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Rules on Large Exposures and Credit Risk Concentration for Banks

1. STATEMENT OF OBJECTIVES

To set out the Cayman Islands Monetary Authority's rules on Large Exposures and Credit Risk Concentration for banks (each of paragraphs 3 to 8 below referred to as a "Rule," and collectively, the "Rules"), pursuant to the Monetary Authority Law (2004 Revision) ("MAL").

2. INTRODUCTION

2.1. Section 34 of the MAL provides that the Cayman Islands Monetary Authority (the "Authority") may issue rules:

(34) (1) After private sector consultation and with the approval of the Governor, the Authority may –

(a) Issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees.

2.2. This document establishes the Rules and must be read in conjunction with the Statement of Guidance on Large Exposures and Credit Risk Concentration for Banks.

3. SCOPE OF APPLICATION

3.1. These Rules apply to all banks regulated by the Authority under the Banks and Trust Companies Law (2003 Revision) ("BTCL").



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Rule 5 applies to all banks incorporated in the Cayman Islands and Rule 6 applies only to branches of banks not incorporated in the Cayman Islands. Banks with restricted licenses that prohibit third party transactions must adhere to the requirements set out in Rules 5.1 and 5.7, but are not subject to the remaining limits set out in Rules 5.2 through 5.6 and 5.8 through 5.17 respectively.

3.2. These Rules apply to a bank both on an unconsolidated (solo) basis, and on a consolidated basis that includes its subsidiaries.

4. DEFINITIONS

4.1. A **bank** means a bank licensed under the Banks and Trust Companies Law (2003 Revision).

4.2. An **exposure** is the maximum loss including accrued interest that a bank might suffer if a counterparty fails to meet its obligations.

4.3. A **large exposure** means any exposure that exceeds 10% of a bank's capital base.

4.4. The **capital base** means the sum of Tier 1 and Tier 2 capital, less goodwill and other intangible assets, capital investments in affiliates and other financial institutions, and any other deductions as determined by the Authority.

4.5. A **counterparty** is any party with whom a bank has an exposure.

4.6. An **individual counterparty** means a single counterparty that includes a natural or legal person, government, local authority,



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public sector entity, individual trust, corporation, partnership, limited partnership, unincorporated business, and non-profit bodies.

4.7. A **group of connected counterparties** means two or more individual counterparties whose exposures constitute a single exposure because the counterparties have:

- a) a group relationship; or
- b) a business interdependency that is so close that it cannot be quickly unwound and in which financial problems of one counterparty is likely to cause repayment difficulties for another counterparty within the group.

4.8. A **related counterparty** is a counterparty that is linked to the bank and includes:

- a) Any parent, subsidiary, or sister company that together with the bank constitutes a group;
- b) associated entities (in which the bank owns at least 20% but less than half of the voting shares)
- c) a natural person who is a director, controlling shareholder, senior officer, or otherwise has control of the bank, or any business partner or immediate relative of such individual; and
- d) any company of which any of the persons referred to in sub-rule (c) is a director, controlling shareholder and senior officer or has control.

4.9. **Consolidated supervision** means a group-wide approach to supervision whereby all the risks (wherever they are booked) that



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are run by a banking group (including the bank), is taken into account by a capable home country banking supervisor.

4.10. **Group** means two or more entities or persons that are connected to each other in that:

- a) one entity legally or beneficially owns and/or controls the other(s) (eg: parent–subsidiary relationship); or
- b) another entity legally or beneficially owns and/or controls the entities (eg: sister companies); or
- c) the entities have common director(s) and/or common management; or
- d) they are related to each other as prescribed in Rule 4.8 (c) or (d).

4.11. **Control** means the ability of a legal or natural person to ensure the affairs of a legal entity are conducted in accordance with the wishes of that person by means of either:

- a) the holding of shares, voting rights, or the position of voting power; or
- b) by virtue of any agreement or any other powers conferred by the articles of association or other document.

4.12. **Immediate relative** in respect to any person means spouse, children including adopted children, parent, brother or sister.

4.13. **Unsecured** means not guaranteed or protected as to payment, performance, or satisfaction by an interest in personal or real property that is charged, mortgaged, assigned or pledged (as the case may be) as security.



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5. FOR ALL BANKS OTHER THAN BANK BRANCHES

Bank's Policy Statements on Large Exposures and Credit Risk Concentration

5.1. The board of directors of a bank must establish and maintain a written policy (a copy of which must be provided to the Authority) concerning its large exposures and credit risk concentrations, including exposures to an individual counterparty, group of connected counterparties, related counterparties, countries, and economic sectors.

Internal Monitoring Large Exposures (Systems and Controls)

5.2. A bank must adopt internal policies and internal limits that will ensure compliance with the exposure limits contained in Rules 5.8 through 5.17 below.

5.3. A bank must have adequate information systems to identify and measure its large exposures and identify breaches of any of these Rules.

5.4. Any breach of these Rules must be reported directly to the bank's board of directors and/or audit committee.

5.5. A bank must assign a designated independent unit or officer, (e.g. compliance officer), to monitor large exposures to ensure its compliance with the limits established by these Rules and the bank's internal limits.

5.6. A bank must ensure that regular independent reviews are conducted to verify that the bank's established policies, limits



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and procedures are strictly adhered to in relation to large exposures.

Reporting Requirements

5.7. A bank must report all large exposures quarterly on the Authority's Form BS and schedules.

Single Exposure Limits

5.8. A bank must not incur exposures to an individual counterparty or group of connected counterparties that exceeds 25% of its capital base, without prior written approval of the Authority.

