



BANK OF MAURITIUS

Guideline on Cross-Border Exposure

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Introduction

Cross-border exposure offers opportunities to banks in terms of revenue generation, product diversification and access to a wider market.

However, cross-border exposure may lead to heightened risks mainly on account of:

- (i) inadequate knowledge of overseas markets including counterparties, products, legal and regulatory framework and recovery processes;
- (ii) lack of expertise and experience in dealing with overseas counterparties;
- (iii) unavailability of credit history information on counterparties; and
- (iv) additional risks which are not present in the domestic environment.

Purpose

The Bank of Mauritius has issued several guidelines in respect of the identification, measurement, management and mitigation of credit risk. These include, *inter alia*, the Guideline on Country Risk Management, the Guideline on Credit Risk Management and the Guideline on Credit Concentration Risk.

This Guideline on Cross-Border Exposure (Guideline) supplements the existing guidelines issued by the Bank of Mauritius and provides a set of additional minimum standards that would need to be followed by banks in respect of their cross-border exposure. These minimum standards provide a risk-based management framework aiming to mitigate the main cross-border banking risks.

Authority

This Guideline is issued under the authority of section 50 of the Bank of Mauritius Act 2004 and section 100 of the Banking Act 2004.

Scope of application

This Guideline shall apply to banks licensed under the Banking Act 2004.

Effective date

This Guideline shall come into effect on 4 September 2020.

Interpretation

In this Guideline,

“Bank” means the Bank of Mauritius established under the Bank of Mauritius Act 2004;

“bank” has the same meaning as in the Banking Act 2004;

“cross-border exposure” refers to a commitment by a bank to provide funds or substitute of funds, including leasing facilities (other than operating leases), specialised lending, investment in equity, investment in fixed dated securities/debentures and off-balance sheet facilities, to a counterparty or group of connected counterparties based outside Mauritius or whose majority of operational cash flows is derived from operations in a jurisdiction other than Mauritius. This includes direct and indirect exposures (fund based and non-fund based) to banks and other counterparties;

“control functions” mean those functions that have a responsibility independent from management to provide objective assessment, reporting and/or assurance. This includes the risk management function, the compliance function and the internal audit function;

“independent appraiser” refers to an appraiser who:

- is a valuation surveyor recognised by a government, by a reputable institute or by an appropriate foreign authority for appraisal of a property;
- has no direct or indirect financial interest in the property being appraised, or in the transaction involving the bank in respect of that property; and
- has no credit granting or investment decision-making authority within the bank;

“large exposure” refers to aggregate exposure to a counterparty or a group of connected counterparties which represents over 10 per cent of a bank’s Tier 1 capital;

“silent guarantees” refer to financial instruments issued by a bank for the account of a seller/exporter to serve as indemnity against the non-performance of a buyer’s/importer’s payment or commercial obligations, without disclosure to the buyer/importer;

“specialised lending” includes project finance, object finance, commodities finance, structured trade finance, income-producing real estate lending and high-volatility commercial real estate lending. It refers to any cross-border exposure which possesses all the following characteristics, in legal form or economic substance:

- The exposure is typically to an entity (often a special purpose entity) that was created specifically to finance and/or operate physical assets;
- The borrowing entity has little or no other material assets or activities, and therefore little or no independent capacity to repay the obligation, apart from the income that it receives from the asset(s) being financed;
- The terms of the obligation give the lender a substantial degree of control over the asset(s) and the income that it generates; and
- As a result of the preceding factors, the primary source of repayment of the obligation is the income generated by the asset(s), rather than the independent capacity of a broader commercial enterprise.

