

GUIDELINE ON LARGE EXPOSURES

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1. **AUTHORITY, PURPOSE AND SCOPE**

(a) **Authority**

This Guideline is issued by the Bank of Botswana (Bank) pursuant to its authority set forth in Section 4(2) of the Bank of Botswana Act (CAP. 55:01).

(b) **Purpose**

The purpose of this Guideline is to provide guidance for the implementation of the provisions of Section 17(1) - (5) of the Act and Regulation 9(1) - (2) of the Banking Regulations, 1995.

(c) **Scope**

This Guideline applies to any bank licensed under the Act, statutory banks and other financial institutions established under separate Acts of Parliament, but falling under the purview of the Bank's supervision in terms of Section 53(2) of the Banking Act and/or their respective statutes.

2. **DEFINITIONS**

(a) **Accommodation** - A loan, advance or other credit facility, financial guarantee or other liability granted or incurred by a bank to or on behalf of any person, physical or juridical.

(b) **Act** - The Banking Act (CAP. 46:04).

(c) **bank** - A company which is licensed by the Bank, pursuant to the Act, to conduct banking business in Botswana.

(d) **Board of Directors** - The highest body of authority in a bank responsible for strategically guiding the bank, effectively monitoring management, and properly accounting to shareholders.

(e) **The Bank** - The Bank of Botswana established under the Bank of Botswana Act (CAP. 55:01).

(f) **Common Directors** - Whereby one or more individuals are directors of two companies.

(g) **Common Management** - Whereby one or more individuals are managers of two companies.

(h) **Common Ownership** - Whereby the assets of an enterprise or other organisation are held indivisibly rather than in the name of the individual members.

(i) **Controlling Interest** - Ownership and/or control of the largest amount of voting stock of shares (50 percent of voting shares plus one) in a company.

- (j) **Exposure** - The amount of a bank's exposure is calculated as follows:
- (i) The sum of loans and credit facilities granted, either directly or indirectly, to a person or group of inter-related persons, such as:
 - term loans, overdrafts, credit lines and other credit facilities;
 - trade bills discounted, invoice discounted and factoring;
 - credit substitutes, such as guarantees, acceptances, letters of credit and bills, and finance lease receivables;
 - underwriting of debt and equity securities, and other forms of participation;
 - securitised assets and other transactions with recourse;
 - credit derivatives, futures and forwards, swaps and option contracts such as credit default swaps and other derivatives;
 - contingent liabilities, such as commitments to extend credit, performance bonds and warranties.
 - (ii) Less the amount by which the above-listed accommodation are irrevocably secured by:
 - collateral in the form of cash deposits placed with a bank that granted the accommodation (the lending bank);
 - collateral in the form of cash deposit placed with another bank in Botswana;
 - an eligible guarantee by any sovereign with a credit rating of AA- or better, issued by a recognised external credit rating agency;
 - any listed financial instrument of a company listed in Botswana (treasury bills, listed bonds, etc).
 - (iii) To be considered eligible, the guarantee must: (1) represent a direct claim on the guarantor; (2) be denominated in the same currency as the exposure; (3) clearly define the extent of the guarantee's cover of a specific exposure and be incontrovertible; (4) except for non-payment of the credit protection contract, be irrevocable and non-cancellable by the guarantor; (5) have as its only condition for its enforcement the counterparty's failure to meet his/her obligation to the bank; and (6) be structured such that neither the guarantor nor any other person is in a position to challenge the legal rights of the bank in calling the guarantee.

