



LARGE EXPOSURES GUIDELINE

CENTRAL BANK OF BARBADOS
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LARGE EXPOSURES GUIDELINE

A. Introduction

1. The Central Bank of Barbados (Bank), in furtherance of its responsibility for the regulation and supervision of licensees under the Financial Institutions Act, Cap. 324A (FIA), has developed this Large Exposures Guideline (guideline) to provide guidance to licensees on their legal obligations relating to Sections 21, 41F and 41N of the FIA.
2. This guideline draws on the Basel Committee on Banking Supervision (BCBS) standards on measuring and controlling large exposures.¹ A large exposure framework complements the Bank's capital adequacy requirements² which are not designed specifically to protect licensees from large losses resulting from the sudden default of a single counterparty. In particular, the minimum capital requirements (Pillar 1) of the Basel risk-based capital framework assume the absence of concentration risk. Notwithstanding, large exposures to individual counterparties or group of connected counterparties may be present in licensees' portfolios. To serve as a backstop to risk-based capital requirements, the objective of this guideline is to limit the maximum possible loss a licensee could incur if a single counterparty or group of connected counterparties were to suddenly fail.

B. Scope of Application

3. This guideline applies, on a solo and consolidated basis, to all of the Bank's licensees incorporated in Barbados, save those exempted as discussed at paragraph 28. The application of the large exposure framework at the consolidated level, means that a licensee must consider all exposures to third parties across the relevant regulatory consolidation group, and compare the aggregate of those exposures with the group's capital base.
4. Exposures booked by licensees that are the branches of banks incorporated outside Barbados, are subject to the large exposure regulations of their home regulatory authority.³
5. Large exposure limits are set out in sections 21, 41F and 41N of the FIA. This guideline applies to those limits that are set for exposures to counterparties (person, group, related party) and that are expressed as a percentage of the capital base. See Exposure limits in Part C.

C. Definitions and Limits

Exposures

6. Section 2 of the FIA defines an exposure as follows:
"exposure" means claims, commitments and contingent liabilities arising from on and off balance sheet transactions and includes:

¹ Basel Committee on Banking Supervision. (2014, April). Supervisory framework for measuring and controlling large exposures. Basel, Switzerland: Bank for International Settlements

² Capital Adequacy Guideline: Measurement of Credit Risk – Standardised Approach; Capital Adequacy Guideline – Measurement of Market Risk; Capital Adequacy Guideline – Measurement of Operational Risk; Internal Capital Adequacy Assessment Process Guideline

³ These entities are still required to report as detailed under Section F of this guideline. Such licensees should also report on an annual basis, the level of parental capital against which large exposures will be measured.



- a. credit facilities such as loans, advances, financial leases and lines of credit whether or not with accrued interest amounts
 - b. investments such as debt securities, equity securities, participations
 - c. guarantees
 - d. acceptances
 - e. contingent liabilities which would arise from the drawing down in full of undrawn advised facilities, whether revocable or irrevocable or conditional or unconditional, that the licensee has committed itself to provide, arrange, purchase or underwrite
 - f. placements with another financial institution
 - g. derivative instruments
7. Further, as set out in Section 41F(3) of the FIA, an equity investment in a wholly owned subsidiary that is a financial institution shall not be taken into account in the determination of an exposure.

Large Exposures

8. Section 2 of the FIA defines a large exposure as follows:
"large exposure" means an exposure to a person or group that is greater than or equal to 10 per cent of the licensee's capital base.
9. The licensee will also have a large exposure to a person or group where it has two or more types of exposure to a person or group and the individual exposures are each less than 10 per cent of the capital base, but the sum of those exposures is greater than or equal to 10 per cent of the capital base.

