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## Risk Diversification in the Credit Portfolio: An Overview of Country Practices

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**IMF Working Paper**

Monetary and Exchange Affairs Department

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**Abstract**

<p>The views expressed in this Working Paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy. Working Papers describe research in progress by the author(s) and are published to elicit comments and to further debate.</p>
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This paper reviews the rules in place in selected countries to limit risk concentrations in the credit portfolio. The paper focuses on a number of issues suggested by international organizations for countries and bank supervisors to consider in imposing standards for risk diversification in the credit portfolio. The issues reviewed for each country are the large exposure limits, the definition of credit exposure (including application on a consolidated basis), and the definition of a group of related borrowers. The paper concludes that most of the countries reviewed set limits on large exposures for banks and define a related group of borrowers in line with recommended international standards. The major differences identified among countries include how to determine the credit exposure, the application of the exposure limits on a consolidated basis, and whether to impose limits on exposure to a specific sector.

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## I. INTRODUCTION

The need for countries and bank supervisors to limit risk concentrations by banks is widely recognized. As recently as the Asian crisis of 1997–1998, several countries were subsequently found to have had inadequate lending practices, including high exposure to individual clients and excessive sectoral concentration of loans.<sup>2</sup> A large credit exposure by a bank to an individual borrower, a group of related borrowers, or a sector of the economy may lead to extensive financial loss and even failure of the bank should that creditor or economic sector experience financial difficulties. One approach used by bank supervisors to limit credit risk includes setting a limit on large exposures to a single borrower or a group of related borrowers. This method has been implemented in a great number of countries by setting a maximum ratio to bank regulatory capital for exposure to a single borrower or a related group of borrowers.

While superficially simple, setting a limit on large exposures raises a number of related issues. First among these is the appropriate level of the large exposure limit. The international organizations reviewed recommend a large exposure limit of no more than 25 percent of bank regulatory capital for a single or related group of borrowers. Even with the exposure limit set, efforts to define: (1) a credit exposure, and (2) a group of related borrowers raise numerous issues and can vary widely among countries. Some of the issues raised include whether to: (1) include contingent liabilities in the definition of exposure; (2) specify exceptions to the exposure limits or exemptions from the definition of exposure; (3) apply the large exposure limits on a consolidated basis; (4) encourage or impose exposure limits to specific geographic or economic sectors; and (5) consider the pledge of collateral in determining the level of exposure to a creditor. The treatment of collateral may range from allowing deduction of the collateralized portion before testing the loan amount against the limit, to setting different risk exposure limits for collateralized and noncollateralized obligations, to not taking the collateral into consideration at all.

This paper briefly discusses some international sources for best practices regarding large credit exposures and summarizes some common elements found in those sources. It then reviews the rules in place in selected countries to limit risk concentrations in the credit portfolio focusing on certain key elements of the rules on large credit exposures.<sup>3</sup> The issues reviewed are the large

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<sup>2</sup>Lindgren (1999). The countries analyzed are Indonesia, Korea, Malaysia, the Philippines, and Thailand; Borensztein (1999); and Bank for International Settlements (1999b).

<sup>3</sup> The source of specific country information is the Banking Supervision Regulatory Database (BSRD) maintained by the International Monetary Fund. The accuracy of the information cannot be guaranteed, and some of the information is currently under review by the country authorities. The BSRD is a database of laws and rules that summarizes legislation of a country organized by the framework of the Basel Core Principles for Effective Banking Supervision and other international standards. It allows for searches by topic and country, including cross-comparisons among countries, for over 50 countries.

exposure limits, the definition of credit exposure (including application on a consolidated basis), and the definition of a single borrower or a group of related borrowers.

Most of the countries reviewed set limits on large exposures for banks in line with broadly applied international standards, generally with a limit of 25 percent of a bank's regulatory capital for an individual large exposure to a single borrower or a closely related group of borrowers. While the definition of a connected or related group of borrowers varied among the countries, most countries incorporate the elements of legally or financially related companies or persons. The major differences identified among countries concern the application of the exposure limits on a consolidated basis, whether limits are encouraged or set on exposure to a specific sector rather than only on individual credit, the treatment of collateral, and other issues associated with determining the amount of the credit exposure.

## **II. BEST PRACTICES RECOMMENDED BY INTERNATIONAL ORGANIZATIONS**

### **A. Sources of International Best Practices**

#### **Basel Committee on Banking Supervision**

The Basel Committee on several occasions has studied risk diversification in a bank's credit portfolio and issued papers on this topic.<sup>4</sup>

In January 1991, the Basel Committee issued a paper entitled "*Measuring and Controlling Large Credit Exposures*." This paper provides an overview and analysis of the important issues for bank supervisors in measuring and controlling large credit exposures. The paper recognizes that a "significant proportion of major bank failures have been due to credit risk concentration of one kind or another" and expresses the "need to address what is probably the major single cause of bank failures...." The paper further states: "Experience suggest that credit concentrations... can result in substantial losses without necessarily any commensurate increase in prospective returns. The Basel Committee believes that it is important for supervisors to consider measures limiting banks' exposures to concentrated forms of credit risk in general and large borrowers in particular."<sup>5</sup>

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<sup>4</sup> The Basel Committee was established by the central bank Governors of the Group of Ten countries at the end of 1974 and provides a forum for regular cooperation among member countries on bank supervisory matters. Committee members now come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

<sup>5</sup> Bank for International Settlements (1991), paragraphs 1-3.

*“Measuring and Controlling Large Credit Exposures”* was issued by the Basel Committee “as a guide to best practice for bank supervisors in monitoring and control of large credit exposures” and analyzes several issues which bank supervisors need to address regarding large credit exposures. These are: the definition of a credit exposure, the definition of a single counterparty or group of related counterparties, the appropriate level for a lending limit and a reporting threshold, risks arising from an over-concentrated or “clustered” loan book, and risks arising from excessive exposure to individual geographic areas or economic sectors.

In September 1997 the Basel Committee on Banking Supervision issued a set of “*Core Principles for Effective Banking Supervision*,” which provides a set of 25 principles for an effective supervisory system. In October 1999, the Basel Committee issued a “*Core Principles Methodology*” to facilitate implementation and assessment of the Core Principles.

Principle 9 states: “Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.”

The “*Core Principles Methodology*” lists several essential criteria for compliance with Principle 9 as well as one additional criterion.<sup>6</sup>

In June 1999, the Basel Committee on Banking Supervision issued Working Paper No. 2 entitled “*Supervisory Lessons to be drawn from the Asian Crisis*.” The working group was asked to draw lessons from the 1997–1998 Asian financial crisis, particularly in relation to the Basel Capital Accord and the “Core Principles.” The working paper raises a number of relatively new issues in the area of risk concentration.

The paper finds that the interrelationship between different types of risk in times of crisis was an important lesson to be learned, as was the speed and extent of contagion. As far as the regulatory guidelines are concerned, the working paper concludes that the guidance contained in the 1991 Basel paper on large credit exposures remains largely valid, but observes that “possibly the main missing element is a suggestion that bank management and supervisors need

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<sup>6</sup> Among these essential criteria are the requirements that: (1) a “closely related group” be explicitly defined to reflect actual risk exposure; and (2) laws or regulations, or the supervisor, set prudent limits on large exposures to a single borrower or closely related group of borrowers. “Exposures” should include all claims and transactions, on-balance sheet as well as off-balance sheet. The additional criterion for Principle 9 is a requirement that banks adhere to the following definitions: (1) 10 percent or more of a bank’s capital is defined as a large exposure; and (2) 25 percent of a bank’s capital is the limit for an individual large exposure to a private sector nonbank borrower or a closely related group of borrowers.

to look not only at the absolute levels of credit concentrations relative to capital, but the evolution of all exposures...the speed with which exposures build up may indicate inadequate credit assessment.”<sup>7</sup> The paper goes on to further observe that “the Asian crisis involved the complex interrelations of credit, market and liquidity risks...banks should be encouraged to have appropriate internal policies to respond to these risks. Bank management and supervisors should devote adequate attention and resources to growing, highly profitable or high-risk business activities.”<sup>8</sup>

This analysis also finds the Asian crisis to be an example of the dangers of substantial exposure on a geographic basis. It observes that “There is a need for a very strong message on the importance of effective internal controls on large exposures, particularly in respect of counterparties exempt from the formal limits and in respect of exposures, which represent concentrations of risk to geographic regions or industrial sectors. Monitoring of sectoral and geographic exposures needs to extend to the pace of growth in such exposures and not just the current level.”<sup>9</sup>

### **The Joint Forum**

In December 1999, the Joint Forum, composed of the Basel Committee on Banking Supervision, the International Organization of Securities Commissions and the International Association of Insurance Supervisors issued two papers: “*Risk Concentrations Principles*” and “*Intra-Group Transactions and Exposures Principles*.”

The purpose of the paper “*Risk Concentrations Principles*” is “To provide to banking, securities and insurance supervisors principles for ensuring through the regulatory and supervisory process the prudent management and control of risk concentration in financial conglomerates.” The paper recognizes that “By combining business lines, conglomerates offer the potential for broad diversification. However, new risk concentrations may arise at the group level.” The paper also notes that “risk concentrations historically have been an important cause of losses in all three sectors....”<sup>10</sup>

The paper analyzes some of the issues in the supervision of financial conglomerates. One of the major principles advanced in this paper is that supervisors should take steps to provide that conglomerates have adequate risk management processes in place to manage group-wide risk

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<sup>7</sup> Bank for International Settlements (1999b), Chapter 3 (b), pp. 26–27.

<sup>8</sup> Ibid., Chapter 3 (b), p. 27.

<sup>9</sup> Ibid., Chapter 3 (c) (ii), p. 29.

<sup>10</sup> Joint Forum (1999b), paragraphs 1, 2, 23.

concentrations, and, where necessary, the supervisors should consider appropriate measures, such as supervisory limits.

The purpose of the paper “*Intra-Group Transactions and Exposures Principles*” is to “provide banking, securities and insurance supervisors principles for ensuring through the regulatory and supervisory process the prudent management and control of intragroup transactions and exposure by financial conglomerates.”

### **European Union**

The importance of risk diversification has been recognized by the European Union in its Council Directives, which include a directive on the monitoring and control of large exposures of credit institutions.<sup>11</sup> This directive was recently codified and combined in a single text with other directives by the European Parliament and the Council of the European Union as “an essential instrument for the achievement of the internal market...from the point of view of both the freedom of establishment and the freedom to provide financial services, in the field of credit institutions.”<sup>12</sup> This new directive recognizes that “The monitoring and control of a credit institution’s exposures is an integral part of its supervision. Excessive concentration of exposures to a single client or group of connected clients may result in an unacceptable risk of loss.”<sup>13</sup> The directive places individual and aggregate limits on exposure to a single or group of connected clients as well as defines the terms: (1) exposure; (2) large exposure; and (3) a group of connected clients.

### **World Bank**

In August 1992 the Financial Policy and Systems Division of the World Bank published its Bank Supervision Guidelines. In Guideline 7, Credit Concentrations, the World Bank makes recommendations covering credit exposure limits to a single or related group of borrowers and the definitions of: (1) exposure; (2) large exposure; and (3) single borrower and connected interests or group of affiliated borrowers. Consolidated supervision for large exposures is also recommended.

