Cayman Monetary Regulatory Authority International

At the forefront of financial regulation, the Cayman Monetary Regulatory Authority International (CMRAI) is dedicated to upholding the highest standards of financial oversight and compliance. Our mission is to safeguard the stability and integrity of the global financial system by ensuring that financial services operate within a framework of transparency, accountability, and excellence.

As a trusted partner to financial institutions worldwide, CMRAI provides rigorous supervision, innovative solutions, and strategic guidance to foster a secure and thriving financial environment. With decades of experience and a commitment to global standards, we stand as a pillar of trust and security in an ever-evolving financial landscape.

With a legacy of excellence in financial oversight, the Cayman Monetary Regulatory Authority International (CMRAI) is a beacon of trust in the international financial community. Our role extends beyond regulation; we are innovators, collaborators, and protectors of the global financial ecosystem. By fostering compliance, promoting best practices, and embracing technological advancements, CMRAI ensures that financial services remain resilient and adaptable in a dynamic global market.

Our comprehensive approach to regulation encompasses a deep understanding of financial risks and a proactive stance on emerging challenges. We are committed to empowering financial institutions with the tools and guidance necessary to navigate complex regulatory landscapes, thereby contributing to global economic stability and growth.

November 2006 Page 1 of 10 Statement of Guidance Statement of GuidanceStatement of Guidance Statement of Guidance Large Exposures and Credit Risk Concentration Large Exposures and Credit Risk ConcentrationLarge Exposures and Credit Risk Concentration Large Exposures and Credit Risk Concentration For Banks For Banks For Banks For Banks 1. 1.1. 1. S SS STATEMENT OF TATEMENT OF TATEMENT OF TATEMENT OF O OO OBJECTIVES BJECTIVESBJECTIVES BJECTIVES To provide guidance to banks on their obligations set out in the Rules on Large Exposures and Credit Risk Concentration for Banks (collectively, the Rules and individually each a Rule). 2. 2.2. 2. I II INTRODUCTION NTRODUCTIONNTRODUCTION NTRODUCTION 2.1. The diversification of risk is a key precept in banking as banks are exposed to various forms of credit risk concentration which, if not properly managed, may cause significant losses that could threaten their financial strength and undermine public confidence in banks. 2.2. Credit risk concentrations may arise from excessive exposures to individual counterparties, related counterparties, and a group(s) of connected counterparties with similar characteristics (e.g. counterparties in specific geographical locations, economic or industry sectors). In this regard, safeguarding against credit risk concentrations should form an important component of a bank s risk management system. 3. 3.3. 3. T TT THE HE HE HE I II IDENTITY DENTITY DENTITY DENTITY OF AN OF AN OF AN OF AN E EE EXPOSURE XPOSUREEXPOSURE XPOSURE 3.1. An exposure includes the gross amount at risk including the following: 3.1.1 claims on a counterparty including actual claims, and potential claims that would arise from the drawing down in full of undrawn advised facilities (whether revocable or November 2006 Page 2 of 10 irrevocable, conditional or unconditional) that the bank has committed itself to provide, and claims that the bank has committed itself to purchase or underwrite. Typically these will be in the form of: a) placements made with another banking institution; b) all loans and advances (including overdrafts), however denominated; c) the net book value of finance leases, less deferred tax; d) discounted bills held outright; e) bonds, acceptances, promissory notes, loan stocks and other paper held outright; f) margin held with investment exchanges, clearing houses or other counterparties; g) claims arising in the course of settlement of securities or other transactions; h) claims arising in the case of forward sales and purchases of instruments in both the trading and banking books that either settle on a date beyond the market norm for that instrument or where the payment due is deferred until some future date; i) any commitment with a certain or uncertain drawdown entered into by the bank. This includes amounts outstanding under: o sale and repurchase agreements; o forward asset purchase agreements; o buy back agreements; o forward deposits placed (i.e. where a bank contracts to make a deposit with another party at a future date at a pre-determined rate); and o the unpaid part of partly-paid shares; and j) any other claims arising from similar transactions November 2006 Page 3 of 10 entered into by the bank; 3.1.2 contingent liabilities arising in the normal course of business, and those contingent liabilities that would arise from the drawing down in full of undrawn advised facilities (whether revocable or irrevocable, conditional or unconditional) that the bank has committed itself to provide. These include: a) direct credit substitutes (including guarantees, standby letters of credit serving as financial guarantees, bills accepted but not held by the bank, per aval and equivalent endorsements); b) claims sold with recourse, where the credit remains with the bank; c) transaction-related contingent items not having the character of direct credit substitutes (including tender and performance bonds, bid bonds,