The main sub-classes of specialised lending are defined below:

- (1) **“project finance”** is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements.
- (2) **“object finance”** refers to a method of funding the acquisition of physical assets (e.g. ships, aircraft, satellites, railcars, or fleets) where the repayment of the exposure is dependent on the cash flows generated by the specific assets that have been financed and pledged or assigned to the lender.
- (3) **“commodities finance”** refers to structured short-term lending to finance reserves, inventories, or receivables of exchange-traded commodities (e.g. crude oil, metals, or crops), where the exposure will be repaid from the proceeds of the sale of the commodity and the borrower has no independent capacity to repay the exposure. The structured nature of the financing is designed to compensate for the weak credit quality of the borrower. The exposure’s rating reflects its self-liquidating nature and the lender’s skill in structuring the transaction rather than the credit quality of the borrower.
- (4) **“structured trade finance”** refers to short-term, uncommitted, generally self-liquidating trade facilities secured by a combination of the inventory financed and/or the receivables arising from the sale of such inventory and/or partial cash collateral.
- (5) **“income-producing real estate lending”** refers to a method of providing funding to real estate (such as office buildings to let, retail space, multi-family residential buildings, industrial or warehouse space, or hotels) where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the asset.
- (6) **“high-volatility commercial real estate lending”** is the financing of commercial real estate that exhibits higher loss rate volatility (i.e. higher asset correlation) compared to other types of specialised lending.

Section I – Governance Framework

1. Policy on cross-border exposure

- 1.1 Banks having cross-border exposure shall establish a comprehensive board-approved policy on cross-border exposure, either on a stand-alone basis or integrated within relevant existing policies.
- 1.2 The policy shall clearly define the responsibilities and processes in relation to cross-border exposure, taking into consideration the requirements stipulated in this Guideline. The policy, processes, controls and systems for cross-border exposure shall be commensurate with the underlying risks.

2. Responsibilities of the board of directors

- 2.1 The board of directors of a bank (board) shall exercise adequate oversight on the bank's cross-border operations. The board shall *inter alia*:
 - (a) approve and ensure compliance with the bank's:
 - (i) business strategy for cross-border exposure in respect of different overseas markets, client segments, etc; and
 - (ii) policy and frameworks for cross-border exposure, including the risk appetite statements and risk limits;
 - (b) review the policy and frameworks for cross-border exposure (including the risk appetite statements and risk limits) at an interval not exceeding twelve months, or, at such higher frequency as may be required in anticipation of or subsequent to material events and in light of the performance of the bank's cross-border exposure;
 - (c) ensure that appropriate due diligence procedures are put in place for on-boarding of cross-border counterparties, including requirements for site visits and face-to-face meetings;
 - (d) require appropriate verification/due diligence procedures for jurisdictions and third-parties involved in the transactions;
 - (e) oversee and be satisfied with the processes and controls for credit processing/appraisal, credit approval/sanction, credit documentation, credit administration, credit monitoring/control as well as for valuation, perfection and enforceability of collaterals;
 - (f) set the level of materiality as required in the Guideline;
 - (g) ensure appropriate oversight and coverage by the control functions and external auditors taking into consideration the requirements of this Guideline;
 - (h) receive periodic reports, at intervals not exceeding three months, from the board sub-committees, senior management, Chief Risk Officer and other relevant functions, covering:

- (i) performance of the bank's cross-border exposure, including compliance with the risk appetite statement, risk limits, overall requirements set out in the policy/frameworks on cross-border exposure, breaches of covenants, deterioration in credit quality, impairment of assets and non-perfection of collateral;
 - (ii) implementation of recommendations made by the compliance function, internal audit function, external auditors and regulators; and
 - (iii) proceedings of the risk management committee, audit committee and credit committee;
- (i) ensure that there is a follow-up on pertinent matters and timely remediation of issues at the level of the board, relevant board sub-committees and senior management;
 - (j) ensure that it is promptly apprised of new cross-border exposures and material developments regarding the bank's cross-border exposure;
 - (k) ensure that board deliberations with respect to cross-border exposure are duly documented in the minutes of board meetings;
 - (l) ensure that there is adequate expertise and experience at the level of senior management, frontline/sales teams, credit risk function, credit approval authorities/committees and control functions, in respect of the bank's cross-border exposure. Staff allocated to the frontline/sales teams and credit risk function shall have adequate knowledge of cross-border products, applicable overseas markets, legal and regulatory frameworks of those jurisdictions in which the bank has cross-border exposure and other relevant areas; and
 - (m) oversee and be satisfied with the delivery of comprehensive training programmes, incorporating all aspects of cross-border exposure, to relevant staff (including senior management, frontline teams, credit risk function, credit approval authorities/committees and control functions) and board members.

