PRINCIPLES FOR THE MANAGEMENT OF CREDIT RISK

MEMORANDUM
FILE REF: B52
TO: Managing Directors and Branch Managers of Guernsey Banks

23 May 2003

I enclose for your attention a copy of the Basel Committee on Banking Supervision's paper entitled "Principles for the Management of Credit Risk." It can be obtained in electronic format (PDF) from the Committee's website at www.bis.org/publ/bcbs75.pdf

Management of Credit Risk

Although this paper was issued in September 2000 it continues to be the definitive text on expected international standards for credit risk management. The Commission endorses the principles contained in the paper and expects banks to have taken account of the principles. The extent to which banks have taken account of those principles will be reviewed when the Commission carries out on-site credit reviews but there will be specific briefing ahead of such visits setting out the particular objectives of the visit.

The Commission is aware that several banks in Guernsey do not have credit books. However, it has noted the Basel paper's statement that:

"For smaller or less sophisticated banks, supervisors need to determine that the credit risk management approach used is sufficient for their activities and that they have instilled risk-returns discipline in their credit management process."

The Commission will only expect banks to adopt principles that are relevant to, and proportionate for, the business they undertake.

I should be grateful if you would ensure that, if you have a credit function in your bank, the appropriate staff have read the Basel paper and have ensured that, where appropriate, your bank adopts the principles contained within it. May I commend also the Appendix entitled "Common Sources of Major Credit Problems" which notes that severe credit losses in a banking system usually reflect simultaneous problems in several areas, such as concentrations, failure of due diligence and inadequate monitoring.

Large Exposure Regime

This may be an appropriate opportunity to remind Guernsey bankers that the purpose of our Large Exposures regime (as described in the Commission document: "Principles and guidance to be followed by a locally incorporated licensed deposit-taking institution entering into a large exposure") is to address concentration risk primarily through our focus on the concept of single-obligor exposure.

In the case of banks operating as Guernsey subsidiaries, exposures over 10 per cent of capital base are required to be notified to the Commission after the event in the quarterly BSL/1 return. Exposures of 25 per cent and over however also have to be pre-cleared by the Commission. Details of the proposed exposure should be sent to the Banking Division in good time. We will expect the risks in such large exposures to be clearly identified but any measures taken to mitigate those risks should also be set out. The Commission will seek clarification if the risks have not been identified.

P J Marr
1 May 2003