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<sup>11</sup> European Union (1992).

<sup>12</sup> European Union (2000), “Whereas” No. (4).

<sup>13</sup> Ibid., “Whereas” No. (55).

## **B. Common Elements Found in International Sources**

Common elements appear in many of the recommendations by international organizations concerning risk diversification and the implementation of large concentration limits.<sup>14</sup> Some of these recommendations are discussed below. Common elements emanating from country practices are discussed later in this paper in the section entitled Findings.

### **Exposure limits**

The Basel Committee on Banking Supervision and the World Bank each recommend that 25 percent of a bank's capital be the limit for an individual large exposure to a private sector nonbank borrower or a closely related group of borrowers.<sup>15</sup> The directives of the European Union also impose a 25 percent limit.<sup>16</sup> The World Bank further recommends that the unsecured credit limit not exceed 15 percent of capital funds.

Both the Basel Committee and the World Bank acknowledge that some countries have aggregate large exposure limits.<sup>17</sup> For example, the members of the European Union do not permit a credit institution to incur large exposures (defined as exceeding 10 percent of capital), which in total exceed 800 percent of own funds.

The Basel Committee recognizes that exemptions or higher exposure limits may be appropriate for some counterparties, such as the domestic government, public-sector entities below the level of the central government, other governments, or bank counterparties.<sup>18</sup>

The Basel Committee also concludes that there are risks arising from an over-concentrated loan book or from over-exposure to geographic areas or economic sectors and recommends that

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<sup>14</sup> The terms "capital" and "regulatory capital" appear throughout this paper. When discussing an international source or a country's rules, the term used in the source document appears; otherwise, the term "regulatory capital" is used. For purposes of this paper, the terms should be interchangeable.

<sup>15</sup> Bank for International Settlements (1991), paragraph 18; Bank for International Settlements (1997), Core Principle 9; Bank for International Settlements (1999a), Core Principle 9, Additional Criteria; The World Bank (1992), Guideline 7.

<sup>16</sup> European Union (1992), Article 4; European Union (2000), Title V, Chapter 2, Section 3, Article 49.

<sup>17</sup> Bank for International Settlements (1997), Core Principle 9; The World Bank (1992), Guideline 7.

<sup>18</sup> Bank for International Settlements (1991), paragraph 19.

attention be drawn to the need to monitor these exposures also.<sup>19</sup> The World Bank also recognizes the potential risk exposures that exist from geographic and economic sector concentrations. The Bank Supervision Guidelines issued by the World Bank state: “Most bank supervisors would consider that any exposure of credit to any geographical, economic or activity sector larger than 5 percent of capital funds to be worthy of special attention. Such exposures require monitoring, including a periodic assessment of key factors that could affect repayment by that sector.”<sup>20</sup>

### **Definition of credit exposure**

The Basel Committee on Banking Supervision and the World Bank each recommend that “exposures” include all claims and transactions, on-balance sheet as well as off-balance sheet.<sup>21</sup>

The Basel Committee also raises an issue concerning the application of the risk weights used in the capital adequacy framework to determine exposure to risk assets for the purposes of determining large credit exposures. The Basel Committee does not recommend the use of risk weights in determining the credit concentration risk exposure, with one exception. As stated by the Basel Committee: “The main problem in defining an exposure is to quantify the extent to which less direct forms of credit exposure should be included alongside straightforward bank loans.... A similar question is whether to recognize the lesser credit risk arising in relation to claims enhanced by collateral or guarantees. One possibility is to adopt en bloc the measure of credit risk laid down in the capital exercise for measuring credit risk concentrations. This would mean multiplying each type of risk asset by the weight attributed to it in the Capital Accord.”<sup>22</sup> For example, a loan secured by a residential mortgage, which carries a 50 percent risk weight in the capital adequacy framework, would be included as a credit exposure at 50 percent of the claim amount for purposes of the large credit exposure limit. After weighing the pros and cons of this approach, the Basel Committee concludes that “to use the capital weights for measuring credit concentrations could significantly underestimate potential losses.... It would also mean

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<sup>19</sup> Ibid., paragraphs 22–24.

<sup>20</sup> The World Bank (1992), Guideline 7. In evaluating lessons to be learned from the Asian crisis, the Basel Committee suggests that supervisors also look at the speed with which exposures build up, including the pace of growth for sectoral and geographic exposures. Bank for International Settlements (1999b), pp. 26–28.

<sup>21</sup> Bank for International Settlements (1991), paragraph 9; Bank for International Settlements (1999a), Core Principle 9, Essential Criteria 2; The World Bank (1992), Guideline 7.

<sup>22</sup> Bank for International Settlements (1991), paragraphs 6–7.

relying on the value attributed to collateral or guarantees, which, in extreme cases, often turns out to be illusory.”<sup>23</sup>

As noted, the World Bank recommends that the unsecured credit limit not exceed 15 percent of capital funds, without defining “unsecured” or “secured.” The Bank Supervision Guidelines issued by the World Bank further state that “collateral or security supporting credit should not affect the established limit, since the worth of collateral cannot be tested until it has been realized.”

The Basel Committee and the World Bank further recommend that a large exposure be defined as 10 percent or more of a bank’s capital.<sup>24</sup> The European Union also uses that definition. The Basel Committee finds merit in a supervisory reporting requirement for large exposures.<sup>25</sup> Members of the European Union also are required to report every large exposure in accordance with established procedures.<sup>26</sup>

Both the Basel Committee and the World Bank Guidelines recommend consolidation of all exposures of a group as an essential principle.<sup>27</sup> Generally, the European Union monitors compliance on a consolidated basis for an institution.

#### **Definition of related groups of borrowers**

An essential criterion under Basel Core Principle 9 is that a “closely related group” be explicitly defined to reflect actual risk exposure. The essential criteria for that principle states that the

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<sup>23</sup> Ibid., paragraph 8. However, the Basel Committee notes that “one part of... the capital weighting framework... would be appropriate for this purpose, namely that which specifies the conversion factors applied for off-balance-sheet items such as swaps, options and futures, where the creditor is not at risk for the full principal amount but only for the *replacement cost*. However, some supervisors and banks would consider that measure of risk... not necessarily appropriate for large exposures, where... a more rigorous measure may be justified.” Ibid., paragraph 10.

<sup>24</sup> Bank for International Settlements (1997), Principle 9; Bank for International Settlements (1999a), Principle 9, Additional Criteria; The World Bank (1992), Guideline 7.

<sup>25</sup> Bank for International Settlements (1991), Paragraph 20; Bank for International Settlements (1997), Principle 9; Bank for International Settlements (1999b), Core Principle 9.

<sup>26</sup> European Union (2000), Title V, Chapter 2, Section 3, Article 48.

<sup>27</sup> Bank for International Settlements (1991), paragraph 12; Bank for International Settlements (1997), Core Principle 9; Bank for International Settlements (1999a), Core Principle 9; The World Bank (1992), Guideline 7.

definition can include not only legally related companies but also financially related companies, e.g., with common ownership. Physical persons (for example large shareholders) can also be considered.

The Basel Committee states: “One of the main problems in restricting credit concentrations is the need to identify potential linkages between exposures to single debtors.... In defining related counterparties, it is insufficient simply to consider groups that produce consolidated accounts. Relationships can include, for example, connection through common ownership, control, or management.... Supervisors may wish to consider as a suitable example the definition used in the European Commission’s Recommendation of 1986.”<sup>28</sup> This EC Recommendation is similar to that found in the directives of the European Union. In general terms, these state that a group of connected clients means two or more natural or legal persons: (1) who constitute a single risk because one of them, directly or indirectly, has control over the other or others; or (2) who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties. By way of example, this interconnection can include common ownership, common directors, cross guarantees, etc. The Bank Supervision Guidelines of the World Bank similarly state that connected interests or a group of affiliated borrowers means a group connected through management, ownership, or control by the primary borrower. “The basic factor in the determination of a group is ownership and control.”<sup>29</sup> The World Bank Guidelines also refer to the European Commission’s Recommendation.

### III. COUNTRY PRACTICES

The remainder of this paper discusses the rules in place in selected countries concerning exposure limits, the definition of exposure, and the definition of a group of related borrowers.<sup>30</sup> Information, where available, is included on whether the rules are applied on a consolidated basis. Similarly, information on the use of collateral, sectoral exposure limits, the application of risk weights and exceptions to the rules is included if discussed in that country’s legislative acts relating to large exposure limits.

The similarities and differences among the countries for the elements reviewed are discussed at the end of this paper in the section on Findings.

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<sup>28</sup> Bank for International Settlements (1991), paragraphs 13–14.

<sup>29</sup> The World Bank (1992), Guideline 7.

<sup>30</sup> Citations to the relevant part of the laws and regulations for each country are located in Appendix I. The terminology used in this paper may vary by country because terms appear as used or defined in the laws or regulations.

## **A. Limits on Large Exposures**

### **Albania**

The large exposure limit is a maximum ratio of 20 percent of total risks assumed by a bank in its operations with a single beneficiary to regulatory capital. Additionally, a maximum ratio of 700 percent of total significant risks (greater than 10 percent of regulatory capital to a single beneficiary) to regulatory capital is established.

The Bank of Albania has the authority to prescribe the maximum aggregate amounts of credit, expressed as a percentage of the aggregate of all credits, that a bank is permitted to have to 10 persons (including groups) with respect to whom the bank's credit exposure is the greatest.

### **Armenia**

The maximum risk permitted to a single borrower is 20 percent to total capital of the bank. There is no requirement to apply this rule on a consolidated basis.

### **Australia**

An authorized deposit taking institution (ADI) is required to maintain and implement appropriate policies to monitor and manage the risk of credit concentrations on a consolidated group basis to ensure that it is not unduly exposed to a single or small number of counterparties such that their default would adversely affect the ADI's financial position. The policy should place a limit on the size of individual exposures relative to the capital base of the consolidated group, and should provide for large credit exposures (exposure to an individual or a related group which exceeds 10 percent of consolidated capital) to be kept under regular review.

While not placing actual limits on large exposures, the Australian Prudential Regulation Authority (APRA) has a prior notification requirement, which requires that an ADI first consult with APRA before committing to enter into an exposure in excess of 30 percent (30 percent for banks and 10 percent for other ADIs) of its consolidated capital base. The ADI must be able to satisfy APRA that the proposed exposure does not constitute an excessive risk to the consolidated group.

An ADI, which has, on a consolidated group basis, a significant number of large exposures must be able to satisfy APRA that excessive risks are not being undertaken. An ADI with a high volume of large exposures is likely to be required to maintain a higher capital ratio.

For a foreign-owned locally incorporated ADI, direct exposures to a foreign parent and its related entities are limited to one times the ADI's consolidated capital base. Indirect exposures, represented by the shedding of credit risk from the ADI to its foreign bank parent or to the foreign parent's banking subsidiaries, are limited to four times the ADI's consolidated capital base.

### **Brazil**

A limit of 25 percent of adjusted net assets is established for the diversification of risk by customer for loans and guarantees, as well as loans relating to operations with derivatives.

A limit of 25 percent of adjusted net assets is established in operations of subscription for resale and guarantee of subscription for securities, as well as in investments in securities issued by the same enterprise, related enterprises, or controlling companies and their controlled entities.

