING

Bank's records on monitoring of large exposures shall be made available to the BSP examiners for verification at any given time. When warranted, the BSP may impose additional reporting requirements on bank in relation to its large exposures and credit risk concentrations.

F. SANCTION

Any failure or delay in complying with the requirements under Section 1.D and 1.E above shall be subject to penalty applicable to those involving major reports.

SECTION 2. Applicability to Non-Bank with Quasi-Banking Functions (NBQBs)

The regulations contained herein shall also apply to NBQBs.

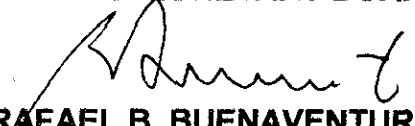
SECTION 3. Repealing Clause

This Circular supersedes/amends/modifies provisions of existing circulars, memoranda and/or regulations that are inconsistent herewith.

SECTION 4. Effectivity

This Circular shall take effect fifteen (15) days following its publication in a national newspaper of general circulation.

FOR THE MONETARY BOARD:


RAFAEL B. BUENAVENTURA
Governor

13 January 2004