Aggregate Limits

5.9. The total of all large exposures that are not exempt pursuant to Rules 5.18.1 through 5.18.6 must not exceed 800% of the bank's total capital base, without prior written approval of the Authority.

Related Counterparty Limits

5.10. The total of all exposures to related counterparties must not exceed 25% of a bank's capital base.

5.11. Exposures to related counterparties that are made on concessionary terms or of a capital nature may be deducted from the bank's capital base.

5.12. Exposures to related counterparties as defined in Rules 4.8 (c) and (d) may be excluded from the aggregate limits defined in Rule 5.10, and subject instead to Rule 5.8, if:

- a) the terms of the exposures are agreed at arm's length;
and
- b) the relationship between the bank and the related



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counterparty is remote.

5.13. The total of unsecured exposures to any one group of related counterparties defined in Rules 4.8 (c) and (d) must not exceed 1% of the bank's capital base.

5.14. The total of unsecured exposures to all related counterparties defined in Rules 4.8 (c) and (d) must not exceed 5% of the bank's capital base.

Guarantees

5.15. In the case of banks subject to consolidated supervision, the Authority may permit exposures that are guaranteed by another banking institution (the "guarantor bank") to exceed the 25% single exposure limit contained in Rule 5.8, provided:

- 5.15.1 the guarantor bank is supervised in accordance with the Basel Core Principles for Effective Banking Supervision;
- 5.15.2 the bank pre-notifies the Authority of the guarantee;
- 5.15.3 the guarantor bank is prepared to assume the full amount of the exposure and not just the amount in excess of 25% of the bank's capital base;
- 5.15.4 the guarantor bank is, in the opinion of the Authority, a continuing source of financial strength for the bank and can at any time assume the exposure itself without exceeding its own large exposure limits;



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5.15.5 the Authority receives written confirmation from the guarantor bank's supervisor that the guaranteed exposure is consolidated with the guarantor bank and does not breach any regulatory or statutory requirements in the guarantor's home country; and

5.15.6 the Authority approves the guarantee.

Exposures Secured by Cash and Securities

5.16. An exposure secured by cash (including CDs issued by the bank) held by a bank is exempt from the limits contained in Rule 5.8 up to a maximum of 100% of the bank's capital base, provided that:

5.16.1 both the exposure and the deposit are made in the same country and currency;

5.16.2 the deposit that secures the exposure must have the same or a longer maturity than the exposure; and

5.16.3 the bank must have a legal opinion that confirms the right of set-off between the deposit and the exposure.

5.17. An exposure secured by securities may be partially exempt from the limits contained in Rule 5.8 provided that:

5.17.1 the Authority approves securities that are to be used as collateral;

5.17.2 the exposure does not exceed 100% of the bank's capital base;

5.17.3 the bank obtains a legal opinion that confirms a valid



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security agreement and right of set-off between the securities and the exposure;

5.17.4 the marked to market value of the securities must exceed the amount of the exposure.

5.17.5 The marked to market value of the securities must,

- a) in case of Zone A central government or central bank securities, be at least 110% of the amount of the exposure;
- b) in case of debt securities issued by banking institutions, investment banks that are subject to capital adequacy rules similar to banking institutions, and multilateral development banks, be at least 150% of the amount of the exposure;
- c) in case of other debt securities, be at least 200% of the amount of the exposure;
- d) in case of shares, be at least 250% of the amount of the exposure.

Exemptions

5.18. The following exposures are exempted from the Authority's large exposure limits set out in Rules 5.8 through 5.14:

5.18.1 exposures of one year or less to banks, securities firms (approved on a case-by-case basis) and multilateral development banks, in Zone A countries as listed in the Authority's Form BS and Schedules;

5.18.2 exposures to, or guaranteed by, central governments or central banks or monetary authorities, from Zone A countries (as listed in the Authority's Form BS and Schedules);



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5.18.3 exposures to Zone B central governments (as listed in the Authority's Form BS and Schedules) if they are denominated in the respective country's national currency and funded by liabilities in the same currency;

5.18.4 exposures that are placements made with another banking institution, with an original maturity of one year or less;

5.18.5 exposures to related counterparties where:

- a) the bank is fulfilling a treasury role on behalf of the banking group; and
- b) the banking group (inclusive of the related counterparties) is subject to consolidated supervision by its home country supervisor;

5.18.6 exposures that are deducted from the bank's capital.

Notification and Correction of Breaches of Exposures

5.19. A bank must notify the Authority immediately of any breach of any limits imposed by these Rules and as otherwise agreed with the Authority.

5.20. A bank must take immediate action to bring the exposure within permitted limits as soon as possible.

6. FOR BANK BRANCHES

6.1. A bank branch must report its twenty (20) largest exposures on



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the Authority's Form BS and schedules.

6.1.1 A bank branch must comply with the large exposure limits established by its head office.

6.1.2 If in the Authority's opinion, a branch's head office does not have a comparable relevant policy, the Authority may require a branch to comply with any one or more of Rules set out in Rule 5 herein, as appropriate.

7. ADDITIONAL RESERVATIONS AND LIMITS

Notwithstanding any limits or exemptions provided by these Rules, the Authority may on a case-by-case basis:

- a) limit the availability and amount of any exemption provided by Rules 5.18.1 through 5.18.6;
- b) vary the limits as provided in Rules 5.8 through 5.17;
- c) require a bank to limit its exposures to any country, economic sector, or as the Authority may determine.

8. ENFORCEMENT

Whenever there has been a breach of the Rules, the Authority's policies and procedures as contained in its Enforcement Manual will apply, in addition to any other powers provided in the Banks and Trust Companies Law (2003 Revision) and the Monetary Authority Law (2004 Revision).