

## **BANKING INSTITUTIONS ACT**

### **CIRCULAR - BIA 4/98**

**TO:** ALL BANKS

**DATE:** 4 June 1998

#### **CLARIFICATION OF ISSUES RELATING TO DETERMINATIONS BID-2 & BID-4 ISSUED UNDER THE BANKING INSTITUTIONS ACT (No 2 of 1998)**

##### **1. Background**

This circular is issued for the purpose of providing clarification on certain issues pertaining to the Determinations on the Classification of Loans, the Suspension of Interest on Non-performing Loans and the Provision for Bad and Doubtful Debts (BID-2), as well as, the Determinations on Large Exposures to a Single Person or Group of Related Persons (BID-4).

The determinations cannot cater for every situation which may arise, therefore, in cases of uncertainty, discretion needs to be exercised. Banking institutions are advised to adopt a prudent approach when dealing with such cases. Where doubts persist banking institutions should approach this department for guidance. The contents of this circular should provide a better understanding to some of the issues raised by the Technical Committee of the Bankers Association.

##### **2. Determination on the Classification of Loans and the Suspension of Interest on Non-Performing Loans and the Provision for Bad and Doubtful Debts: BID-2.**

###### **Question 1:**

Should interest be suspended if the outstanding balance (including accrued interest) is fully covered by the collateral?

As stated in para. 2.1 of the Determination BID-2, all interest accrued (but uncollected) from the date an account is classified as non-performing shall forthwith be suspended and credited to the "interest in suspense account", regardless of the extent to which security is provided. In this case the consideration is whether the account is classified as non-performing. If so, ignoring collateral, interest must be suspended.

**Question 2:**

How would a "delinquent" account within a group have to be handled? Notwithstanding the need to come to a satisfactory agreement with that specific client, would the bank have to suspend interest?

Generally, the delinquent account could have a bearing on the classification status of the group, but this would depend on a more extensive review of the various facilities. The minimum requirement however, is that the delinquent account will be classified and interest should be suspended accordingly.

**Question 3:**

How would the situation be with regard to the suspension of interest if an account would be dormant for six months and in excess of the limit confirmed to the client but still within the higher limit internally approved by the bank?

Overdrafts which are dormant for six months or more and subsequently breach the approved limit, as a result of the accrual of interest, shall be classified as non - performing as and when the approved limit is breached. For the purpose of the Determination BID-2, para 1.2.2, the term "approved limit" refers to the current approved line of credit granted to the borrower. An unadvised line of credit shall not be regarded as the "approved limit" for purposes of classification of overdraft facilities and the "approved limit" must be transparent to the borrower.

3. Determinations on Large Exposures to a Single Person or Group of Related Persons: BID-4.

The basis applied in establishing whether a person or group of persons are to be considered as a single exposure, is to determine who exercises effective control over the person, partnership, or company.

Control is deemed to exist, when there is ownership or power to control 20 per cent or more of the voting shares of the company or when there is power to determine the composition of the board of directors.

In cases where ownership or power to control 20 per cent or more of the voting shares of the company rests with more than one person, to avoid double or multiple counting, banking institutions are required to exercise their best judgment in ascertaining which one of the two or more persons has effective management control.

However, in instances where for example, ownership and /or control is equally divided and each holds 20 per cent or more of the voting shares, and it is not quite clear who exercises control, it would be required that the related exposure be aggregated with exposures of each of the persons who are deemed to have control. To avoid penalizing a banking institution in terms of its compliance with the limit imposed on aggregate large exposures, amounts that are double counted may be set-off from the aggregate total. Where double counting does result, all amounts counted more than once may be set off against the aggregate amount of the large exposures.

Two additional copies of this Circular are enclosed for the use of your institutions external auditors. The attached acknowledgment of receipt duly completed and co-signed by the said auditors, should be returned to this Office at your earliest convenience.

Any further enquiries related to any of the above, can be directed to this Office.

R W Lawrence  
**Senior Manager:**  
**Bank Supervision Department**