Group

10. Section 2 of the FIA defines a group as follows:
"group" means
- a. in relation to a company, that company and
 - i. any other company which is its holding company or financial holding company or subsidiary
 - ii. any other company which is a subsidiary of its holding company or financial holding company
 - iii. any company which directly or indirectly controls or is controlled by a company referred to in subparagraph (i) or (ii)
 - iv. any company which is controlled by a person who directly or indirectly controls a company referred to in sub-paragraph (i), (ii) or (iii)
 - v. any company in which a group of immediate relatives has a controlling interest
 - b. in relation to a person other than a company
 - i. a group of immediate relatives where each member of the group is substantially dependent upon the same income source
 - ii. a group of persons in which one member has power directly or indirectly to control the other members
 - iii. any other group of persons that may be prescribed by the Central Bank



Related Party

11. Section 2 of the FIA defines a related party as follows:

“related party” means

- a. the holding companies, financial holding companies, subsidiaries or affiliates of a licensee and the directors and senior officers of such companies
- b. any person that a licensee exerts control over or that exerts control over a licensee
- c. any person who holds more than 20 per cent of a licensee’s shares
- d. an entity in which a licensee owns at least 20 per cent of the shares
- e. a director or senior officer of a licensee
- f. an immediate relative of a director or senior officer of a licensee or immediate relative of a director or senior officer of a holding company, a financial holding company, a subsidiary or an affiliate of a licensee
- g. any firm which is controlled by a director or senior officer of a licensee or controlled by an immediate relative of a director or senior officer of a licensee
- h. any person, firm or corporation, where the credit facilities of that person, firm or corporation are guaranteed by a director or senior officer of a licensee or guaranteed by an immediate relative of a director or senior officer of a licensee
- i. any other similar person or group of persons determined by the Central Bank

Capital Base

12. A licensee’s capital base is also defined in section 2 of the FIA:

“capital base” means the sum of stated capital and published reserves of the licensee and any other capital account approved by the Central Bank.

For the purposes of this guideline, the capital accounts that comprise the capital base are the capital items that qualify for Tier I capital.⁴

Exposure Limits

13. Sections 21, 41F and 41N of the FIA contain the large exposure limits for the:

- a. total value of all large exposures to one person or group
- b. aggregate amount of all large exposures
- c. total value of exposures to one related party
- d. aggregate amount of all related party exposures.

Part II (Commercial Banks), Part III (Trust and Finance Companies and Merchant Banks) and Part IIIB (Foreign Currency Earning Banks) Licensees

14. Section 21(1)(a) to (f) of the FIA contains the large exposure limits for licensees under Part II and Part III.⁵ Section 41N(1)(a) to (c) of the FIA contains the large exposure limits for licensees under Part IIIB.

⁴ See Instructions for Completing Basel II Forms.

⁵ Paragraphs f(i), g and h are not included because they either do not meet the definition of an exposure or there is an outright prohibition rather than a limit.



Table 1 Single Counterparty Limits	
Secured exposures	25 percent of the capital base to any one person or group
Unsecured credit facilities	10 percent of the capital base to any one person or group
Unsecured credit facilities, financial guarantees or liabilities	one percent or \$40,000 of the capital base, whichever is the greater to or on behalf of a licensee's: <ul style="list-style-type: none"> ▪ director or any person in whom that director is interested ▪ holding company, financial holding company, subsidiary or affiliate or any director thereof
Unsecured advances or credit	one year's emolument for aggregate exposures to an officer or employee
Share capital of any commercial, agricultural, industrial or other undertaking	25 percent of the capital base for five years
Share capital of any entity	10 percent of the capital base*
Aggregate large exposure limit	
800 percent of the capital base for all large exposures	
Related party limits	
Single related party	10 percent of the capital base
Aggregate related party exposures	25 percent of the capital base

Source: Bank Supervision Department

*for Part IIIB licensees only

Part IIIA Licensees (Financial Holding Companies)

15. Section 41F(1) of the FIA contains the large exposure limits for licensees under Part IIIA.

Table 2 Exposure Limits for an Entity	
Secured exposures	10 percent of the capital base to any subsidiary or affiliated company
Unsecured credit facilities	one percent of the capital base to any subsidiary or affiliated company
Aggregate exposures	25 percent of the capital base for all exposures to subsidiaries or affiliated companies
Exposure limits on a consolidated basis	
Affiliated companies	25 percent of the capital base for aggregate exposures to its affiliated companies
Single counterparty	25 percent to a person or group
Aggregate exposures	800 percent of the capital base for all large exposures to a person or a group