If the customer and the enterprise issuing the securities are the same person, the sum of the transactions referred to in the above two paragraphs may not exceed 25 percent of the adjusted net assets of the institution.

### **Bulgaria**

The exposure to one person or related persons may not exceed 25 percent of own funds. The total amount of all big exposures (10 percent or more of own funds to one or related persons) may not exceed eight times own funds.

Exposures are added and reported as one exposure carrying total risk for the bank/bank group in the cases where relatedness between individual clients on a nonconsolidated or consolidated basis is ascertained. In their internal credit rules banks are required to prescribe restrictions on concentrations of exposures to an economic sector and/or geographic region.

### **Canada**

The aggregate exposure of a consolidated company or authorized foreign bank to any entity or a connection may not exceed 25 percent of total capital. Notwithstanding this limit, it is expected that companies will establish lower internal limits and that the 25 percent regulatory limit will be employed only on an exceptional basis. All companies are required to set out in writing their internal policies on large exposures and make them available for review upon request of the Office of the Superintendent of Financial Institutions.

A Canadian resident company that is the subsidiary of a parent bank may have an exposure to any entity or connection that is no greater than 100 percent of the total capital of the subsidiary, subject to specified conditions, such as adequate supervision and the presence of a parent company that is a continuing source of financial strength. Notwithstanding this limit, it is expected subsidiary companies will establish lower internal limits and that the 100 percent regulatory limit will be employed only on an exceptional basis. Failure to meet all of the specified conditions will result in the Superintendent reducing the limit to not lower than 25 percent of the total capital of the company subsidiary.

Where applicable, limits should be established on exposures to industries and geographic regions.

### **Central African Banking Commission**<sup>31</sup>

The total exposure to a single beneficiary may not exceed 45 percent of the net equity capital of the institution. The total exposure to beneficiaries whose individual obligations exceed 15 percent of the net equity capital of the institution may not exceed eight times the net equity capital.

These restrictions do not apply to exposure to the Bank of Central African States (BEAC) member States or to credit institutions with headquarters located within the geographic purview of the Banking Commission. Institutions are required to declare to the Commission the cash advances granted to credit institutions whenever they exceed 15 percent of their net equity capital.

### **Egypt**

A bank's investments with a single client in the form of capital shares and credit facilities and any form of financing may not exceed 30 percent of the bank's capital base.

For a bank's investments abroad, banks which are registered with the Central Bank and permitted to transact in foreign currencies (excluding the branches of foreign banks) are limited to 10 percent of total investments with a single correspondent or \$3,000,000, whichever is greater, provided such investments do not exceed 40 percent of the bank's equity according to the capital adequacy measure. The branches of Egyptian banks abroad are excluded from the framework of correspondents abroad.

### **European Union**<sup>32</sup>

A credit institution may not incur an exposure to a client or group of connected clients the value of which exceeds 25 percent of its own funds. Where that client or group of connected clients is the parent or subsidiary of the credit institution and/or one or more subsidiaries of that parent, the percentage limit is reduced to 20 percent. A credit institution may not incur large exposures (10 percent or more of own funds to client or connected group), which in total exceed 800 percent of its own funds.

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<sup>31</sup> The member countries of the Central African Banking Commission are Cameroon, Chad, the Central African Republic, the Republic of the Congo, Gabon, and Equatorial Guinea.

<sup>32</sup> The member countries of the European Union are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom. Additionally, Iceland, Liechtenstein, and Norway, as members of the European Economic Area, have adopted the same rules.

Member states may exempt the exposures subject to the 20 percent limit if they provide for specific monitoring of such exposures by other measures or procedures. They are to inform the Commission and the Banking Advisory Committee of the content of such measures or procedures. Member states may impose limits more stringent than those set forth above.

If the credit institution is neither a parent nor a subsidiary, compliance with the obligations in this area is monitored on an unconsolidated basis. In other cases, compliance is monitored on a consolidated basis. Waivers by member states are permitted in specified circumstances.

### **India**

The bank's exposure should not exceed 25 percent of capital funds in the case of individual borrowers and 50 percent in the case of a group of borrowers. In the case of infrastructure projects (*i.e.*, power, telecommunication, road, and ports), the credit exposure to a group of borrowers is fixed at a higher level of 60 percent (the exposure norm of 25 percent still applies to individual borrowers). The banks should also fix internal limits for aggregate commitments to specific sectors (e.g., textiles, jute, and tea) with a view to ensuring that the exposures are evenly spread over to various sectors. For loans and advances granted to Indian joint ventures or wholly owned subsidiaries abroad, the aggregate of such loans and advances may not exceed 5 percent of unimpaired Tier I capital of the bank.

### **Indonesia**

The legal lending limit for an individual debtor or group of debtors comprising an unconnected party is 30 percent of capital until the end of 2001, 25 percent of capital throughout the year 2002, and 20 percent of capital from January 1, 2003 on.

### **Latvia**

Exposure to any single customer (or any group of connected customers) may not exceed 25 percent of the credit institution's own funds. The total large exposures (10 percent or more of own funds to an individual or group) of a credit institution may not exceed the credit institution's own funds by more than eight-fold.

The limits are enforced on a consolidated supervision basis. A credit institution that is the parent of other financial institutions, that is a direct or indirect owner of 20 percent or more of the share capital or voting shares in financial institutions, or whose parent is registered in Latvia, as a financial holding company must comply with the limits on the basis of consolidated financial statements. Should the Bank of Latvia require it, a credit institution whose supervision is on a consolidated basis must comply also on the basis of nonconsolidated financial statements.

While specific limits on sectoral exposures are not stated, credit institutions are expected to develop policies for controlling large exposures by establishing types and limits of exposures to certain customers or categories of customers, including by credit institutions, countries (regions) and national economy sectors.

## **New Zealand**

There are no prudential limits on exposures to individual counterparties or groups of closely related counterparties. Instead, banks are required to publish information about the number of credit exposures to individual counterparties or groups of closely related counterparties, which exceed 10 percent of equity, including a breakdown by equity range (10 percent bands). Information on both end of quarter and peak exposure is required. The information included in disclosure statements is subject to a full audit at the end of each accounting period and a limited scope audit at the end of each interim accounting period.

The information disclosed relates to the banking group, defined as the financial reporting group (including or excluding an entity or part of that entity, where the Reserve Bank has agreed to or required its inclusion or exclusion, after notice and consultation with the bank).

## **Peru**

Credit concentration limits, based on a sole counterpart or a group of related counterparts, are established for five categories:

(1) A domestic nonfinancial individual or legal entity: Credit, investment or contingency funds granted, directly or indirectly, may not exceed 10 percent of regulatory capital (except bonds guaranteeing the signing of contracts in public bids, which are subject to a limit of 30 percent). Under exceptional circumstances, institutions may exceed the 10 percent limit, up to 15 percent, 20 percent, or 30 percent of regulatory capital, provided that the excess is covered by specified collateral at realization value;

(2) A domestic individual or entity: Financial leasing granted may not exceed, directly or indirectly, 70 percent of regulatory capital;

(3) A foreign nonfinancial individual or legal entity: Credits, contingency funds, investments and financial leasing may not exceed 5 percent of regulatory capital. This limit may be raised to 10 percent or 30 percent provided that specified guaranties are given for the excess;

(4) A domestic financial institution: Credit granted and any deposits, added to the warranty bonds, collateral, and other guaranties received, may not exceed 30 percent of regulatory capital. Warrants issued by a single general warehouse as guarantee may not exceed 60 percent of regulatory capital (excluding general warehouses in which the institution is the majority shareholder); and

(5) A foreign banking or financial institution: Credits granted and the deposits made therein, added to the warranty bonds, collateral, and other guaranties received, may not exceed the following limits of regulatory capital: (1) 5 percent for institutions not subject to supervision by an agency similar to the Superintendency of Banking and Insurance; (2) 10 percent for institutions subject to supervision by an agency similar to the Superintendency; (3) 30 percent

for top-rated banks; and (4) 50 percent if the excess over a previous limit is represented by specified letters of credit.

The Superintendency may not authorize the incorporation of companies designed to support only one sector of the economy. The Central Reserve Bank of Peru may not impose sectoral or regional ratios on the composition of the loan portfolios of financial institutions.

For purposes of calculating the limits, financial institutions take account of financing resources made available, deposits made, and endorsements, pledges, and other guarantees received from their subsidiaries and other enterprises of the same economic or a financial group which is able to be consolidated.

### **Philippines**

Except as the Monetary Board of the Bangko Sentral ng Pilipinas may otherwise prescribe for reasons of national interest, the total amount of loans, credits and guarantees (as defined by the Monetary Board) that may be extended by a bank to any person or entity may not exceed 20 percent of the net worth of the bank. Unless the Monetary Board prescribes otherwise, the total amount of loans, credit accommodations and guarantees may be increased by an additional 10 percent of the net worth of the bank provided the additional liabilities of any borrower are adequately secured by specified collateral.

There is a separate single borrower's limit (SBL) of 35 percent of unimpaired capital and surplus for the wholesale lending activities of government banks to participating financial institutions (PFIs) for relending to end-user borrowers, subject to certain guidelines, including only for loan programs funded by multilateral, international or local developmental agencies specially designed for wholesale lending activities of government banks.

Whenever the Monetary Board considers it advisable to prevent or check an expansion of bank credit, the Board may place an upper limit on the amount of loans and investments which the banks may hold, or may place a limit on the rate of increase of such assets within specified periods of time. The Monetary Board may apply such limits to the loans and investments of each bank or to specific categories thereof. An aggregate limit on real estate loans of 20 percent of the respective total loan portfolio is in place. Excluded from this ceiling are loans not exceeding P3.5 million to finance the acquisition or improvement of residential units, provided that the aggregate real estate loans including those over P3.5 million for residential units not exceed 30 percent of the respective total loan portfolio.

### **Russian Federation**

The maximum amount of credits, guarantees, and warranties in favor of one borrower or group of related borrowers may not exceed 25 percent of capital.

The maximum amount of big credit risks (greater than 5 percent of capital) may not exceed 800 percent of capital.

## **Switzerland**

A risk position may not exceed 25 percent of the bank's eligible equity resources. The upper limit may be exceeded without immediate notification whenever the excess is covered completely by freely eligible equity resources, but must be disclosed in specified statements.

The aggregate amount of risk concentrations (10 percent or more of eligible equity resources to a counterparty) may not exceed 800 percent of the bank's eligible equity resources.

The provisions regarding risk diversification are to be complied with both on a single-company and consolidated basis if and in so far as the bank is obligated to comply with the capital adequacy requirements on a consolidated basis. Exempt are consolidated group companies individually subject to appropriate supervision or as counterparty only have group companies, which are individually subject to appropriate supervision.

In special cases the Federal Banking Commission can allow an easing or tightening of the regulations. The Federal Banking Commission can also stipulate upper limits for land holdings held by a bank.

