BANK OF MAURITIUS

Guideline on

Credit Concentration Risk

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TABLE OF CONTENTS

INTRODUCTION 1
- **PURPOSE** 1
- **AUTHORITY** 1
- **SCOPE OF APPLICATION** 1
- **EFFECTIVE DATE** 1
- **INTERPRETATION** 2
- **STRUCTURE OF THE GUIDELINE** 2

SECTION I – BOARD AND SENIOR MANAGEMENT RESPONSIBILITIES 3

SECTION II - REGULATORY CREDIT CONCENTRATION LIMITS AND SET-OFFS 4
- **REGULATORY CREDIT CONCENTRATION LIMITS** 4
  - ***(i) Banks other than Subsidiaries and Branches of Foreign Banks*** 4
  - ***(ii) Subsidiaries of Foreign Banks*** 5
  - ***(iii) Branches of Foreign Banks*** 5
  - ***(iii) (A) Provisions applicable to both subsidiaries and branches of foreign banks*** 6
  - ***(iv) Non-Bank Deposit Taking Institutions*** 6
- **EXTRANEOUS FACTORS** 7
- **SET-OFFS** 8

SECTION III – REGULATORY REPORTING AND SUPERVISORY REVIEW 9

SECTION IV - TRANSITIONAL PROVISION 9

ANNEX I 10

ANNEX II 12

INTRODUCTION

A financial institution is exposed to various types and levels of credit concentration risk, with the potential of causing significant losses that could materially affect a financial institution's continued viable existence. Concentration risk may arise from excessive exposure to individuals or groups of counterparties and asset types. Safeguarding against credit concentration to different types of counterparties, industries, geographical regions and asset classes must form the basis of concentration risk management.

Purpose

The Bank of Mauritius enunciates through this guideline the regulatory credit concentration limits and the basic framework of credit concentration risk management to be put in place by financial institutions.

Authority

This guideline is issued in terms of section 29 (Limitation on concentration of risk) and section 100 of the Banking Act 2004, and section 50 of the Bank of Mauritius Act 2004.

Scope of application

This guideline applies to all banks and non-bank deposit taking institutions (NBDTIs) licensed under the Banking Act 2004 (referred to as 'financial institutions' for the purpose of this guideline).

Effective date

This revised guideline will come into effect as from 2 October 2017.

Interpretation

1. In this guideline,

- "Tier 1 capital[1]" has the same meaning as in the *Guideline on Scope of Application of Basel III and Eligible Capital* or the *Guideline on Capital Adequacy for Non-Bank Deposit Taking Institutions*, as the case may be.

- "credit exposure/facility[2]" means a commitment by a financial institution to provide funds or substitute of funds, including leasing facilities other than operating leases, investment in equity, investment in fixed dated securities/debentures and off-balance sheet funds to a customer or group of connected counterparties[3] on a secured or unsecured basis.

- "credit concentration risk" means part of credit risk that measures the risk concentration to any single customer or group of connected counterparties with the potential of producing losses which are substantial enough to affect the soundness of a financial institution.

- "customer" means a natural person, a body corporate, trust, partnership, unincorporated association or organisation, fund, joint venture, an agency of the Government of Mauritius, or an agency of a foreign government.

- "large credit exposure" means the sum of all exposures to a customer or a group of connected counterparties in Mauritian Rupees or foreign currencies or both which is over 10 per cent of the financial institution's Tier 1 capital.

Structure of the guideline

This guideline is divided into four sections:

Section I	-	Board and Senior Management Responsibilities
Section II	-	Regulatory Credit Concentration Limits and Set Offs
Section III	-	Regulatory Reporting and Supervisory Review
Section IV	-	Transitional Provision

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[1] Tier 1 Capital of the financial institution or the group, as the case may be.

[2] Please refer to Annex 1 for computation of exposure.

[3] Please refer to Annex II for more details on what constitutes a group of connected counterparties.