3. Board composition

- 3.1** The board shall collectively possess adequate expertise and experience relating to the bank's cross-border exposure.
- 3.2** At least one member of the board, board risk management committee and board credit committee (where applicable) shall have relevant cross-border banking expertise and experience.

4. Conflicts of interest

- 4.1** A bank shall have in place a suitable framework duly approved by its board to avoid any actual or perceived conflict of interest, for instance, in circumstances where certain costs incurred need to be claimed from counterparties/third-parties.

4.2 The framework shall encompass a clearly defined approval process and a policy on conduct, ethics and gifts/entertainment among others.

5. Control functions

5.1 A bank shall have robust control functions with adequate resources and expertise.

5.2 In cases where banks have cross-border exposure in a jurisdiction in which they have branches or subsidiaries, they shall ensure that staff allocated to the control functions of these branches or subsidiaries have the requisite expertise and experience.

5.3 The control functions shall adequately cover the practices and processes with respect to the bank's cross-border exposure.

5.4 The compliance function and internal audit function shall conduct a periodic review, at intervals not exceeding twelve months, of the cross-border exposure.

5.5 The requirement for annual reviews by the compliance and internal audit functions would not be mandatory for subsidiaries and branches of foreign banks where there is appropriate oversight of the group office on the cross-border exposure, including adequate coverage by the local/group audit and compliance functions.

6. External audit

6.1 The external auditors of the bank shall conduct a periodic review, at intervals not exceeding twelve months, of the bank's cross-border exposure.

Section II - Risk Management Framework

7. Risk appetite framework

7.1 Banks shall establish a risk appetite framework in respect of their cross-border exposure, including a risk appetite statement, which incorporates:

(i) risk appetite by country and other factors such as currency, industry sector, counterparty, type of counterparty, external/internal rating of counterparties and secured/unsecured exposures;

(ii) risks arising from specialised lending and silent guarantees, where applicable;

(iii) risk limits for cross-border exposure;

(iv) potential losses/margin calls on investments in securities.

7.2 The risk appetite framework shall take into account available resources, i.e. the size and capital of the bank, the liquidity/funding capacity of the bank, the expertise and experience of staff and board of directors, systems and processes for risk identification, measurement, monitoring and reporting.

7.3 The Bank may, where relevant, take into consideration a bank's group risk appetite framework when assessing the adequacy of the risk appetite statement of banks which are branches or subsidiaries of foreign banks.

8. Risk identification and assessment

8.1 Banks shall establish procedures for identifying and reviewing cross-border exposures in excess of the bank's risk appetite/risk limits and shall take appropriate corrective measures, which may *inter alia* include exit.

8.2 Banks shall duly assess the foreign exchange risks of their cross-border counterparties.

8.3 Banks having cross-border investments in securities shall duly assess the market risks and establish appropriate internal limits in respect of investments in securities which are collateralised and subject to margin calls.

8.4 Banks may consider credit protection measures including insurance and participation in consortium/syndicated lending when assessed risks are high.

9. Due diligence on counterparties, jurisdictions, and third-parties

9.1 Counterparties

9.1.1 Banks shall conduct the requisite Know Your Customer verifications and Customer Due Diligence on their cross-border counterparties, taking into account the **Guideline on Anti-Money Laundering and Combating the Financing of Terrorism and Proliferation**.

9.1.2 With respect to large trade-related or other receivable financing exposures, banks shall, in addition, conduct appropriate due diligence on the cash flow generators of their cross-border counterparties, including the main buyers and suppliers.

9.1.3 The existence of a counterparty and its existing banking relationships shall be ascertained through suitable bank references (where possible, through a SWIFT message) and/or other appropriate means.

9.1.4 Banks shall obtain appropriate legal advice/opinion from a reputable legal counsel in the relevant jurisdiction on, *inter alia*, the existence of the counterparty and its capacity to execute relevant transactions and documents, and, on the legitimacy and enforceability of collateral as well as cross-border facility agreements, guarantees and other documentation.