## **United States of America**

A national bank's total outstanding loans and extensions of credit to one borrower may not exceed 15 percent of the bank's capital and surplus, plus an additional 10 percent of the bank's capital and surplus, if the amount that exceeds the bank's 15 percent general limit is fully secured by readily marketable collateral. Special lending limits apply to certain categories of loans, such as loans secured by bills of lading or warehouse receipts covering readily marketable staples (additional 35 percent to above combined 25 percent limit, with collateral at least 115 percent for outstanding loan over 25 percent limit), discount of installment consumer paper with full recourse (additional 10 percent above combined 25 percent limit), and specified additional advances to complete project financing pursuant to renewal of a qualifying commitment to lend. Specified loans are not subject to the lending limits, such as loans fully secured by obligations guaranteed by the United States, loans to a financial institution or any receiver of a financial institution approved by the Comptroller of the Currency when an emergency exists and a national bank is asked to provide assistance to another financial institution, specified bankers' acceptances, certain loans arising from the discount of commercial or business paper, and loans secured by segregated deposit accounts.

The limits apply to all loans and extensions of credit made by national banks and their domestic operating subsidiaries.

## **West African Economic and Monetary Union<sup>33</sup>**

The total amount of risks that can be taken on one signature is limited to 75 percent of the effective capital of the bank or financial institution. The overall volume of risks individually totaling 25 percent of the effective capital of a bank or financial institution is limited to eight times the effective capital of the institution.

### **B. Definition of Exposure**

#### **Albania**

Risk is defined to include both on- and off-balance sheet items at risk of failure by the counterparty. Any guarantee and collateral received, if effective for a period longer than the duration of the risks they cover, are deducted from the risks. These include securities issued by governments and central banks of specified countries (such as the European Community, and local or regional administration of countries that are members of the European Union), cash deposits in the lending bank or the parent of the lending bank, guarantees issued by a third party (with specified characteristics), etc.

The amount of risks, reduced by the amount of provisions and collateral and guarantees, are weighted by the risk weights used in determining capital adequacy.

Significant risks means all risks assumed by a bank in its operations with a single beneficiary, when the total of such risks exceeds 10 percent of regulatory capital.

#### **Armenia**

Liabilities, warranties, and guarantees against liabilities (using established risk weights) are included in the calculation of the maximum permissible ratio.

#### **Australia**

Exposures include claims and commitments recorded both on and off the balance sheet of an institution on a consolidated group basis.

A large exposure is defined as an exposure to an individual counterparty or a group of related counterparties which exceeds 10 percent of consolidated capital base.

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<sup>33</sup> The members of the West African Economic and Monetary Union include Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.

## **Brazil**

The customer exposure limit applies in contracting to make loans and commercial leases and in providing guarantees, as well as loans relating to operations with derivatives. It does not include on lending transactions or credits flowing from the renegotiation of debts authorized by specified laws, nor any lines of supplementary credit intended to repay debts renegotiated under the protection of those and other specified laws. For purposes of verifying the limit, adjusted net assets is reduced by the amount of any equity interest in financial institutions and other institutions authorized to operate by the Central Bank of Brazil.

The limit for securities operations does not apply to federal public securities, or to debentures issued by related commercial leasing companies. In the case of financial institutions that engage in the primary placement of securities, this limit must be observed only after the end of the distribution period, and any excess may be eliminated as specified, that is 50 percent within 30 days, and 100 percent within 60 days, after the close of the period. The limit does not apply to securities that are the object of a loan or investments in the shares of mutual funds.

## **Bulgaria**

Exposure to one person or to related persons is established as a sum of non risk-weighted balance sheet assets and off-balance sheet commitments. Certain exclusions from the definition of exposure are specified, such as securities transactions in the process of settlement, assets fully covered by specific provisions, etc. Exclusions from the exposure limits are also specified, such as exposures guaranteed by the state or central bank, exposures guaranteed by securities issued by the Bulgarian government, etc.

An exposure to one person or related persons is considered large when it equals or exceeds 10 percent of the own funds of the bank or the bank group. A large exposure is the total exposure to an individual client or related persons, established for an individual bank or a bank group on a consolidated basis.

## **Canada**

An exposure is defined to include claims comprising: (1) any drawdowns on arrangements for providing funds or credit including loans and advances, debt and equity securities, etc., (2) all undrawn amounts of irrevocable advised credit commitments including standby letters of credit, financial guarantees, revolving underwriting facilities, etc., and (3) the credit equivalent amount of foreign exchange, interest rate, equity and commodity contracts (recognizing the net amount where transactions are subject to a legally valid contractual right of set-off). Extensive guidance is provided on claims included and excluded in the definition of exposure. For example, exclusions include deposits and other specified contracts with banks that have a residual maturity of less than one year, direct obligations or obligations guaranteed by the Canadian government or OECD central governments, etc.

### **Central African Banking Commission**

Risk exposure includes disbursed loans, financial leasing, and leases with option to purchase, securities issued by the beneficiary, correspondent liabilities, and signature liabilities. With the prior authorization of the Banking Commission, security deposits and guarantees formally issued by a Bank of Central African States (BEAC) member state or by a credit institution, for a period no less than the duration of the risks covered, is deductible from these risks.

The net risk of any guarantees received is weighted at 50 percent or 100 percent (reduced by half in exceptional cases for some companies of very high standing and of national importance whose credit rating is sound, or for some enterprises which are particularly significant to the national economy and designated so by the Banking Commission) based upon the risk, such as 50 percent for crop credits, documentary credit opened, commercial discounting, loans guaranteed by a first-class mortgage weighted at the real value of the collateral, sureties and other signature guarantees granted to customers, etc. and 100 percent for cash loans (other than above), investment and equity securities, equity lending and subordinated loans, financial leasing and leases with option to purchase, etc. The accounting headings covering different types of credit are included in the risk-based capital ratio using the highest weight applicable to the credits.

### **Egypt**

The bank's investments with a single client include credit facilities provided by the bank to the client and securities possessed by the bank, which represent an obligation owed by the client, whether in the form of capital shares of the client or bonds, instruments, or other securities issued by the client. A credit facility is defined to include the used balance of loans and advances, contingent liabilities and personal guarantees provided by a client to the bank to guarantee another client of the bank. Excluded is the portion of any balance of loans and advances covered by cash deposits, letters of guarantee, and securities issued by the Ministry of Finance or by first-class banks in Egypt or abroad. Saving certificates and investment certificates of the Egyptian National Bank, Egyptian treasury bonds, and Egyptian Government securities are considered cash deposits for this purpose. Contingent liabilities include securities, guarantees, credits, or bills of exchange, excluding the value of these liabilities covered by a cash margin, letters of guarantee, and securities issued by the Ministry of Finance or first-class banks in Egypt or abroad. Investments also include the stocks and shares of the client's capital held by the bank as its participation in the capital of companies and other securities held by the bank, e.g., bonds and instruments issued by the bank's client to secure financing.

Credit facilities and any form of investment granted to government agencies, except public authorities, public-sector companies, and public business sector companies, are exempt from the lending limits. The lending limits do not apply to interbank transactions.

## **European Union**

Exposures are defined to mean assets and off-balance sheet items without application of the weightings or degrees of risk. Elements covered entirely by own funds may, with the agreement of the competent authorities, be excluded provided that such own funds are not included in the calculation of solvency or other monitoring ratios.

Member states may fully or partially exempt from the limits exposures contained in a lengthy list of exemptions, such as claims on credit institutions for cash-clearing operations, certain claims on specified governments, exposures secured by specified securities, etc. While member countries do not apply capital adequacy risk weights to determine the credit exposure, some of the potential exemptions mirror the risk weights used for capital adequacy purposes. For example, potential exemptions include: (1) claims on Zone A central governments or central banks (these same assets carry a 0 percent risk weight for capital adequacy purposes); (2) loans secured by mortgages on residential property up to 50 percent of the value of the residential property (these assets carry a 50 percent risk weight for capital adequacy purposes); and (3) 20 percent on exposures to credit institutions (20 percent risk weight for capital adequacy purposes for some claims on credit institutions).<sup>34</sup> Possible exemptions also include 50 percent of the medium/low risk off-balance sheet items.

A credit institution's exposure to a client or group of connected clients is considered a large exposure where its value is equal to or exceeds 10 percent of its own funds.

## **India**

Exposure includes funded and nonfunded credit limits and underwriting and similar commitments. The sanctioned limits (for nonfunded credit limits, only 50 percent of such limits) or outstanding, whichever are higher, are used for arriving at the exposure limit. The investments in shares and debentures/bond of companies/public sector undertakings and in commercial papers are included, but advances granted by a bank against its deposits need not be considered for the exposure norms.

## **Indonesia**

The provision of funds by an institution is defined as the placement of bank funds in rupiahs or foreign currencies, comprising credit, securities, interbank placements, and equity participation, and includes commitments and contingencies in off balance sheet transactions. Rules are provided for determining the provision of funds, such as guarantees issued by the bank are based on the nominal value, loans are based on the outstanding balance, derivative transactions

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<sup>34</sup> Zone A comprises all Member States of the European Union and other countries that are full members of the Organization for Economic Cooperation and Development (OECD), with a few specified exceptions.

are based on value of their credit risk, etc. The legal lending limits are waived for specified categories of funds, such as placements in Bank Indonesia Certificates and Treasury Bills issued by the government of Indonesia, funds issued and/or guaranteed by the Government of Indonesia or guaranteed by Bank Indonesia, temporary equity participation in a debtor company for the purpose of resolving credit default (as specified in a Decree concerning debt restructuring), funds guaranteed by cash collateral in specified deposits (demand deposits, time deposit, etc.), interbank placement as long as the government guarantee scheme remains in force and the bank accepting the placement satisfies the requirements of the guarantee scheme, etc.

### **Latvia**

Exposures defined as transactions with assets and off-balance sheet items (for those assets specified in the capital adequacy regulation without considering risk weighting with a few exceptions specified). Exposure includes credits extended to a customer, shares and other securities issued by a customer and possessed by the institution, etc. A detailed procedure for determining exposure is set forth. Specific items to be included and excluded are listed, such as the exclusions of specified transactions with 0 percent risk weighting, short term claims on credit institutions in Zone A countries, etc. A credit institution's exposure is classified as large if it exceeds 10 percent of the credit institution's own funds.

### **New Zealand**

Credit exposure means the maximum loss that a party to a contract could incur as a result of the counterparty failing to discharge its obligations, without taking into account the value of collateral, guarantees, indemnities, other support arrangements, and any potential recoveries, where the maximum loss in relation to:

- (a) A market related contract means the credit equivalent amount of the contract (determined in accordance with a specified Reserve Bank document); and
- (b) Any other contract means the full value of the contract; provided that a financial liability and a financial asset may be offset if to do so would accord with generally accepted accounting practice.

The credit exposure information is calculated net of specific provision and excludes any OECD government.

### **Peru**

In the case of nonfinancial entities and individuals, financing is defined as credits, investments, financial leases and contingent items. Exposure to another financial institution includes credits, as well as deposits and warranty bonds, collateral and other guarantees received.

## **Philippines**

The basis for determining compliance with the single borrower limit is the total credit commitment of the bank to the borrower. Loans, other credit accommodations and guarantees exclude loans and other credit accommodations: (1) secured by obligations of the Bangko Sentral or of the Philippine Government; (2) fully guaranteed by the government as to the payment of principal and interest; (3) covered by assignment of deposits maintained in the lending bank and held in the Philippines; (4) under letters of credit to the extent covered by margin deposits (and acceptances); and (5) which the Monetary Board may specify as nonrisk items. Loans and other credit accommodations, deposits maintained with, and usual guarantees by a bank to any other bank or nonbank entity, whether locally or abroad, are subject to the limits prescribed. Certain types of contingent accounts of borrowers may be included as may be determined by the Monetary Board.