- (k) **Group of Inter-related Persons** - Two or more persons holding exposures from the bank, whether on a joint or separate basis, who are mutually associated with at least one of the following: (1) a controlling interest; (2) common ownership or control; (3) common management; (4) common directors; (5) cross guarantees; or (6) direct financial interdependence which cannot be substituted in the short-term. Where banks are uncertain on grouping connections for large exposure reporting, clarity and guidance may be sought formally and in writing from the Bank.
- (l) **Large Exposure** - An exposure, direct or indirect, of the bank to any person or group of inter-related persons which equals or exceeds 10 percent of the unimpaired capital of the bank.
- (m) **Person** - Either a: (1) Physical person - an individual; or (2) juridical person - a company, partnership, association, or group of persons acting in concert, whether or not organised as a formal business entity.
- (n) **Regulations** - The Banking Regulations, 1995, Statutory Instrument No. 73 of 1995, published on October 20, 1995.
- (o) **Unimpaired Capital** - With regard to the capital of a bank, means the absence of any:
 - (i) legal or technical covenant, term, restriction or encumbrance which would otherwise render such capital to be not freely available for distribution to depositors or other creditors in the event of the liquidation or dissolution of the bank; and
 - (ii) condition or arrangement which would, in the opinion of the Central Bank, diminish the value of the whole or any portion of the capital of the bank.

3. REQUIREMENTS

(a) Policies and Procedures

The Board of Directors of a bank shall formulate a policy on large exposures and put in place measures to ensure effective implementation by management. This policy shall constitute an integral part of the bank's overall credit policy. The policy, at a minimum, shall:

- (i) address concentrations of risk arising from individual large exposures and total large exposures, including those to groups of inter-related persons; and
- (ii) impose strict and binding limits on large exposures, including those to groups of inter-related persons, which do not exceed the limitations contained in this Guideline.

(b) **Total Exposures to Groups of Inter-related Persons**

If the interests of two or more persons are such that they are deemed to be a “group of inter-related persons”, then the total exposures of all persons in that group shall be combined for purposes of applying the limitations of large exposures. If the Bank designates a group of inter-related persons that has not been so designated by a bank, and if the total exposure of that group of inter-related persons exceeds the limitations of the Bank or of the bank’s own credit policy, then the bank shall be permitted to dispose of the excess exposure within such reasonable period as the Bank shall determine, in any case within a period of not more than 12 months.

(c) **Approval by the Board of Directors**

In accordance with Section 17(1) of the Act, any large exposure to any counterparty must be approved by the bank’s Board of Directors or a duly authorised Sub-Committee thereof.

(d) **Record-keeping**

Each bank shall maintain adequate records to identify all large exposures, including those to groups of inter-related persons, and other concentrations within the portfolio.

4. **LIMITATIONS**

- 4.1 Except as provided for in Section 5 of this Guideline, a single large exposure or a group of interrelated exposures shall not exceed 30 percent of a bank’s unimpaired capital.
- 4.2 A bank’s total amount of large exposures shall not exceed 800 percent of its unimpaired capital.

5. **APPLICATION TO THE BANK**

- 5.1 With the prior written approval of the Bank for good cause shown, a bank may, in unusual circumstances, grant an accommodation that would result in a large exposure exceeding 30 percent of the bank’s unimpaired capital; provided, however, that such large exposure shall be reduced to an amount equal to 30 percent or less of the bank’s unimpaired capital within 12 months, and the bank remains within the 800 percent total large exposure limit.
- 5.2 Requests for the prior written approval of the Bank for a bank to grant an accommodation that will result in a large exposure exceeding 30 percent of the bank’s unimpaired capital shall be made in writing in the form prescribed in Annex 1. The Bank may request additional or supplementary information if, in its opinion, the basic information submitted is incomplete or insufficient. Failure to provide the Bank with all required information in a timely manner will result in the Bank returning the request without consideration.