Source: Bank Supervision Department



Definition of Secured

16. For the purposes of this guideline, an exposure is considered secured when the following assets have been provided as collateral:
- a. Cash⁶
 - b. Certificates of deposit or comparable instruments issued by the licensee and on deposit with the licensee which is incurring the counterparty exposure⁶
 - c. Gold
 - d. Debt securities issued or guaranteed by the Government of Barbados⁶
 - e. Central Government of Barbados Guarantee⁶
 - f. Debt securities issued or guaranteed by sovereigns or their central banks that are 0 percent risk-weighted in accordance with Part A of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach, and denominated in the local currency of that jurisdiction and funded by liabilities in the same currency
 - g. Guarantees issued by sovereigns or their central banks that are 0 percent risk-weighted in accordance with Part A of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach, and denominated in the local currency of that jurisdiction and funded by liabilities in the same currency
 - h. Guarantees or credit derivatives that are direct, explicit, irrevocable and unconditional⁷. Minimum acceptance criteria are set out in **Appendix 2**
 - i. Bill of Sale
 - j. Debenture over Fixed and Floating assets
 - k. First Legal Mortgage
 - l. Second Legal Mortgage
 - m. Further Charge⁸
 - n. Chattel Mortgage
 - o. Any other asset as approved by the Central Bank
17. Collateral in the form of securities issued by the counterparty (or by any person or entity related or associated with the counterparty) is not eligible collateral.
18. Licensees should ensure that assets accepted as collateral satisfy, at minimum, the following criteria:
- a. The licensee's right to repossess the asset is legally enforceable and without impediment
 - b. The market value of the asset is readily determinable or can be reasonably established and verified
 - c. The asset is marketable and there exists a readily available secondary market for disposing of the asset
 - d. The licensee is able to secure control over the asset if necessary. In the case of a movable asset, the licensee should either have physical custody of the asset (e.g. security certificates) or have the means of locating its whereabouts (e.g. vehicle, machinery or equipment)

⁶ See also section E of this guideline.

⁷ See also Part C (iii) of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach.

⁸ A further charge usually refers to a subsequent mortgage to a mortgagee of a property that is already subject to a prior mortgage in favour of the same mortgagee, as security for a further loan to the same borrower as in the prior mortgage



D. Measurement of Exposures

Value of the Exposure

19. The exposure values a licensee must consider in order to identify large exposures to a counterparty are all those exposures defined under the risk-based capital framework. A licensee must consider both on- and off-balance sheet exposures included in the banking book and instruments with counterparty credit risk under the risk-based capital framework. An exposure amount to a counterparty that is deducted from capital must not be added to other exposures to that counterparty for the purpose of the large exposure limit.⁹

Banking book on-balance sheet non-derivative assets

20. The exposure value must be defined as the accounting value of the exposure i.e. net of specific provisions and value adjustments.

Banking book off-balance sheet non-derivative items

21. The exposure value for non-derivative off-balance sheet items is obtained by converting off-balance sheet exposures into credit equivalent exposures using the credit conversion factors (CCFs) set out in Part B(i) of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach, with a floor of 10 percent. An example is set out in **Appendix 1**.

Off-balance sheet items – derivative items

22. The exposure value for instruments that give rise to counterparty credit risk and that are not securities financing transactions must be the exposure at default calculated by using the current exposure method as described in Part B(ii) of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach.

Securities financing transactions

23. Securities Financing transactions such as repos, reverse repos and stock borrowing or lending transactions are to be measured in accordance with the provisions of Part C of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach.

On-Balance Sheet Netting

24. Where a licensee has in place legally enforceable netting arrangements for loans and deposits, it may calculate the exposure values for large exposures purposes according to the calculation it uses for capital requirements purposes – i.e. on the basis of net credit exposures subject to the conditions set out in the approach to on-balance sheet netting in Part C(ii) of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach.

E. Exemptions

Exemptions not Requiring Prior Approval

25. The large exposure limits in 21(1)(a), 41F(1) and 41N(1)(a) to (c) of the FIA do not apply to:

- exposures to the Barbados Government
- exposures to a Barbados statutory corporation where repayment is guaranteed by the Barbados Government

⁹ Exposures that are deducted from capital include goodwill, investments in financial subsidiaries not consolidated in national systems, other intangibles, and when the capital framework is applied on an individual basis, investments in subsidiaries and significant minority-owned stakes.