## **Russian Federation**

When determining the risk amount, the whole sum of the credits, guarantees, and warranties given by the credit organization to the borrower or the group of related borrowers is taken into account. The total in respect of credits (including interbank), placed deposits (including interbank), discounted bills of exchange, loans, credits and deposits in precious metals and the amounts not collected by the bank on its guarantees are included. The claims are computed with account taken of the degree of risk. Off-balance sheet accounts are generally included but specified guarantees and sureties are not.

The limit is computed for each issuer in debentures of which the bank has invested funds, including the state. The limit is computed separately in respect of the federal bodies of state power, the bodies of power of the subjects of the Russian Federation and local self-government bodies, should the latter have an isolated budget.

A large credit risk is defined as the volume of the credits, guarantees, and warranties in favor of one client over 5 percent of the capital.

## **Switzerland**

The risk position of a counterparty comprises receivables using risk weighting, off-balance sheet transactions converted into their credit equivalent and risk weighted and net long positions in securities computed as specified. Further rules are in place for computing the risk position and on the application of collateral. Rules are provided for forward contracts, purchased options, etc.

The upper limit of 25 percent may be exceeded without immediate notification whenever the excess is covered completely by freely eligible equity resources. For the upper limit for aggregate risk concentration (800 percent), specific positions are not required to be included in the computation, such as certain receivables, portions covered by freely eligible equity resources, etc.

A risk concentration arises when the aggregate risk position for one counterparty reaches or exceeds 10 percent of the bank's eligible equity resources.

### **United States of America**

Loans and extensions of credit means a bank's direct or indirect advance of funds to or on behalf of a borrower based on an obligation of the borrower to repay the funds or repayable from specific property pledged by or on behalf of the borrower. Inclusions and exclusions are specified, such as a contractual commitment to advance funds is included, as well as accrued and discounted interest on an existing loan or extension of credit is excluded.

### **West African Economic and Monetary Union**

Exposure includes both balance sheet risks, including securities held, and off-balance sheet liabilities. The weights applied to each risk category, as well as the guarantees backing the risks in question, are those adopted for the rule on risk hedging. Crop credits and credits guaranteed by government contracts are included in the scope of the rule on risk diversification.

## **C. Definition of Connected or Related Group of Borrowers**

### **Albania**

A beneficiary is defined as an individual, a person, or a group of juridical persons interrelated in a way that the financial difficulties of one or more members may cause financial difficulties to other members in meeting their obligations. Interrelated juridical persons are defined as a juridical person or some juridical persons which directly or indirectly: (1) own equity interest or significant interest of the bank, or other juridical persons; (2) control the bank or other juridical persons; and (3) influence the management of the bank or other juridical persons. Significant interest means a direct or indirect holding that represents 10 percent or more of the equity or voting rights, or that makes it possible to exercise a significant influence over the management or policies of such juridical person.

### **Armenia**

The maximum risk for one borrower is defined as including loans to a single borrower and linked persons. Persons are considered linked if: (1) one person is the subsidiary company of the other person; (2) one person is vested with the right of acquisition, or acquires, more than half of the voting stock of the other person, or is capable of influencing, or influences, the decisions of the other person through any other manner not prohibited by the law; or (3) the majority of members, directors or other participants of its Board are at the same time members, directors or other participants of the Board of the latter. Physical persons are considered linked if they are members of the same family or carry out joint economic activity.

## **Australia**

An authorized deposit taking institution (ADI) treats counterparties as related where they are linked by cross guarantees, common ownership, ability to control, financial interdependency, or other connections which, in the ADI's assessment, identify the counterparties as representing a single risk. Family members are not treated as related where they have independent retail relationships with the ADI.

## **Brazil**

A customer is considered to be any person, individual, or corporation, or any group of persons acting in isolation or jointly or representing a common economic interest. In the case of the public sector, customer refers to the federal government, the state, the federal district, or the municipality, together with any directly or indirectly related entities (public enterprises, mixed capital corporations, their subsidiaries and other related enterprises; "*autarquias*" and foundations; and other entities).

## **Bulgaria**

Limits apply to the total exposure to individual clients related by virtue of mutual guarantees or direct commercial dependence such as intercorporate lending or mutual indebtedness, which cannot be settled immediately. Limits are on exposures to one person or related persons. Related persons include: (1) where one person participates in the management of another person's company or subsidiary; (2) where a company or a person holds more than 5 percent of a company's voting shares; (3) persons whose activities are controlled by a third person or its subsidiary; (4) persons who jointly control a third person or its subsidiary; (5) persons where one of them is the other person's commercial representative; (6) persons where one of them has made a donation to the other person; (7) spouses, lineal relatives up to any degree and collateral relatives up to the fourth degree of consanguinity, and relatives by marriage up to the third degree of affinity; (8) an employer and employee; or (9) partners. Control means where the controlling person: (1) holds more than 50 percent of the votes in another person's general meeting, including through a subsidiary; (2) may determine more than 50 percent of the members of another person's managing body; or (3) may manage another person's activity.

## **Canada**

A connection exists where two or more entities are a common risk. Common risk is determined on a case-by-case basis, with reference to the material facts of the situation. The presence of either of the following conditions indicates a common risk: (1) the expected source of repayment is the same for each entity; or (2) the entities are part of a corporate group and there is material financial interdependence between the entities. Corporate group is defined to include an entity and all of its subsidiaries, whether they are owned directly or indirectly. Further definitions and guidance are provided on expected source of repayment, financial interdependence, entity, and situations where common risk and therefore a connection exist. An example of intercompany funds movements that indicate financial interdependence would be

the reliance arising from a company in a corporate group obtaining more than 50 percent of its gross receipts for the most recent 12-month period from another company in the corporate group.

### **Central African Banking Commission**

Legal entities, which are connected in such a way that one is able to exercise, directly or indirectly, exclusive control over the other, are deemed to be a single beneficiary. Also, legal entities that are connected in such a way that the financial difficulties faced by one necessarily cause serious financial difficulties in one or all of the others are regarded as a single beneficiary. These links may exist between two or more individuals or legal entities in cases where: (1) one of them exercises joint control over the other, either directly or indirectly; (2) they are subsidiaries of the same parent company; (3) they have the same de facto management; (4) each entity is a territorial government or public institution, and one is financially dependent on the other; or (5) one of them has a share exceeding 10 percent in the other and they are linked by crossed guarantee contracts or have considerable business relations with each other (subcontracting, franchising, etc.).

If the institution is able to prove that its risk exposure to the individuals and legal entities is sufficiently independent and unconnected, the institution may consider them not to be a single beneficiary. Notwithstanding the above, the Secretary-General of the Banking Commission may, when such individual deems that prudential regulations so require, regard a group of customers as a single beneficiary if the links binding these customers seem to so require.

### **Egypt**

A single client is defined to include a natural person, sole proprietorship, partnership, stock corporation (public sector, public business sector, or private sector), public economic authorities, cooperative associations or other local agencies, and a foreign or international organization or agency. Service authorities are considered government agencies and soft loans granted to public authorities and companies under the economic and social development plan and the government budget are treated as credit facilities granted to government agencies.

### **European Union**

A group of connected clients means: (1) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or (2) two or more natural or legal persons between whom there is no relationship of control as defined but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties. Control is defined, and the definition generally focuses on a shareholder or member who: (1) has a majority of voting rights; (2) has the right to appoint or remove a majority of the members of the management body; (3) has the right to exercise a dominant influence pursuant to a contract or a provision in the articles of association; (4) has appointed solely as a result of the exercise of

its voting rights a majority of the members of the management body during the previous and present financial year (member states may make dependent upon the holding representing 20 percent or more of the shareholders' or members' voting rights and not apply where another undertaking has rights referred to above); or (5) controls alone, pursuant to an agreement with other shareholders or members, a majority of shareholders' or members' voting rights.

### **India**

No definition of a group of borrowers is specified. The concept of group and the task of identification of borrowers belonging to specific industrial groups are left to the financial institutions. The guiding principles in this regard are commonality of management and effective control.

### **Indonesia**

A group of debtors is defined as a grouping of debtors linked to each other by ownership, management, and/or financial ties. A company is categorized as a member of a group if it satisfies at least one of the following criteria with one or more other companies: (1) 25 percent or more of the ownership of each company is controlled by a company or person or jointly by a family; (2) one of the companies controls 25 percent or more of the ownership of other companies; (3) a member of the Board of Directors, Board of Commissioners or other officer holding an executive position in a company is also a member of the Board of Directors, Board of Commissioners, or an executive officer in another company with powers to decide matters related to the operations of the company; and (4) in the absence of ownership and/or management ties as referred to in the above, two or more companies are deemed a group if financial ties exist as follows: (a) one company acts as guarantor for provision of funds received by the other company; and (b) one company provides financial assistance to the other company to the extent that it results in control of business operations by the company providing the assistance. State-owned enterprises and/or regional government owned enterprises are not treated as a group of debtors.

### **Latvia**

A group of connected customers is defined as two or more persons who constitute a single risk for a credit institution as a result of the following: (1) one of them has a direct or an indirect control or exercises a significant influence over the other or others; or (2) they are interconnected in such a way that if one of them were to experience financial problems, the other or all others would be likely to encounter repayment difficulties. Control is defined as the relationship between a parent and a subsidiary (more than 50 percent of share capital or voting shares or able to exercise direct or indirect control) or similar relations between an individual and a business, or the power to determine the financial and operational policy of an undertaking. Significant influence is defined as the power to exercise an influence in determining the financial and operational policy of an undertaking.

## **New Zealand**

“Group of Closely Related Counterparties” has the same meaning as in FRS-33, which is a Financial Reporting Standard approved or given authoritative support from time to time by the Accounting Standards Review Board pursuant to sections 24 and 27 of the Financial Reporting Act 1993.

## **Peru**

Sole or common risk is defined as the relationship between two or more individuals or legal entities, where the financial or economic position of one party affects that of the other party or parties, to the extent that if one party experiences financial or economic difficulty, the other party or parties may experience difficulties in meeting their obligations. This common risk exists among legal entities belonging to the same economic group and between them and the individuals who exercise control of that economic group (as defined) and in other cases where the condition mentioned in the previous sentence occurs.

Linkage by sole risk is presumed to exist among spouses, individuals, and/or legal entities having ownership and/or management relationships, unless evidence is provided to the contrary. Ownership relations exist when a party directly or indirectly owns 4 percent or more of the voting stock or interests of an entity. Management relations are defined. Rules exist on linkages and economic groups.

## **Philippines**

The limits apply to any person, partnership, association, corporation, or other entity. The ceilings include: (1) the direct liability of the maker or acceptor of paper discounted with or sold to such bank and the liability of a general endorser, drawer or guarantor who obtains a loan or other credit accommodation from or discounts paper with or sells papers to such bank; (2) in the case of an individual who owns or controls a majority interest in a corporation, partnership, association or any other entity, the liabilities of said entities to such bank; (3) in the case of a corporation, all liabilities to such bank of all subsidiaries in which such corporation owns or controls a majority interest; and (4) in the case of a partnership, association or other entity, the liabilities of the members thereof to such bank. Even if a parent corporation, partnership, association, entity or an individual who owns or controls a majority interest in such activities has no liability to the bank, the Monetary Board may prescribe the combination of the liabilities of subsidiary corporations or members of the partnership, association, entity or such individual under certain circumstances, such as the parent corporation or individual guarantees the repayment of the liabilities, the subsidiaries though separate entities operate merely as departments or divisions of a single entity, etc.