- 5.3 Within 7 to 14 days from the date that the Bank receives all information required and sufficient for making a decision, the Bank shall render a decision on the request and shall notify the bank of its decision in writing.
- 5.4 The decision of the Bank whether or not to authorise a bank to grant an accommodation that will result in a large exposure exceeding 30 percent of the bank's unimpaired capital will include consideration of the following criteria:
- (a) the bank is currently meeting its minimum requirement for unimpaired capital and maintains a ratio of unimpaired capital to total risk-weighted assets of at least 15 percent;
 - (b) including the subject accommodation, the total notional amount of large exposures do not exceed 800 percent of its unimpaired capital;
 - (c) there is no supervisory enforcement action outstanding or pending against the bank, nor is the bank otherwise subject to a specific supervisory programme on account of deficiency on a matter of prudent banking practice;
 - (d) the bank's existing credit risk management system and management information system are adequate, and the bank has adequate financial, managerial and organisational resources to handle the increased concentration risk;
 - (e) the bank has a history of properly reporting and managing large exposures;
 - (f) the extent to which the accommodation will be secured by cash in whole or in part, Government of Botswana securities, bills eligible for discounting at the Bank, assets eligible for liquidity support pursuant to the Bank's *Guideline on Managing Liquidity Risk*, or other assets as may be acceptable to the Bank;
 - (g) the person(s) incurring the subject accommodation has made full disclosure of any "group of inter-related persons" in which the person(s) is included and which also has exposure to the bank. The bank has properly included the person(s) in such group(s) for purposes of calculating compliance with the limitations on large exposures;
 - (h) with the exception of exceeding the 30 percent limit on large exposures, the accommodation meets all of the bank's credit-granting standards based on current audited financial information as stipulated in the bank's written application;
 - (i) the Board of Directors or its duly authorised sub-committee has approved the large exposure, subject to the approval of the Bank; and
 - (j) the aggregate amount of the large exposure will be reduced to a level below 30 percent of the bank's unimpaired capital within 12 months, in accordance with a specific plan of reduction presented by the bank in its application.

6. REPORTING

6.1 Each bank shall submit to the Bank a report, as at the end of each quarter and in the format prescribed by the Bank, showing all large exposures.

7. ANNEXES

7.1 Prescribed form for reporting a bank's large exposures to the Bank (Annex 2).

7.2 Prescribed form for application by a bank for the prior written approval of the Bank to grant an accommodation that will result in a large exposure exceeding 30 percent of a bank's unimpaired capital (Annex 1).

7.3 The application to the Bank must be signed by a senior management official of the bank and submitted in writing, in English, and in official duplicate. Information should be presented in the order requested and be accompanied by the required documents, which should include the following:

- (a) application date;
- (b) name of bank;
- (c) amount of core capital (audited, P'000);
- (d) amount of unimpaired capital (audited, P'000); and
- (e) name of the counterparty/group.
- (f) details of the proposed accommodation, including the following: (If two or more accommodations are proposed, please provide the information on each separate accommodation in a table format).
 - specific counterparty/group;
 - type of accommodation (loan, lease, guarantee, L/C, performance bond, forex, etc);
 - amount (P'000);
 - risk-weight (percent - use risk-weights by category and facility as prescribed by the Bank in the Capital Adequacy Measurement and Standard Directive); and
 - risk-weighted amount.
- (g) provide the same information as in item 6 on existing accommodations from the bank.

- (h) total amount (P'000) of all exposures to the counterparty/group, including the proposed accommodation.
- (i) risk-weighted amount (P'000) of all exposures to the counterparty/group, including the proposed accommodation.
- (j) total exposure, including the proposed accommodation, as a percentage of core capital.
- (k) risk-weighted amount as a percentage of core capital.
- (l) total exposure, including the proposed accommodation, as a percentage of unimpaired capital.
- (m) the specific purpose of the proposed accommodation.
- (n) description of collateral, including:
 - the amount, including the method and source of the determination of value;
 - the percentage of the accommodation covered by the collateral; and
- (o) the method by which the bank's interest in the collateral has been perfected.
- (p) repayment schedule or terms of amortisation for each proposed accommodation.
- (q) the reason why the bank proposes to exceed the 30 percent limitation on large exposures.
- (r) a specific plan, including methods and time frames, to reduce the proposed exposure below 30 percent of the bank's unimpaired capital within the stipulated timeframe. (The plan may include amortisation of the proposed accommodation and a reasonable estimate of growth in the bank's unimpaired capital).
- (s) a copy of the analysis performed by the bank showing that the proposed accommodation meets the bank's credit-granting standards.
- (t) the counterparty's current, audited financial statements and other information used by the bank in underwriting the proposed accommodation.
- (u) evidence of appropriate approval by the bank, including the approval of the bank's Board of Directors, subject to the approval of the Bank.

- (v) official resolution of the Board of Directors authorising the subject requests to the Bank.

Issued this day of, 2009

ACTING DIRECTOR
BANKING SUPERVISION DEPARTMENT