- c. exposures to a person where repayment is guaranteed by the Barbados Government
 - d. exposures to the extent that they are secured against cash deposits provided that:
 - i. the cash deposit that secures the exposure has the same or a longer maturity than the exposure
 - ii. the licensee has a legal right of set-off between the deposit and the exposure
 - e. exposures to the extent they are secured against securities issued by the Barbados Government.
26. In addition to the exemptions set out in paragraph 25, the large exposure limits in 41F(1) do not apply to exposures to related parties where the licensee is fulfilling a treasury role on behalf of the financial group and the financial group is subject to consolidated supervision by its home regulator, provided the exposures have an original maturity of one year or less. The licensee is required to provide an estimated level of activity of these exposures and notify the Central Bank in advance, if the level of activity is expected to increase.
27. To avoid disturbing the payment and settlement processes, this guideline does not apply to intraday interbank exposures, either for reporting purposes or for application of the large exposure limit.

Exempted Licensees

28. The large exposure limits set out in 41N(1)(a) to (c) of the FIA do not apply to a Part IIIB licensee that does not accept third party deposits.

Exemptions Requiring Prior Approval for All Licensees

29. Licensees require prior approval for the following exemptions:
- a. exposures to the extent that they are guaranteed by a central government, central bank or monetary authority outside Barbados as approved by the Central Bank.
 - b. exposures to the extent that they are secured against such central government securities as approved by the Central Bank.
30. Sections 21(2), 41F(2) and 41N(2) of the FIA exempt exposures in such other form as the Central Bank may determine. Licensees wishing to avail themselves of this dispensation should apply formally to the Bank seeking specific approval for an exemption. Exposures eligible for approval include, *inter alia*:
- a. Exposures to sovereigns or their central banks that are:
 - i. 0 percent risk-weighted in accordance with Part A of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach, and
 - ii. denominated in the local currency of that jurisdiction and funded by liabilities in the same currency
 - b. Exposures to the Bank for International Settlements, the International Monetary Fund, and all other multilateral development banks eligible for a 0 percent risk weight in the Capital Adequacy Guideline: Measurement of Credit Risk – Standardised Approach
 - c. Exposures of three months or less to regulated financial institutions up to a maximum of 50 percent of capital
 - d. Exposures that are guaranteed by the licensee’s parent or a wholly-owned subsidiary of the parent (“the guarantor”). Minimum acceptance criteria are set out in **Appendix 2**



31. The Bank reserves the right to deny an application for the exemption of any of the exposures listed above.

F. Reporting Requirements

32. Section 43(6) of the FIA requires licensees to disclose to the Central Bank all of their large exposures. Licensees must report to the Bank on a quarterly basis or such other increased frequency as the Bank may determine, in a format specified by the Bank:

- a. all exposures with values measured as specified in Section D equal to or above 10 percent of the capital base
- b. all the exempted exposures with values equal to or above 10 percent of the licensee's capital base
- c. the largest 25 exposures to counterparties measured as specified in Section D and included in the scope of application, irrespective of the values of these exposures relative to the licensee's capital base.

33. Licensees must also immediately advise the Bank of any breaches of the large exposure limit. The Bank will not consider that a licensee has satisfied this requirement where the breach is included on the relevant reporting form. A licensee must report to the Bank, on such frequency as the Bank may determine, the progress of bringing the exposures below the regulatory limits. **Appendix 3** outlines the Bank's expectations where licensees identify breaches.

34. Where deemed necessary, the Bank may impose additional reporting requirements on a licensee in relation to its large exposures and risk concentrations.

35. Licensees that are the branches of banks incorporated outside Barbados are subject to the reporting requirements in this section. The capital base reported will be the level of parental capital against which large exposures are measured.

G. Concentration Risk and Pillar II

36. Paragraphs 14 and 15 set out the aggregate large exposure limits for all licensees. These limits apply to the sum of all large exposures, whether exempted or not.

37. Notwithstanding the aggregate limits, licensees are expected to set the maximum level of large exposures that is considered acceptable to the Board, and where deemed necessary, set aside adequate capital to cover the concentration risk that these large exposures present¹⁰.

38. Where the licensee has a number of large exposures or where, in the Bank's opinion, the licensee is exposed to a significant level of risk concentration, the Bank may, as part of its responsibilities under Principle 4 or Pillar II¹⁰, require the licensee to maintain a higher Tier I capital ratio. In considering whether the licensee's capital ratio should be increased, the Bank will, *inter alia*, take account of:

- a. the number of exposures, their individual size and nature
- b. the characteristics of the licensee, including the nature of its business, the experience of its management and the robustness of its risk management systems.