## **Russian Federation**

"Interrelated borrowers" means legal entities and natural persons related to each other economically and legally (i.e., having common property and/or mutual guarantees and/or

liabilities and/or controlling the property of each other also as a natural person combining executive positions) in such a way that financial difficulties of one of the borrowers causes or makes probable the occurrence of financial difficulties with the other borrower(s). "Control" means either direct or indirect (through affiliates) possession of over 50 percent of the votes of a party (entity) or the ability to control over half of the votes under a special agreement with the other shareholders (stake-holders) or under the by-laws, i.e., one party (entity) being able to control the other and substantially affect the financial and day-to-day decisions.

### **Switzerland**

Two or more natural persons or legal entities are considered as a group of related counterparties and are to be dealt with as a unit, if: (1) one of them directly or indirectly holds more than half of the voting rights of the other or exercises a controlling influence over the other in another manner; (2) recognizable inter-dependencies exist between them which render it probable that if one of them falls into financial difficulties, the other will encounter payment difficulties; or (3) they form a consortium; several consortiums are not considered as inter-related counterparties even if individual or all consortium members are identical; similarly, other receivables from individual consortium members are not to be cumulated therewith.

Legally independent public enterprises are not considered as related counterparties either amongst themselves or together with the controlling public body if the public body is not liable for the liabilities of the enterprise or if it is a bank with head office in an OECD country.

### **United States of America**

Loans or credit extended to one borrower are attributed to another person when: (1) the proceeds are used for the direct benefit of the other person; or (2) a common enterprise is deemed to exist between the persons. The proceeds are deemed to be used for the direct benefit of another person when the proceeds, or assets purchased with the proceeds, are transferred to another person, other than in a bona fide arm's-length transaction where the proceeds are used to acquire property, goods, or services. A common enterprise is deemed to exist when:

(1) The expected source of repayment is the same for each borrower and neither borrower has another source of income from which the loan (together with the borrower's other obligations) may be fully repaid;

(2) Loans or extensions of credit are made—(1) to borrowers related directly or indirectly through common control; and (2) substantial financial interdependence exists between or among the borrowers. Control is presumed to exist when a person, directly or indirectly, or acting through or together with one or more persons: (1) owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another person; (2) controls, in any manner, the election of a majority of the directors, trustees, or other persons exercising similar functions of another person; or (3) has the power to exercise a controlling influence over the management or policies of another person. Substantial financial interdependence is deemed to

exist when 50 percent or more of one borrower's annual gross receipts or expenditures are derived from transactions with the other borrower;

(3) Separate persons borrow from a bank to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests; or

(4) The Office of the Comptroller of the Currency determines, based upon an evaluation of the facts and circumstances that a common enterprise exists.

Special rules for loans to: (1) corporate groups (not to exceed 50 percent of capital and surplus); (2) partnerships, joint ventures, and associations; and (3) foreign governments, their agencies and instrumentalities.

### **West African Economic and Monetary Union**

The following are deemed to be of the same signature: (1) individuals or legal entities representing a common view of risk because one of them directly or indirectly holds controlling interests (in particular, exclusive or joint control, or considerable influence) in the other(s); and (2) individuals or legal entities related in such a way that any financial difficulties experienced by one or certain of them would necessarily lead to serious financial difficulties for the other(s). Such links may, for instance, exist between two or more individuals or legal entities in the following cases: (1) they are related to the first degree; (2) they are from subsidiaries of the same parent-company; (3) they are subject, de facto, to common management; or (4) each is a local government or a public institution, and one depends financially on the other.

## **IV. FINDINGS**

### **A. Limits on Large Exposures**

In almost all of the countries reviewed, supervisory authorities set limits on large exposures for banks, generally with a limit of about 25 percent of a bank's regulatory capital for an individual large exposure to a single borrower or a closely related group of borrowers. A few countries have established higher limits, such as India, which limits lending to individual borrowers at 25 percent of the bank's capital funds, but up to 50 percent for a group of borrowers, and up to 60 percent for a group of borrowers engaged in the infrastructure sector (i.e., power, telecommunications, and roads). Two unions in Africa have established substantially higher limits. The Central African Banking Commission limits total exposure to a beneficiary to 45 percent of the net equity capital. The West African Economic and Monetary Union limits the total amount of risks that can be taken on one beneficiary or signature to 75 percent of the effective capital of the bank or financial institution. While the United States has a combined lending limit of 25 percent (15 percent if unsecured and an additional 10 percent if secured), additional lending limits may apply to specified categories, such as loans secured by bills of lading or warehouse receipts covering readily marketable staples (additional 35 percent).

In addition, some countries set limits on the total of all large exposures. For example, for members of the European Union, a credit institution may not incur large exposures, which in total exceed 800 percent of its own funds. Similar overall limits exist for Bulgaria, members of the Central African Banking Commission, Latvia, the Russian Federation, Switzerland, members of the West African Economic and Monetary Union, and Albania (700 percent). Those countries that define a large exposure generally use a definition of 10 percent of capital for a single exposure, with the exception of the Central African Banking Commission (15 percent), the Russian Federation (5 percent), and the West African Economic and Monetary Union (25 percent).

In only two of the countries surveyed, the supervisory authority does not set limits on large exposures. These are Australia and New Zealand. In Australia, the banks set their own internal limits and policies regarding large exposures; however, the supervisory authority has a prior notification requirement which requires the bank to first consult with the authority, and satisfy it that the bank is not incurring an excessive risk, before committing to enter into an exposure in excess of 30 percent (30 percent for banks and 10 percent for other authorized deposit-taking institutions) of its consolidated capital base. In New Zealand, banks are required to publish at regular intervals information about the number of credit exposures, which exceed 10 percent of equity, including a breakdown by equity range. There are no prudential limits on exposures to individual counterparties or groups of closely related counterparties because the disclosure requirements are viewed as creating incentives for banks to ensure that exposure concentrations do not reach imprudent levels.

## **B. Definition of Exposure**

Most countries surveyed defined exposures to include claims and commitments recorded both on and off the balance sheet of an institution. The differences identified among countries concern the application of the limits on a consolidated basis, whether exclusions are specified from the exposure limits, and the use of risk weights.

About one-half of the countries or unions reviewed apply the risk exposure limits on a consolidated basis. The remaining countries or unions either do not require consolidation or no information was available indicating that consolidation is required.

Numerous countries specify exemptions from the definition of exposure or exceptions to the large exposure limits. These include countries such as Albania, Brazil, Bulgaria, the Central African Banking Commission, Canada, and Egypt, the members of the European Union, India, Indonesia, Latvia, the Philippines, the Russian Federation, and the United States. These exemptions or exceptions frequently include exposures such as those guaranteed by obligations of the government and interbank transactions.

Most countries reviewed do not consider the risk weights used in the capital adequacy framework to determine the amount of a credit exposure; however, a few countries, such as Albania, Armenia, the Russian Federation, and Switzerland apply the risk weights used for capital adequacy purposes to determine the exposure amount for calculating compliance with

the large credit exposure limits. The Central African Banking Commission weights the net risk of any guarantees received at 50 percent or 100 percent, based upon the risk involved. In India, for nonfunded credit limits, only 50 percent of the limits or outstandings, whichever is higher, is taken into account.

While member countries of the European Union do not apply capital adequacy risk weights to determine the credit exposure, they are permitted to fully or partially exempt specified assets from the exposure limits. A few of these exemptions mirror the risk weights used for capital adequacy purposes. For example, loans secured by mortgages on residential property may be exempted from the large exposure limits up to 50 percent of the value of the residential property, while these same assets also carry a 50 percent risk weight for capital adequacy purposes. Possible exemptions also include 50 percent of the medium/low risk off-balance sheet items.

### **C. Definition of Related Group of Borrowers**

While the definition of a connected or related group of borrowers varied among the countries reviewed, most countries incorporate the elements of legally or financially related companies or persons.<sup>35</sup> For example, for those institutions found in member countries of the European Union, a group of connected clients means two or more natural or legal persons who constitute a single risk because one of them, directly or indirectly, has control over the other or who are regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties. This definition or one very similar is used among a number of the countries reviewed, such as Albania, the Central African Banking Commission, Latvia, Peru, the Russian Federation, Switzerland, and the West African Economic and Monetary Union. Among the countries reviewed, the definition of control generally focuses on the ability to vote a specified percentage (a majority in the European Union) of voting rights, the right to appoint or remove a certain number of members of the management body, or the right to exercise a

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<sup>35</sup> Notwithstanding broad agreement on the general elements of a connected group of borrowers by various international organizations, in reviewing countries for compliance with the Basel Core Principles, the Monetary and Exchange Affairs Department of the International Monetary Fund has expressed the opinion that “[t]he present formulation of CP 9, on large exposures, ...allows for rather wide differences in definitions of “related groups of borrowers” when dealing with risk concentration... . Some counties apply broad definitions and others are much more restrictive. More precision in the assessment criteria is warranted.” See International Monetary Fund (2000), Appendix 2, Information for the Basel Core Principles Liaison Group on Findings and Recommendations, Paragraph 83. The paper summarizes the results from 26 Core Principles Assessments, which are a joint effort between the International Monetary Fund and the World Bank to assess compliance with the Core Principles Methodology and with principles and standards in other areas.

dominant influence. Interrelated entities are generally defined among the countries by some form of ownership, control, influence or mutual guarantees. Family relations are listed as an independent basis for connecting individual borrowers in a few countries, such as Armenia, Bulgaria, Peru, and the member countries of the West African Economic and Monetary Union.

In India, the task of identification of borrowers belonging to specific industrial groups is left to the institution as the supervisory authority views the institution as generally aware of the basic constitution of its clientele; however, some general guiding principles are stated, such as commonality of management and effective control.

#### **D. Ancillary Issues**

Other differences identified among countries concern the treatment of collateral and whether limits are set on exposure to a specific sector.

Several differences exist among countries on the treatment of collateral and guarantees. A few countries increase the large exposure limit based upon the existence of qualifying collateral, such as Peru, the Philippines and the United States. The great majority of the countries reviewed do not mention collateral in setting the large exposure limit; however, as noted previously, in some countries, the existence of specified collateral or guarantees may be the basis for a complete exception to the limit or for an exemption from the amount of the risk exposure. In the European Union, member states may exempt fully or partially certain risk assets from the exposure limits based upon the pledge of specified collateral, such as certain readily marketable securities valued at market price, or upon the grant of specified guarantees. Also, in a few countries, risk weights from the capital adequacy framework are applied to determine the exposure amount, although at present this procedure has quite limited usefulness if the objective is to take the pledge of collateral into consideration.

In a few countries, limits on exposures to certain sectors are recommended. For example, in Canada, supervisory guidelines state that where applicable, limits should be established on exposures to industries and geographic regions. In Bulgaria and Latvia, banks are expected in their internal credit rules to prescribe restrictions on concentrations of exposures to an economic sector and/or geographic region. In India, the banks are to fix internal limits for aggregate commitments to specific sectors (e.g., textiles, jute, and tea) with a view to ensuring that the exposures are evenly spread over various sectors. In contrast, the Central Reserve Bank of Peru is prohibited from imposing sectoral or regional ratios on the composition of the loan portfolios of financial institutions.