9.2 Jurisdictions

9.2.1 Notwithstanding the requirements of the **Guideline on Country Risk Management**, banks shall conduct a thorough due diligence on relevant jurisdictions before taking up any cross-border exposure. Banks may leverage on any due diligence already carried out by group entities, provided that it meets the requirements of this Guideline. The due diligence shall be conducted annually or at such higher interval based on perceived risks and

shall cover at least:

- (a) reports from external economic research services, ratings from external credit assessment institutions, other published economic data and analysis;
- (b) internal country risk ratings, which should, *inter alia*, be based on an assessment of sovereign risk factors such as political stability and exchange control which may affect the bank's cross-border exposure;
- (c) analysis of legislations which may significantly impact the recourse to borrower/enforceability of collateral or guarantee in jurisdictions where banks have material cross-border exposure;
- (d) assessment of Money Laundering / Financing of Terrorism and Proliferation risks; and
- (e) assessment of all significant risks associated with the bank's cross-border exposure.

9.3 Third-parties

9.3.1 Banks shall ensure that appropriate due diligence/verifications have been conducted on third-parties such as lead arrangers, professionals appointed by lead arrangers, agents, deal referrers, legal advisers, independent appraisers, auditors or any other professional service provider, prior to engaging their services. It is expected that such third-parties are professionals of repute duly registered/authorised in their respective jurisdictions and experienced in their relevant fields.

10. Credit risk management

10.1 Banks shall, in addition to the requirements prescribed in the **Guideline on Credit Risk Management**, comply with the following provisions:

- (a) They shall factor in the credit history of their counterparties in their credit appraisal. In this respect, they shall ensure that they obtain sufficient credit history information from relevant sources which may, *inter alia*, include credit information bureaus, other credit reports and financial statements. Latest financial statements which have been audited by a duly registered firm of auditors shall be required for cross-border exposures other than project finance.
- (b) They shall ascertain the enforcement procedures and comply with all relevant statutory requirements prior to accepting collaterals to ensure their enforceability. Banks shall also be satisfied with the effectiveness of the enforcement procedures in the overseas country.
- (c) They shall ensure that assets pledged as collateral are duly valued and charges inscribed thereon are duly registered.
- (d) They shall assign an internal credit risk rating to all counterparties.

- (e) Where the size and type of the prospective cross-border exposure so warrant, banks shall, prior to disbursement, conduct site visits and face-to-face client meetings, which shall be followed by a duly documented call report. **Annex 1** provides the requirements that banks shall comply with in respect of site visits/meetings under different types of cross-border exposure arrangements.

10.2 In line with the requirement of the **Guideline on Country Risk Management**, banks shall conduct an independent risk assessment in all instances including for syndicated/consortium lending and irrespective of whether the lead/participating/selling bank may be known to have a first-class risk assessment system.

11. Requirements for specialised lending and silent guarantees

11.1 A bank engaging in specialised lending and/or issuing silent guarantees shall, in addition to the applicable requirements of this Guideline, have:

- (a) specific expertise and experience in the relevant field;
- (b) a board-approved policy setting out the approach, processes and controls for these cross-border exposures. The bank may opt to have a separate policy or integrate it within its existing policies;
- (c) an appropriate framework for due diligence and risk assessment on counterparties, sellers/suppliers/exporters, buyers/offtakers/importers and other parties involved in the transactions. With respect to project finance, the business plan, including financial projections, shall be independently assessed by staff of the bank/its group entities having the necessary expertise. Where relevant, banks may require that business plans are duly certified by a competent firm;
- (d) minimum standards in respect of:
 - (i) acceptable counterparties for specialised lending; and
 - (ii) clients on behalf of which the bank takes exposures through silent guarantees or discounting facilities to, *inter alia*, ensure that these clients have a proven track record in such transactions and a strong relationship with their obligors.
- (e) an appropriate risk appetite framework for such exposures, which incorporates risk limits by (i) counterparty; (ii) sub-class of exposures; and (iii) risk rating of exposures.
- (f) an effective collateral management procedure, including a list of acceptable collaterals and independent monitoring of collateral;
- (g) an appropriate framework to ensure ring-fencing of receivables;
- (h) appropriate controls to prevent the occurrence of frauds;
- (i) a robust monitoring framework for such exposures, consisting of processes

to ensure, amongst others:

- (i) timely receipt of payments from buyers/offtakers/importers or other parties involved in the transactions;
 - (ii) compliance with approved terms and conditions; and
 - (iii) compliance with set risk limits; and
- (j) adequate oversight by a team independent from the frontline teams.