SECTION I – BOARD AND SENIOR MANAGEMENT RESPONSIBILITIES

2. The board of directors of a financial institution incorporated in Mauritius, shall:

   (a) establish, assess and approve the credit concentration risk policy;

   (b) review at least once a year the credit concentration risk policy and related techniques, procedures and information systems;

   (c) ensure through audit and inspection, adherence to the credit concentration risk policy; and

   (d) review all significant exposures to credit concentration risk on a regular basis.

3. In the case of the branch operation of a foreign institution, the head office or the local advisory board/committee shall assume the above role of the board of directors.

4. A financial institution shall develop credit policies which shall, *inter-alia*, comprise the credit concentration risk policy. This should include the principles and objectives governing the extent to which they are willing to accept credit concentration risk. The policy shall set out prudent rules and internal limits for granting credit to a single customer and its related parties, which shall not exceed the regulatory limits stipulated therein.

5. A financial institution shall also develop prudent rules and internal limits to industry sectors, and interlinked borrowers who may not have any common shareholding like sugar plantation and sugar manufacturing, tea plantation and tea processing, hire purchase and automobile trading.

6. There will be no limit on the exposure which a financial institution can take on a bank through guarantee, co-acceptances, etc. issued by that bank, or through placements. However, the board should develop internal limits for these exposures. Subsidiaries and branches of foreign banks may opt not to have an internal limit for the exposures to their parent bank.

7. A financial institution shall develop and implement information systems and procedures and techniques that accurately and continually identify, measure and monitor credit concentration risk in its credit portfolio.

8. A financial institution shall at least once a year conduct stress tests of its major credit risk concentrations and review the results of those tests to identify and respond to potential changes in market conditions that could inversely impact the financial institution's performance. The results of the stress test shall be made available to the Bank of Mauritius for examination.

SECTION II - REGULATORY CREDIT CONCENTRATION LIMITS AND SET-OFFS

Regulatory Credit Concentration Limits

(i) Banks other than Subsidiaries and Branches of Foreign Banks

9. The credit exposure, *denominated in Mauritian Rupee and in currencies other than the Mauritian Rupee*[4], shall be within the following limits:

   (a) for the bank entity on a stand-alone basis:

      (i) aggregate credit exposure to any single customer shall not exceed 25 per cent of the bank's Tier 1 Capital;

      (ii) aggregate credit exposure to any group of connected counterparties shall not exceed 40 per cent of the bank's Tier 1 Capital; and

      (iii) aggregate large credit exposures to all customers and groups of connected counterparties shall not exceed 800 per cent of the bank's Tier 1 Capital.

   (b) for a home banking group[5] whose centre of economic interest is in Mauritius:

      (i) aggregate credit exposure to any single customer shall not exceed 25 per cent of the group's Tier 1 Capital;

      (ii) aggregate credit exposure to any group of connected counterparties shall not exceed 40 per cent of the group's Tier 1 Capital; and

      (iii) aggregate large credit exposures to all customers and groups of connected counterparties shall not exceed 800 per cent of the group's Tier 1 Capital.

   For the purpose of (b) above, credit exposure shall also include credit exposure taken through the bank's subsidiaries. In the event that a holding company is at the apex of the bank, credit exposure shall also include credit exposure taken through the banking, non-bank deposit taking subsidiaries and associates.

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[4] For the purposes of sections 9 and 11, an exposure *in currency other than the Mauritian Rupee* will also include a disbursement made in Mauritian Rupees from a loan sanctioned in foreign currency so long as the borrower is obligated to repay the loan in foreign currency.

[5] A group predominantly engaged in banking business.

(ii) Subsidiaries of Foreign Banks

10. The credit exposure, *denominated in Mauritian Rupee*, of a subsidiary of a foreign bank shall be within the following limits:

    (a) aggregate credit exposure to any single customer shall not exceed 25 per cent of the bank's Tier 1 capital;

    (b) aggregate credit exposure to any group of connected counterparties shall not exceed 40 per cent of the bank's Tier 1 Capital; and

    (c) aggregate large credit exposures to all customers and groups of connected counterparties shall not exceed 800 per cent of the bank's Tier 1 Capital.