¹⁰ See the Internal Capital Adequacy Assessment Process Guideline for further guidance.



Appendix 1

The Methodology for Calculating Exposure Values for Banking Book Off-Balance Sheet Assets (Non-Derivative) is set out in Table 3

Table 3 Methodology for Calculating Exposure Values for Banking Book Off-Balance Sheet Assets (Non-Derivative)					
Off-balance sheet item (non-derivative)		Notional Principal Amount before CCF	Credit Conversion Factor (CCF)		Credit Equivalent Exposures for large exposure framework
Category	Example		CCF for measuring capital adequacy	With a floor of 10 percent for large exposure framework	
Commitments that are unconditionally cancellable without prior notice	Undrawn overdraft and credit card facilities	\$450,000	0%	10%	\$45,000
Commitments with an original maturity up to one year	Undrawn formal standby facilities and credit lines	\$10,000	20%	20%	\$2,000
Commitments with an original maturity over one year	Standby letter of credit	\$40,000	50%	50%	\$20,000
Direct credit substitutes	Sale and repurchase agreements	\$125,000	100%	100%	\$125,000

Source: Bank Supervision Department



Minimum Acceptance Criteria for Guarantees

1. In addition to the operational requirements for guarantees set out in Annex 8 of the Capital Adequacy Guideline – Measurement of Credit Risk – Standardised Approach, this appendix sets out the minimum criteria that must be met for a proposed guarantee agreement to be considered for approval by the Bank:
 - a. The guarantor is a licensed financial institution subject to regulation of an equivalent standard to that of the Bank
 - b. The home supervisory authority, where applicable, supervises the capital adequacy and large exposures of the guarantor on a consolidated basis and the exposure of the licensee is considered in such supervision
 - c. The guarantor is obligated to assume the full amount of the exposure upon default and not just the amount in excess of the licensee’s large exposure limit
 - d. The Bank receives written confirmation from the guarantor’s supervisor that the guarantee does not breach any regulatory or statutory requirements in the guarantor’s home country
 - e. The guarantor is, based on a comprehensive assessment conducted by the Bank, a continuing source of financial strength for the licensee
 - f. The guarantee is issued under a resolution of the Board of Directors of the guarantor and a copy of the resolution is provided to the Bank
 - g. The guarantee must be an explicit, unconditional, irrevocable and direct agreement. It may be necessary to ask for evidence that the guarantee is enforceable, for example, an external legal opinion
 - h. The maturity of the guarantee must be at least that of the exposure. If the guarantee has no maturity, it should explicitly state that it is a continuing guarantee or undertaking
2. In addition to the above, the guarantee documentation must explicitly and correctly name the borrower in the agreement, and the undertaking of the guarantor, indemnifier or participant, as the case may be, should be clearly stated.
3. The Bank may attach conditions to its approval of a guarantee arrangement, either generally or in any particular case, as deemed necessary.
4. The beneficiary of the guarantee should notify the Bank immediately of the cancellation, or any variations in the terms, of the guarantee issued on its behalf.
5. To monitor whether the guarantor continues to be financially sound and able to honour its obligations, the Bank will conduct a review of its financial condition at least annually. To facilitate the annual review, the licensee must submit to the Bank, the guarantor’s current audited financial statements, as well as a letter of good standing from the guarantor’s home supervisor.



Reporting Requirements and Ongoing Monitoring of Large Exposure Breaches

Licensee that have identified large exposure breaches are required to submit the following:

1. A letter notifying of the breach, detailing why the breach has occurred and seeking the Bank's approval for a temporary accommodation for same.
2. When a breach to the large exposure limits first occurs, a plan to resolve the breach. This plan should include, where applicable:
 - a. Sources of additional capital in the short-term (e.g. Capital injection from the parent)
 - b. Medium to long-term strategies to contribute to capital through income generation
 - c. Quarterly updates to the capital plan, specifically addressing missed targets;
 - d. The possibility of sourcing additional collateral if large exposures are not fully covered
 - e. the possibility of sourcing additional collateral that qualifies the large exposure for an exemption from the regulatory limit