11.2 In view of the unique characteristics of specialised lending and silent guarantees, all the requirements set out in the other sections of this Guideline may not be applicable. However, all deviations shall be duly documented and approved by the board.

12. Risk monitoring

12.1 Credit monitoring system

12.1.1 In accordance with the **Guideline on Credit Risk Management**, banks shall have a credit monitoring system in place to formally review the status of the credit and the financial health of the counterparties at least once a year. More frequent reviews should be carried out for large credits, problem credits or when the operating environment of the customer is undergoing significant changes.

12.1.2 Banks shall ensure that their cross-border exposure is duly monitored post-disbursement, taking into consideration the requirements of the **Guideline on Credit Risk Management**, amongst others, and that funds are used for the purpose for which they were granted.

12.2 Management Information System

12.2.1 The **Guideline on Country Risk Management** requires banks to have in place an appropriate Management Information System (MIS) for monitoring country risk. In addition to the requirements set out in this guideline, the MIS shall, taking into consideration the credit monitoring system, *inter alia*, cover:

- (a) Maturity patterns, both residual and contractual;
- (b) Counterparty type;
- (c) Counterparty;
- (d) Group of connected counterparties;
- (e) Facility/Product type;
- (f) Currency of exposure;
- (g) Secured/Unsecured exposures;
- (h) Insured/Uninsured exposures;
- (i) Industry/Economic sector of the counterparty;
- (j) Lending arrangement type (Syndication, consortium, or bilateral); and
- (k) Location of collateral/other risk mitigants.

12.2.2 The MIS shall also capture any deviation from board-approved limits.

12.3 Structure of cross-border exposure

12.3.1 Certain banks leverage on their presence in overseas jurisdictions for their cross-border exposure. Such presence may be in the form of branches, group entities or representative offices in the overseas jurisdictions. The requirements in relation to the different types of arrangements and their associated risks are given in **Annex 1**. This shall be subject to appropriate due diligence/verifications being conducted on third-parties, as applicable.

Section III - Exemptions

13. The requirements under this Guideline will not apply to fully cash collateralised cross-border exposure. However, banks are still expected to carry out a proper risk assessment before engaging in such transactions.

Section IV - Regulatory reporting

14. Where a bank is affected by a material increase in underlying risks such as credit, legal or reputational risks in connection with its cross-border exposure or is approached by foreign authorities regarding such matters, it shall immediately inform the Bank.

Section V - Transitional arrangements

15. Banks shall fully implement the requirements of this Guideline within three months from its effective date.

Bank of Mauritius
4 September 2020

Annex 1 - Requirements based on the structure of cross-border exposure

Structure	Site visits/meetings	Verification of enforceability of collateral	Valuation of collateral	Credit risk assessment
Banks having branches or group entities in the overseas jurisdiction	Site visits/meetings may be performed by staff based in those branches/group entities or third-party service providers, as appropriate.	Verification of enforceability of collateral may be performed by staff based in those branches/group entities based on legal opinion from an external or internal legal counsel in the overseas jurisdiction.	Valuation of collateral may be performed by an independent appraiser working for/contracted by those branches or group entities.	Credit risk assessment may be performed by staff based in those branches or group entities, with the validation of the bank. The assessment shall be complemented by external credit ratings, wherever available.
Banks having representative offices only in the overseas jurisdiction	Site visits/meetings may be performed by staff based in the representative offices or third-party service providers, as appropriate.	The bank shall verify the enforceability of collateral based on legal opinion from an external legal counsel in the overseas jurisdiction.	Valuation of collateral may be performed by an independent appraiser working for/contracted by those representative offices.	Credit risk assessment may be performed by staff based in the representative offices, with the validation of the bank. The assessment shall be complemented by external credit ratings, wherever available.
Banks having no presence in the overseas jurisdiction	Site visits/meetings may be performed by third-party service providers.	The bank shall verify the enforceability of collateral based on legal opinion from an external legal counsel in the overseas jurisdiction.	Valuation of collateral shall be performed by an independent appraiser in the overseas jurisdiction.	Credit risk assessment shall be performed by the bank. The assessment shall be complemented by external credit ratings, wherever available.