11. The aggregate credit exposure, *in currencies other than the Mauritian Rupee,* of a subsidiary of a foreign bank shall be within the following limits:

    (a) aggregate credit exposure to any single customer shall not exceed 50 per cent of the bank's Tier 1 Capital;

    (b) aggregate credit exposure to any group of connected counterparties shall not exceed 75 per cent of the bank's Tier 1 Capital; and

    (c) aggregate large credit exposures to all customers and groups of connected counterparties shall not exceed 1200 per cent of the bank's Tier 1 Capital. This limit is exclusive of the limit of 800 per cent imposed in Mauritian Rupee denominated credit.

12. In the case of subsidiaries having as parent an overseas entity, which is not a bank but is regulated by an approved financial regulator acceptable to the Bank of Mauritius, the Bank of Mauritius may consider on a case-by-case basis the applicability of the above limits for subsidiaries of overseas banks regarding their credit exposure *in currencies other than the Mauritian Rupee*. Such banks shall apply to the Bank of Mauritius with all relevant details regarding their promoter(s).

(iii) Branches of Foreign Banks

13. The credit exposure, *denominated in Mauritian Rupee*, of a branch of a foreign bank shall be within the following limits:

    (a) aggregate credit exposure to any single customer shall not exceed 25 per cent of the bank's Tier 1 Capital;

    (b) aggregate credit exposure to any group of connected counterparties shall not exceed 40 per cent of the bank's Tier 1 Capital; and

(c) aggregate large credit exposures to all customers and groups of connected counterparties shall not exceed 800 per cent of the bank's Tier 1 Capital.

14. For credit exposure *in currencies other than the Mauritian Rupee*, there is no limit vis-à-vis the Tier 1 capital of the branch.

(iii) (A) Provisions applicable to both subsidiaries and branches of foreign banks

15. The application of Section *(ii) Subsidiaries of Foreign Banks* and Section *(iii) Branches of Foreign Banks* above is subject to compliance with the following criteria:

    (a) the parent bank/foreign bank is made aware of and/or has sanctioned exposures in both Mauritian Rupee and currencies other than the Mauritian Rupee, which in aggregate exceed 25 per cent of the Tier 1 Capital of the Mauritian subsidiary or branch;

    (b) the parent bank/foreign bank is adequately supervised, in conformity with the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision;

    (c) the parent bank/foreign bank is, in the opinion of the Bank of Mauritius, a continuing source of financial strength for the subsidiary;

    (d) there are no legal, regulatory, statutory or fiscal restrictions in the parent's/foreign bank's home jurisdiction to obtaining capital from the parent bank/foreign bank in the event the parent bank/foreign bank has to make good the losses incurred by its subsidiary or branch; and

    (e) the branch of the foreign bank forwarding the relative approval obtained from its Head Office or a letter from its Head Office delegating its discretionary powers to a Zonal Area to the bank.

16. For customers having exposures both in foreign currency and in Mauritian Rupee, the exposures should, for the purpose of calculating the regulatory limits, be taken into account separately. For reporting purposes, the aggregate exposures in foreign currency and Mauritian Rupee should be taken into consideration.

(iv) Non-Bank Deposit Taking Institutions

17. The credit exposure of a NBDTI shall be within the following limits:

    (a) aggregate credit exposure to any single customer shall not exceed 25 per cent of the NBDTI's Tier 1 Capital;

    (b) aggregate credit exposure to any group of connected counterparties shall not exceed 40 per cent of the NBDTI's Tier 1 Capital; and

(c) aggregate large credit exposures to all customers and groups of connected counterparties shall not exceed 800 per cent of the NBDTI's Tier 1 Capital.

Extraneous Factors

17(A). In the event of a financial institution's existing exposure towards any single customer or group of connected counterparties exceeding the regulatory limits as a result of any extraneous factors such as merger and acquisition leading to a change in the composition of a group, the financial institution shall

(i) not grant any additional facilities to the group.

(ii) operate within the existing credit limits within a period of 2 years in 2 phases as follows:

1. An arrangement being made to bring the exposure to the entity (single customer) or group of entities (group of connected counterparties) or both, as the case may be, within the regulatory limits within a period not exceeding 1 year.