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
Albania	<p>20 percent maximum ratio of total risks with single beneficiary to regulatory capital.</p> <p>700 percent maximum ratio of total significant risks to regulatory capital.</p> <p>Bank of Albania authorized to prescribe maximum aggregate credit, as percentage of aggregate of all credits, for bank to 10 persons with whom credit exposure greatest.</p>	<p>Beneficiary defined as an individual, person, or group of juridical persons interrelated in a way those financial difficulties of one or more members may cause financial difficulties to other members in meeting their obligations. Interrelated juridical persons defined based on ownership (10 percent or more of equity or voting rights), control or influence.</p>	<p>Risk includes on- and off-balance sheet items. Guarantees and collateral received deducted from risks.</p> <p>Risk amount weighted by risk weights.</p> <p>Significant risks defined as exceeds 10 percent of regulatory capital.</p>	No information
Armenia	<p>20 percent maximum risk to a single borrower to total capital.</p>	<p>Persons linked if: (1) subsidiary; (2) can own more than half of voting stock or can influence decisions; (3) majority of Board participants the same; (4) same family; or (5) joint economic activity.</p>	<p>Liabilities, warranties, and guarantees against liabilities included.</p> <p>Risk weights applied.</p>	No
Australia	<p>No specified limits on large exposures. Institution to maintain own policies and place a limit on individual exposures relative to capital base.</p> <p>Prior notification requirement to first consult with supervisory authority before committing to an exposure in excess of 30 percent (30 percent for banks, 10 percent for other institutions) of consolidated capital base and must satisfy the supervisor that proposed exposure is not an excessive risk to the consolidated group.</p>	<p>Counterparties related where linked by cross guarantees, common ownership, ability to control, financial interdependency, or other connections which identify the counterparties as a single risk.</p> <p>Family members not treated as related where independent retail relationships with institution.</p>	<p>Includes claims both on and off the balance sheet on consolidated group basis.</p> <p>Large exposure defined as exceeds 10 percent of consolidated capital base.</p>	Yes

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
Brazil	<p>25 percent limit of adjusted net assets by customer.</p> <p>25 percent limit of adjusted net assets in operations of subscription for resale and guarantee of subscription for securities, as well as in investments in securities issued by the same enterprise, related enterprises, or controlling companies and their controlled entities.</p> <p>If the customer and the enterprise issuing the securities are the same person, the sum of the transactions may not exceed 25 percent of the adjusted net assets of the institution.</p>	<p>A customer is any person, individual, or corporation, or any group of persons acting in isolation or jointly or representing a common economic interest.</p>	<p>Includes loans, guarantees, and operations with derivatives.</p> <p>Does not include onlending transactions or credits from renegotiation of debts authorized by specified laws.</p>	
Bulgaria	<p>25 percent limit of own funds on exposure to one or related persons.</p> <p>8 times own funds limit on total amount of all large exposures.</p>	<p>Includes clients related by mutual guarantees or direct commercial dependence. Related persons include: (1) management; (2) more than 5 percent of voting shares; (3) control; (4) joint control; (5) a commercial representative; (6) a donation to the other; (7) employer and employee; (8) partners; and (9) specified relatives, including spouses. Control means more than 50 percent of voting shares (including through a subsidiary), may determine more than 50 percent of the managing body, or (10) may manage activity.</p>	<p>Exposure is the sum of both balance sheet and off-balance sheet commitments.</p> <p>Risk weights are not applied. Exclusions from exposures specified.</p> <p>A large exposure equals or exceeds 10 percent of own funds.</p>	Yes

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
Canada	25 percent of total capital limit to any entity or connection. Notwithstanding limit, it is expected that companies will establish lower internal limits and that the 25 percent regulatory limit employed only on an exceptional basis.	A connection exists where 2 or more entities are a common risk. Presence of either of following conditions indicates common risk: (1) expected source of repayment is the same for each entity; or (2) the entities are part of a corporate group and there is material financial interdependence between the entities. Further definitions and guidance provided on expected source of repayment, corporate group, financial interdependence, and entity.	Exposure includes: (1) any draw-downs on arrangements for providing funds or credit including loans and advances, etc., (2) all undrawn amounts of irrevocable credit commitments including standby letters of credit, financial guarantees, etc., and (3) credit equivalent amount of specified contracts, such as foreign exchange, commodity, etc. Specified claims included and excluded.	Yes
Central African Banking Commission (Cameroon, Chad, the Central African Republic, the Republic of the Congo, Gabon, Equatorial Guinea)	45 percent limit on exposure to a single beneficiary of net equity capital.  8 times net equity capital limit on exposure to beneficiaries whose individual obligations exceed 15 percent of net equity capital.	Legal entities connected in such a way that one is able to exercise exclusive control over the other, direct or indirect, or connected in such a way that financial difficulties faced by one necessarily cause serious financial difficulties in one or all deemed to be a single beneficiary. These links may exist where: (1) control; (2) subsidiaries of same parent; (3) same de facto management; (4) each is a territorial government or public institution, and one is financially dependent on other; or (5) hold a share exceeding 10 percent in the other and linked by crossed guarantee contracts or have considerable business relations with each other (subcontracting, franchising, etc.).	Risk exposure includes disbursed loans, financial leasing, and leases with option to purchase, securities issued by the beneficiary, correspondent liabilities and signature liabilities.  Security deposits and guarantees by a Bank of Central African States (BEAC) member State or by a credit institution deductible with prior approval.  Guarantees weighted at 50 percent or 100 percent based on risk.	No information
Egypt	30 percent limit of capital on bank's investments with a single client.  Investments abroad limited to 10 percent of total investments with a single correspondent or \$3,000,000, whichever is greater, provided such investments do not exceed 40 percent of bank's equity.	No information on group of borrowers.  A single client defined to include a natural person, sole proprietorship, partnership, stock corporation, public economic authorities, cooperative associations or other local agencies, and foreign or international organization or agency.	Credit facility includes loans and advances, contingent liabilities and personal guarantees for another client of bank.  Exclusions specified, such as covered by cash deposits, letters of guarantee, securities issued by the Ministry of Finance, etc.  Exemptions for government agencies (with exceptions) and interbank transactions.	No information

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
European Union (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom)	<p>25 percent of own funds limit on exposure to a client or group of connected clients (20 percent limit where client or group is parent or subsidiary of institution and/or one or more subsidiaries of parent. Member states may exempt exposures subject to 20 percent limit if provide for monitoring by other measures).</p> <p>800 percent of own funds limit on aggregate large exposures.</p> <p>Member states may impose limits more stringent than those laid down above.</p>	<p>A group of connected clients means: (1) 2 or more persons who, unless shown otherwise, are a single risk because 1 of them, directly or indirectly, has control over the other; or (2) 2 persons between whom there is no relationship of control but who are regarded as a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties.</p> <p>The definition of control generally focuses on a shareholder or member who has: a majority of voting rights, the right to appoint or remove a majority of the management body, or a dominant influence.</p>	<p>Exposures mean assets and off-balance sheet items. Specified exclusions and a lengthy list of potential exemptions by member states.</p> <p>10 percent or more of own funds to a client or group of connected clients considered large exposure.</p>	Yes
India	<p>25 percent of capital funds limit on exposure to individual borrowers and 50 percent in the case of a group of borrowers. 60 percent limit on credit exposure to a group of borrowers for infrastructure projects (i.e., power, telecommunication, road and ports).</p> <p>5 percent of unimpaired Tier I capital limit for aggregate of loans and advances to Indian joint ventures or wholly owned subsidiaries abroad.</p>	<p>No specified definition of group of borrowers. Concept of group and identification of borrowers belonging to specific industrial groups left to financial institutions. Guiding principles are commonality of management and effective control.</p>	<p>Exposure includes funded and nonfunded credit limits and underwriting and similar commitments.</p> <p>Sanctioned limits or outstandings (for nonfunded credit limits, only 50 percent of sanctioned limits), whichever higher, used for limit.</p> <p>Advances against deposits not included.</p>	No

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
Indonesia	30 percent of capital is lending limit for an individual or group of debtors for 2001, 25 percent of capital throughout 2002, 20 percent of capital from January 1, 2003 on.	Group of debtors is a grouping linked by ownership, management and/or financial ties. A company is a member of a group if: (1) 25 percent or more of ownership of each company controlled by a company or person or jointly by a family; (2) one controls 25 percent or more of the ownership of the other companies; (3) member of Board of Directors or executive officer also on Board of Directors or executive officer in another company with powers to decide matters related to operations; (4) one company acts as guarantor for funds received by other; or (5) one company provides financial assistance to other resulting in control of business operations.	Funds include credit, securities, interbank placements, and equity participation, and commitments and contingencies in off balance sheet transactions.  Calculation rules.  Legal lending limits waived for specified funds, such as Indonesian treasury bills, guarantees by Indonesia or Bank Indonesia.	No information
Latvia	25 percent of own funds limit on exposure to any single customer (or any group of connected customers).  8 times institution's own funds limit on total large exposures.	A group of connected customers defined as 2 or more persons who are a single risk because: (1) one of them has direct or indirect control or exercises significant influence over the other or others; or (2) interconnected in such a way that if one were to experience financial problems, the other or all others are likely to encounter repayment difficulties. Control (50 percent or more of shares or voting shares or power to determine policy) and significant influence defined.	Exposures defined as transactions with asset and off-balance sheet items. Detailed procedure for determining exposure set forth with exclusions specified.  10 percent of institution's own funds classified as large.	Yes
New Zealand	No prudential limits on exposures to individual counterparties or groups of closely related counterparties. Banks required to publish information about number of credit exposures to individual counterparties or groups of closely related counterparties which exceed 10 percent of equity, including breakdown by equity range (10 percent bands).	A group of closely related counterparties has the meaning provided in a Financial Reporting Standard approved by the Accounting Standards Review Board.	Credit exposure means maximum loss could incur as result of counterparty failing to discharge its obligations. Value of collateral, guarantees, etc., not considered. Maximum loss in relation to: (1) market related contract means credit equivalent amount of contract (specified); and (2) any other contract means full value of contract; provided offset permitted if in accordance with generally accepted accounting practice.	Yes

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
Peru	<p>Limits based on regulatory capital:</p> <p>(1) 10 percent -Domestic nonfinancial borrower (except bonds guaranteeing signing of contracts in public bids-30 percent). In exceptional circumstances, up to 15 percent, 20 percent or 30 percent, provided excess covered by specified collateral;</p> <p>(2) 70 percent -Financial leasing to domestic individual or entity;</p> <p>(3) 5 percent -Foreign nonfinancial borrower. Up to 10 percent or 30 percent provided specified guaranties for excess;</p> <p>(4) 30 percent -Domestic financial institution. Warrants issued by single general warehouse as guarantee not exceed 60 percent of capital;</p> <p>(5) Foreign financial institution: (a) 5 percent if no similar agency supervision; (b) 10 percent if similar supervision; (c) 30 percent for top-rated banks; (d) 50 percent if excess covered by specified letters of credit.</p> <p>May not incorporate companies to support only one sector of economy.</p> <p>Central Bank may not impose sectoral or regional ratios on loan portfolios.</p>	<p>Sole or common risk defined as the relationship between two or more individuals or legal entities, where the financial or economic position of one affects other, to the extent if one party experiences financial or economic difficulty, other party or parties may experience difficulties in meeting their obligations. Common risk exists among legal entities belonging to same economic group and with individuals who exercise control of that economic group.</p> <p>Linkage by sole risk presumed to exist among spouses, individuals, and/or legal entities having ownership and/or management relationships, unless evidence to contrary. Ownership relations exist when a party directly or indirectly owns 4 percent or more of the voting stock or interests of an entity.</p>	<p>For nonfinancial entities and individuals, financing is defined as credits, investments, financial leases, and contingent items.</p> <p>Exposure to another financial institution includes credits, as well as deposits and warranty bonds, collateral and other guarantees received.</p>	Yes