warranties, standby letters of credit relating to particular transactions, retention money guarantees; d) undrawn documentary letters of credit issued or confirmed; and e) those arising from similar transactions entered into by the bank; 3.1.3 assets, and assets which the bank has committed itself to purchase or underwrite, the value of which depends wholly or mainly on a counterparty performing its obligations, or the value of which otherwise depends on that counterparty s financial soundness but which does not represent a claim on the counterparty; 3.1.4 derivative contracts including, but not limited to the November 2006 Page 4 of 10 following instruments: a) OTC futures (including forwards); b) options; c) swaps; and d) similar contracts on interest rates, foreign currencies, equities, securities and commodities; 3.1.5 All equity securities held for trading 1 , but not long-term equity interests or acquisitions relating to the bank s operations; and 3.1.6 Investments in Collective Investments, Mutual Funds, Hedge Funds, and similar investments. 3.2. For an exposure marked-to-market, any accrued interest must be included in the marked-to-market valuation. 3.3. An exposure reported at book value should be gross of specific allowances for bad and doubtful debts. Similarly, where an exposure is marked-to-market, the valuation is typically gross of any allowances. 4. 4.4. 4. I II IDENTITY OF A DENTITY OF A DENTITY OF A DENTITY OF A C CC COUNTERPARTY OUNTERPARTYOUNTERPARTY OUNTERPARTY The identity of counterparty will include the borrower (customer), the banking institution receiving the inter-bank placement, the person whose obligations the bank is guaranteeing (where the bank is providing such a guarantee), the issuer of a security in the case of a security held, and the 1 Trading securities are securities that are either: a) acquired or incurred principally for the purpose of selling or repurchasing it in the short- term; or b) part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. November 2006 Page 5 of 10 party with whom a contract was made in the case of a derivatives contract. 5. 5.5. 5. G GG GROUP OF ROUP OF ROUP OF ROUP OF C CC CONNECTED ONNECTED ONNECTED ONNECTED C CC COUNTERPARTIES OUNTERPARTIES OUNTERPARTIES OUNTERPARTIES 5.1. In determining a group of connected counterparties, certain interconnections to the bank should be considered, including: a) common ownership; b) common directors; c) cross guarantees; and d) direct commercial interdependency that cannot be subsitituted in the short run. 6. 6.6. 6. R RR RELATED ELATED ELATED ELATED C CC COUNTERPARTIES OUNTERPARTIESOUNTERPARTIES OUNTERPARTIES 6.1. The Authority will pay particular attention to exposures to related counterparties, as possible contagion and the risk assessment of these exposures may be obscured by subjective considerations. The bank should ensure that a proper objective credit assessment is undertaken for exposures to related counterparties, including directors, shareholders and senior manager. In this regard, the exposure should be undertaken for the clear commercial advantage of the bank and negotiated and agreed on an arm s length basis. 6.2. Rule 5.10 stipulates that a bank s exposure to related counterparties is limited to 25% of its capital base, however exemptions have been granted where the bank fulfils a treasury role. The bank should, however, satisfy the Authority that the appropriate management and other group control systems are in place to ensure that risk-taking among the related counterparties is properly monitored and controlled. Notwithstanding, the above, Rule 7 will apply if the Authority is unsatisfied with the bank s November 2006 Page 6 of 10 management and /or group control systems.