2. After 1 year any excess over the regulatory limits being deducted from the financial institution's Tier 1 Capital and reckoning its Capital Adequacy Ratio on the revised Tier 1 Capital for all future calculations for a further period of not more than 1 year. Such Capital Adequacy Ratio should not be less than the regulatory requirement stipulated by the Bank at all times. Any existing exposures of the financial institution will not be affected by the revised Tier 1 Capital.

After the abovementioned period of 2 years, any excess would be in breach of the regulation and the financial institution will render itself liable for regulatory action under the provisions of the Banking Act 2004 and the Bank of Mauritius Act 2004.

In the case of Non-Bank Deposit Taking Institutions engaged in leasing activities, leases may be allowed to run to their maturity on condition that the exposures should be brought within the regulatory limits within a period of 2 years.

17(B). To safeguard themselves against breach of the above requirements, financial institutions may include suitable provisions in the loan/lease agreement to

(i) make it incumbent on their borrowers to inform the financial institutions in advance of any potential development that could result in a change in the shareholding structure of the borrowers.

(ii) reserve the right to impose necessary conditions to enable the financial institutions to be in compliance with the requirements of the Guideline.

Set-Offs

18. A financial institution may set-off the following against its single and aggregate large credit exposure:

    (a) the amount of deposits pledged as security against the facility either with the lending financial institution or other financial institutions provided that the deposits pledged or assigned to the lender is legally enforceable in all relevant jurisdictions;

    (b) claims on/or guaranteed by the Government of Mauritius;

    (c) claims guaranteed by central governments and central banks which attract a risk weight of zero per cent for capital adequacy purposes;

    (d) claims guaranteed/insured by Export Credit Agencies owned by central governments attracting a risk-weight of zero per cent for capital adequacy purposes, subject to the approval of the Bank of Mauritius;

    (e) exposures which have been co-accepted or guaranteed by a bank whose rating is investment grade or better;

    (f) Credit Default Swap (CDS) and Total Return Swap (TRS) issued by a counterparty selling a protection (insurance seller) being rated A- or better; and

    (g) Claims on domestic Public Sector Enterprises (PSEs) which are not guaranteed by Government of Mauritius provided they satisfy the following essential criteria:

        (i) the PSEs have specific revenue raising powers and specific institutional arrangements the effect of which is to reduce the risk of default;

        (ii) the PSEs are operating in monopolistic markets and providing essential services; and

        (iii) a declaration of bankruptcy is not possible due to their special public status, unless an Act of Parliament is passed for this purpose.

SECTION III – REGULATORY REPORTING AND SUPERVISORY REVIEW

19. A financial institution shall report to the Bank of Mauritius on a quarterly basis, in such manner and form as it may require, all information relating to its large credit exposures, including exemptions permitted under this guideline.

20. The Bank of Mauritius will assess the adequacy of processes, procedures and policies put in place by a financial institution to ensure that it does not face excessive concentration risk by way of over exposure to a customer, sector, interlinked industries, financial institutions etc.

21. When the risks arising from credit risk concentrations are not adequately addressed, the Bank of Mauritius may take appropriate action including prohibiting the institution from taking additional exposure and imposing a higher capital charge.

SECTION IV - TRANSITIONAL PROVISION

22. Any financial institution, which is in non-compliance with the requirements of this guideline, shall within three months of the coming into effect of this guideline submit a plan showing the manner in which it will achieve compliance.

    The plan to be submitted by the financial institution should, *inter-alia*, comprise the following:

    (a) reduction in the credit facilities that have been extended, by way of normal repayments or specific accelerated repayments;

    (b) increase in Tier 1 Capital, by way of internal accruals or injection of additional funds; and

    (c) the time frame within which it proposes to become fully compliant with this guideline which shall not, in any event, exceed one year as from the date of this guideline.

    The plan shall be approved by the Bank of Mauritius.

23. As from the effective date of this guideline, a financial institution shall not be allowed to take such new additional exposures which may cause the financial institution to exceed the regulatory credit concentration limits stipulated in this guideline.