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
Philippines	<p>20 percent limit of net worth to any person or entity, except as the Monetary Board may otherwise prescribe for reasons of national interest. May be increased to 30 percent provided additional liabilities adequately secured by readily marketable, nonperishable goods fully covered by insurance.</p> <p>Separate single borrower's limit of 35 percent of unimpaired capital and surplus for wholesale lending activities of government banks to participating financial institutions (PFIs) for relending to end-user borrowers.</p>	<p>Limits apply to any person, partnership, association, corporation, or other entity.</p> <p>Ceilings include: (1) direct liability of maker or acceptor of paper discounted or sold to bank and liability of general endorser, drawer or guarantor who obtains a loan or credit from or discounts or sells papers to the bank; (2) if individual owns or controls majority interest in entity, the liabilities of said entities to bank; (3) for a corporation, all liabilities to bank of all subsidiaries in which the corporation owns or controls majority interest; and (4) for a partnership or other entity, liabilities of the members to the bank.</p>	<p>Exposure includes total credit commitment (loans, other credit accommodations and guarantees).</p> <p>Exclusions specified, such as: (1) secured by obligations of the Bangko Sentral or of Philippine Government; (2) guaranteed by government; or (3) covered by assignment of deposits in lending bank in Philippines; (as specified by Monetary Board, etc.</p>	No information
Russian Federation	<p>25 percent limit capital to one borrower or group of related borrowers.</p> <p>800 percent of capital maximum amount of big credit risks (greater than 5 percent of capital).</p>	<p>"Interrelated borrowers" are entities and persons related economically and legally (i.e., having common property, mutual guarantees, liabilities, and/or controlling the property of each other) in such a way that financial difficulties of one causes or makes probable financial difficulties with other. "Control" means direct or indirect possession or control of over 50 percent of votes, i.e., substantially affect financial and day-to-day decisions.</p> <p>5 percent of capital in credits, guarantees, and warranties for one client is a large credit risk.</p>	<p>Exposure includes the whole sum of credits, guarantees, and warranties given to one borrower or group of related borrowers.</p> <p>Off-balance sheet accounts are generally included but specified guarantees and sureties are not.</p> <p>Account is taken of the degree of risk.</p>	No information

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
Switzerland	<p>25 percent limit of the bank's eligible equity resources for a risk position.</p> <p>800 percent of the bank's eligible equity resources limit for aggregate amount of risk concentrations.</p>	<p>10 percent of eligible equity resources for aggregate risk position for one counterparty is a risk concentration.</p> <p>Two or more persons or entities considered related group if: (1) one directly or indirectly holds more than half the voting rights of other or exercises controlling influence; (2) recognizable interdependencies exist which render it probable if one falls into financial difficulties, the other will encounter payment difficulties; or (3) they form a consortium. Legally independent public enterprises not considered related with controlling public body if public body not liable for liabilities of enterprise or if it is a bank with head office in an OECD country.</p>	<p>Risk position comprises receivables using risk weighting, off-balance sheet transactions converted into credit equivalent and weighted and net long positions in securities computed as specified.</p> <p>Further rules specified for computing risk position.</p> <p>Upper limit may be exceeded without immediate notification whenever excess covered completely by freely eligible equity resources.</p>	Yes
United States of America	<p>15 percent of the bank's capital and surplus limit to one borrower, plus an additional 10 percent if fully secured by readily marketable collateral.</p> <p>Special lending limits to certain categories of loans, such as loans secured by bills of lading or warehouse receipts covering readily marketable staples (additional 35 percent), additional advances to complete project financing pursuant to renewal of a qualifying commitment to lend, etc.</p>	<p>Credit extended to one borrower attributed to another when: (1) proceeds used for direct benefit of other (not arm's length transaction); or (2) common enterprise exists. Common enterprise when: (1) expected source of repayment is same and no other source to repay loan; (2) extensions of credit made—(a) to borrowers related through common control; and (b) substantial financial interdependence exists. Control presumed: (a) can vote 25 percent or more of voting securities; (b) control election of majority of directors, trustees, etc.; or (c) controlling influence. Substantial financial interdependence when 50 percent or more of one borrower's annual gross receipts or expenditures derived from transactions with the other; (3) separate borrowers acquire enterprise of which borrowers will own over 50 percent; or (4) Office</p>	<p>Loans and extensions of credit means a bank's direct or indirect advance of funds to or on behalf of a borrower based on an obligation of the borrower to repay the funds or repayable from specific property pledged by or on behalf of the borrower. Inclusions and exclusions specified.</p> <p>Specified loans not subject to limits, such as loans fully secured by U.S. obligations, loans to a financial institution with approval of the Comptroller of the Currency, etc.</p>	Yes

Table 1. Summary by Country of Large Exposure Issues

Country	Large Exposure Limits	Definition of Connected or Related Group	Definition of Exposure	Consolidation
		<p>of Comptroller of Currency determines common enterprise exists.</p> <p>Special rules for loans to corporate groups, foreign governments, etc.</p>		
<p>West African Economic and Monetary Union (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, Togo)</p>	<p>75 percent of effective capital limit to one beneficiary or same signature.</p> <p>8 times effective capital of institution limit on overall volume of risks individually totaling 25 percent of the effective capital of financial institution.</p>	<p>Following deemed same: (1) individuals or legal entities where one directly or indirectly holds controlling interests (in particular, exclusive or joint control, or considerable influence) in other(s); (2) related in such a way that any financial difficulties experienced by one or certain of them necessarily lead to serious financial difficulties for other(s).</p> <p>Such links may, for instance, exist between two or more individuals or legal entities related to first degree, subsidiaries of same parent, subject to common management, or each is a local government or a public institution and one depends financially on the other.</p>	<p>Include both balance sheet risks, including securities held, and off-balance sheet liabilities.</p> <p>Weights applied to each risk category, as well as guarantees backing the risks in question, are those adopted for the rule on risk hedging.</p>	<p>No information</p>

**CITATIONS TO RELEVANT LAWS OR REGULATIONS**

**Albania**

Regulation on Control of Significant Risks, Decision No. 78 dated 07.07.1999, Chapter I, Articles 3-8

Banking Law, Law No. 8365 dated 02.07.98, Chapter IV, Articles 27 and 30

**The Republic of Armenia**

Law on Banks and Banking, Section 1, Article 8, and Section 5, Article 49

Regulation 2-Banking Regulations and Requirements, Section 2, Part 14 and Section 3, Part 22

**Australia**

APS 221 – Large Exposures (September 2000), Paragraphs 1, 2, 4, 5, 6, 7

**Brazil**

Resolution No. 2474 of March 26, 1998

**Bulgaria**

Law on Banks, Article 29, and Additional Provision, Article 1, Paragraph 3

Regulation No. 7 on the Big Exposures of Banks

**Canada**

Office of the Superintendent of Financial Institutions Guideline B-2, Large Exposure Limits, (December 1994) Pages 2-6

Office of the Superintendent of Financial Institutions Guidance Note – Large Exposures (March 2001)

Office of the Superintendent of Financial Institutions Guideline B-1, Prudent Person Approach, (January 1993) Pages 2-3

### **Central African Banking Commission**

Central African Banking Commission Regulation R-93/04 On Credit Institution Exposure Diversification, Articles 1, 2, 4, 5, 7, 8, 9

### **Egypt**

Law No. 163 of 1957, Promulgating the Banks and Credit Law, as amended by Law No. 97 for 1996, Article 37

Central Bank of Egypt Directive of September 23, 1996

Circular No. 337/87 dated September 28, 1993

### **The European Union**

Council Directive 92/121/EEC of 21 December 1992, Articles 1(l), (m), 3, 4, 5, Combined with various directives into a single text at Council Directive 2000/12/EC of 20 March 2000, Articles 1(8), (24), (25), 48, 49, 50

Seventh Council Directive 83/349/EEC of 13 June 1983, Article 1

### **India**

Instructions of Reserve Bank of India for Banks & Banking Operations: Chapter 13 – Advances, Paragraphs 13A.I-1, 13A.I-22, 13B.I-11

### **Indonesia**

Bank Indonesia Decree No. 31/177/KEP/Dir Concerning the Legal Lending Limit for Commercial Banks, Articles 1, 3, 7, 8, 13

### Latvia

Law on Credit Institutions, adopted October 5, 1995, (with amendments and transitional provisions passed by the Saeima on May 30, 1996, October 17, 1996, October 30, 1997, and May 21, 1998, Articles 1 (paragraphs 10-13, 16, 18), 39, 40, 42, 50”1

Regulation for Compliance with Restrictions on Exposures, Resolution No. 75/5 of May 24, 2000, Sections 2, 3

### New Zealand

Governor-General, Order in Council, Registered Bank Disclosure Statement (Full and Half-Year–New Zealand Incorporated Registered Banks) Order 1998, Part I, Article 2(3), (4)

Governor-General, Order in Council, Registered Bank Disclosure Statement (Full and Half-Year–New Zealand Incorporated Registered Banks) Order 1998, Part II, Article 5(6)(h) and Schedule 3

Reserve Bank of New Zealand, Statement of Principles: Bank Registration and Supervision, Document BS1 Issued October 1997, Section C, Paragraph 12(iv)(b)

### Peru

General Law of the Financial and Insurance Systems and Organic Law of the Superintendency of Banking and Insurance, Law No. 26702 as amended, Preliminary Title, Article 8; Section 2, Title II, Chapter II, Articles 203-213; Transitory Provisions No. 1

Resolution No. 436-2000 of June 23, 2000,

Resolution No. 446-2000 of June 28, 2000, Title II, Chapter II, Articles 9-14 and Transitional Provisions, First

Resolution No. 445-2000 of June 28, 2000,

Central Reserve Bank of Peru Organic Law (Decree-Law No. 26123), Article 83

### **The Philippines**

The General Banking Law of 2000, Section 35

Circular No. 244 (May 2000)

The New Central Bank Act, Republic Act No. 7653, Article 107

### **The Russian Federation**

Federal Law No. 394-1 of December 2, 1990 On The Central Bank of the Russian Federation, Articles 63, 64

Instructions of the Central Bank of the Russian Federation No. 1 of October 1, 1997 On the Procedure for Regulating the Activities of Banks, 4, 5, 11, 13

### **Switzerland**

Implementing Ordinance on Banks and Savings Bank of May 17, 1972, as amended, Section 6, Articles 21, 22

### **The United States of America**

National Bank Act, 12 U.S.C. Section 84

12 CFR Part 32 – Lending Limits

### **West African Economic and Monetary Union**

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