6.3. Pursuant to Rule 5.12, a bank s exposure to a related counterparty (other than its parent, or sister company) may be excluded from the aggregate limits for related counterparty exposures (Rule 5.10), but instead be subject to Rule 5.8. The relationship between the related counterparty and the bank may be remote, for instance, if a non-executive director of a bank is also a borrower. If however, the related counterparty yields significant power or control, such as an executive director or if the borrower is a controlling shareholder, then Rule 5.12 does not apply. 7. 7.7. 7. C CC CAPITAL APITAL APITAL APITAL B BB BASE ASEASE ASE 7.1. The capital base used for the monitoring and controlling of large exposures and credit risk concentration is the same as the capital base used by the Authority to assess banks capital adequacy. 7.2. Tier I capital consists of the core regulatory capital of the bank, and includes: a) common stock / shares; b) non-cumulative perpetual preferred stock / shares; c) additional capital in excess of par or nominal value; d) retained earnings; e) minority interest; and f) current year profits/losses. 7.3. Tier 2 capital is supplemental capital, limited to no more than100% of Tier 1 capital, and includes: a) hybrid debt capital instruments (subject to the conditions stated in the guidance notes to the BS Forms and Schedules); b) subordinated debt (limited to a maximum of 50% of Tier 1 capital and subject to conditions stated in the BS Forms and Schedules); and c) general loan loss reserves (limited to a maximum of 1.25% of risk weighted assets as computed on the BS Forms and Schedules). 8. 8.8. 8. B BB BANK ANKANK ANK S S S S P PP POLICY OLICY OLICY OLICY S SS STATEMENTS ON TATEMENTS ON TATEMENTS ON TATEMENTS ON L LL LARGE ARGE ARGE ARGE E EE EXPOSURES AND XPOSURES AND XPOSURES AND XPOSURES AND C CC CREDIT REDIT REDIT REDIT R RR RISK ISK ISK ISK C CC CONCENTRATION ONCENTRATIONONCENTRATION ONCENTRATION 8.1. With respect to Rule 5.1, the board of each bank should develop a large exposure and credit risk concentration policy, that sets out the bank s acceptable guidelines on exposures to an individual counterparty, group of connected counterparties, related counterparties, countries and economic sectors. 8.2. The Authority will expect a bank to consider the following factors when setting its policy and considering the acceptability of particular exposures: a) the creditworthiness of the counterparty; b) the nature of the bank s relationship with the counterparty: c) the nature and extent of security taken against the exposure; d) the maturity of the exposure; e) the bank s expertise in the particular type of transaction; f) the market conditions and economic trends in particular economic sectors; and g) the economic and political developments in countries where the bank engages in cross-border activities. 8.3. Banks should monitor concentration to a particular country, geographic region, and economic sector. Systems for measuring and monitoring such exposures, and the bank s policy, should be consistent with the size, nature and complexity of the bank s operations. 8.4. The Authority will review the bank s large exposure policy by either requesting a copy of that statement during the off-site surveillance process or during an on-site review. 9. 9.9. 9. G GG GUARANTEES UARANTEESUARANTEES UARANTEES Where a guarantee is in place pursuant to Rule 5.15, the Authority recognises the risk transfer to the guarantor. A guarantee is a legally enforceable undertaking from the guarantor and should specifically state, in the event of default by the counterparty on the exposure or upon the instruction of the Authority, the guarantor will assume the exposure and associated risks. 10. 10.10. 10. E EE EXPOSURES XPOSURES XPOSURES XPOSURES S

SS SECURED BY ECURED BY ECURED BY ECURED BY S SS SECURITIES ECURITIESECURITIES ECURITIES Pursuant to Rule 5.17, the Authority may allow certain exposures secured by collateral in the form of securities to be partially exempt from the limits contained in Rule 5.8 provided that those securities are not issued by the bank itself, its parent company or one of its subsidiaries, or by the counterparty or the group of counterparties. The marked-to-market valuation of these securities should be determined by reference to prices quoted on a recognised stock exchange. The Authority may accept valuations from other independent pricing service providers, (for example, Bloomberg or Reuters) which establish an objective price such that the value of securities may be verified at any time. 11. 11.11. 11. I II INVESTMENTS IN NVESTMENTS IN NVESTMENTS IN NVESTMENTS IN C CC COLLECTIVE OLLECTIVE OLLECTIVE OLLECTIVE I II INVESTMENTS NVESTMENTSNVESTMENTS NVESTMENTS, M , M, M , MUTUAL UTUAL UTUAL UTUAL F FF FUNDS UNDSUNDS UNDS, , , , H HH HEDGE EDGE EDGE EDGE F FF FUNDS AND SIMILAR UNDS AND SIMILAR UNDS AND SIMILAR UNDS AND SIMILAR I II INVESTMENTS NVESTMENTSNVESTMENTS NVESTMENTS Exposures to such funds should be measured at the individual fund level, and not to each of the underlying individual investments within the fund. In some instances, as provided by Rule 7, the Authority may permit a bank s exposure to a particular fund to exceed 25% of its capital, subject to the Authority s prior approval. In reviewing such situations, the Authority will examine factors that include the source of funding (i.e. depositors versus group funds), track record, and the investment manager. 12. 12.12. 12. E EE ENFORCEMENT NFORCEMENTNFORCEMENT NFORCEMENT 12.1. If a bank breaches any of the Rules, the Authority will proceed with Decision Making procedure detailed in its Enforcement Manual. These procedures will include determining an appropriate timetable to bring the exposure below the statutory limit or any agreed limit and requiring the bank to report progress on a regular basis. 12.2. The Authority may take other appropriate actions, (e.g. limiting a bank s business expansion or increasing a bank s minimum capital adequacy ratio). 12.3. An additional capital charge may be determined on a case-by- case basis and will be higher than would be required for an exposure of less than 25%. In considering the amount of capital to be maintained the Authority will consider: a) the acceptability of the exposures when considered in the context of the bank's large exposures policy; b) the particular characteristics of the single bank, including the nature of its business and the experience of its management; and c) the number of such exposures, their aggregate, size and nature. 12.4. The Authority may reduce or waive an additional capital requirement for the bank if: a) the bank provides a guarantee that is pre-approved by the Authority in accordance with Rule 5.15; b) the guarantor has made arrangements to protect the bank in the event of any financial difficulties; and c) the Authority agrees that the additional capital will be held by the guarantor for the benefit of the bank.