24. In case of breaches of the regulatory credit concentration limits, subsequent to the approval of the plan by the Bank of Mauritius, a financial institution may be required to maintain a higher capital adequacy ratio as may be determined by the Bank of Mauritius.

Bank of Mauritius
21 September 2017

ANNEX I

Computation of Exposure

The exposures a financial institution must consider in order to identify large exposures to a counterparty are all those exposures defined under the *Guideline on Standardised Approach to Credit Risk*. It must consider both on- and off-balance sheet exposures included in either the banking or trading book.

An exposure to a customer that is deducted from capital must not be added to other exposures of that customer for the purpose of the regulatory credit concentration limits.

The exposure value must be defined as the accounting value of the exposure, net of specific provisions.

For the purpose of the regulatory credit concentration limits framework, off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCFs) by applying the CCFs set out in the *Guideline on Standardised Approach to Credit Risk*, with a floor of 10%.

Further details of computation are given below.

- ***Fund-Based***

(i) Term loans:

- Fully disbursed: Amount outstanding.
- Partially disbursed: Higher of approved amounts or amounts outstanding.

(ii) Overdraft/other working capital facilities:

- Higher of approved limits or amounts outstanding.

(iii) Finance Lease

- Net Principal Amount outstanding plus unpaid interest accrued. Net Principal Amount will be the sum originally disbursed by the financial institution minus embedded principal out of instalments repaid.

- ***Non-Fund Based***

(i) Guarantees, financial/performance bonds, acceptances, letters of credit and other off balance sheet assets where the financial institution is fully liable in case of default:

  - Higher of approved amounts or amounts outstanding.

(ii) Treasury products such as foreign exchange contracts, interest rate swaps and the like:

  - Higher of approved amounts or amounts outstanding.

(iii) Others

  - Higher of approved amounts or amounts outstanding.

Note: Wherever instruments of set-off are available the exposures should be netted off when calculating the regulatory limits.

ANNEX II

Group of connected counterparties

Two or more counterparties shall be deemed to be a group of connected counterparties constituting a single risk if at least one of the following criteria is satisfied.

(i) Control relationship: one of the counterparties, directly or indirectly, controls the other.

(ii) Economic interdependence: if one of the counterparties were to experience financial problems, in particular funding or repayment problems, the other(s), as a result, would also likely encounter funding or repayment problems.

In assessing whether there is a 'control' relationship between counterparties, a financial institution must consider 'control' as defined in the Companies Act 2001.

In addition, financial institutions must assess connectedness between counterparties using the following criteria:

(i) Voting agreement (e.g. control of a majority of voting rights pursuant to an agreement with other shareholders);

(ii) Significant influence over the appointment or dismissal of an entity's management personnel or its supervisory body;

(iii) Significant influence on the workings of senior management.

Furthermore, in establishing connectedness based on economic interdependence, financial institutions must consider the following criteria:

(i) Where 50% or more of the customer's annual gross receipts or gross expenditures is derived from transactions with the other counterparty;

(ii) Where one counterparty has fully or partly guaranteed the exposure of the other counterparty, and the exposure is so significant that the guarantor is likely to default if a claim arises;

(iii) Where a significant part of one counterparty's production/output is sold to another counterparty;

(iv) When the expected source of funds to repay the loans of two or more counterparties is the same and none of the counterparties has another independent source of income from which the loan may be serviced and fully repaid.

(v) When it is likely that the financial problems of one counterparty will cause difficulties to the other counterparty in making full and timely repayment of liabilities; or

(vi) Where a shareholder owning, directly or indirectly, more than 50% of the shares of a company to which a financial institution has extended credit, also receives credit from the financial institution in his own name or in the name of his spouse or a child of less than 18 years of age or a corporation controlled by the spouse or child, the company, the shareholder, his spouse, the child and the corporation controlled by the spouse or child, as applicable, shall constitute a group of related parties.

If there is a doubt as to the relatedness of counterparties, the matter should be referred to the Bank of Mauritius.