NEVIS FINANCIAL
SERVICES DEPARTMENT

LARGE EXPOSURE POLICY

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GLOSSARY OF TERMS

Associate

in relation to a person entitled to exercise or control the exercise of voting power in relation to, or holding shares in, an institution, means -

(a) the spouse, child or step-child of that person,

(b) any body corporate of which that person is a director,

(c) any person who is an employee or partner of that person,

(d) if that person is a body corporate

(i) any director or subsidiary of that body corporate, and
(ii) any director or employee of any such subsidiary, and

(e) if that person has with any other person an agreement or arrangement as to the acquisition, holding or disposal of shares or other interests in that institution or under which they undertake to act together in exercising their voting power in relation to it, that other person.

BSL/2 return

Quarterly prudential statistics supplied by licensed institutions to the Commission.

Controller

As defined in Appendix 2 of this document

Director

Means a director within the meaning of section 22 of the Nevis International Banking Ordinance

Large exposure	An exposure to an individual counterparty or a group of connected counterparties, where that exposure is greater than or equal to 10% of the reporting bank's net capital base. Exposures to clients in excess of 25% the reporting bank's net capital base must be notified to the Commission in advance of entering into the transaction.
The Ordinance	Nevis International Banking Ordinance, 2014.
Licensed institution	An institution which is licensed to carry out international banking business under the Ordinance
Net capital base	Total Tier 1 and Tier 2 capital less any deductions. It is the "Adjusted Capital Base (Tiers 1 & 2)" figure reported in Module 6 of the quarterly BSL/2 prudential return.

1 INTRODUCTION

1.1 STATUS OF THIS DOCUMENT

This Large Exposure Policy document has the status of guidance made under section 6 of the Nevis International Banking Regulations, 2015.

1.2 DEFINITION OF A LARGE EXPOSURE

A large exposure is defined as an exposure to an individual counterparty or a group of connected counterparties that is greater than or equal to 10% of the reporting bank's net capital base. Net capital base in this context is the "Adjusted Capital Base (Tiers 1 & 2)" figure reported in Module 6 of the quarterly BSL/2 prudential return.

1.3 CONCENTRATION RISK POLICIES AND PROCEDURES

The Regulator requires that each locally incorporated licensed institution ("bank") has policies and procedures in place to provide a comprehensive bank-wide view of significant sources of concentration risk. This includes credit concentration through exposure to:

- single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty);
- counterparties in the same industry, economic sector or geographic region;
- counterparties whose financial performance is dependent on the same activity or commodity;
- off-balance sheet exposures (including guarantees and other commitments) and;
- market risk and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

Such policies and processes should establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff.

The bank's information systems should be able to identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposures to single counterparties or groups of connected counterparties. All material concentrations should be regularly reviewed and reported to the bank's Board.

1.4 LARGE EXPOSURE POLICY

Within this wider concentration risk policy, the bank should set out a specific policy on large exposures; i.e. an exposure to an individual counterparty or a group of connected counterparties, where that exposure is greater than or equal to 10% of the reporting bank's net capital base.

The necessary control systems to give effect to a bank's policy on large exposures must be clearly specified and monitored by its Board. Banks will be required to detail how they intend to monitor the

size of the net capital base to ensure that the limits detailed in this Large Exposure Policy and in accordance with their policy are not exceeded.

Each bank may be required to justify to the Regulator its policy on exposures to individual counterparties, including the maximum size of an exposure contemplated. Relevant factors which the Regulator will expect a bank to have taken into account when setting its policy and considering the acceptability of particular exposures include, for example, the standing of the counterparty, the nature of the bank's relationship with the counterparty, the nature and extent of security taken against the exposure, the maturity of the exposure, and the bank's expertise in the particular type of transaction. Exposures to counterparties related to the bank - for example, subsidiaries or sister companies or companies with common directors – will continue to be particularly closely examined.

The large exposure policy should be formally adopted by the institution's Board of Directors with a copy supplied to the Regulator. The Regulator expects banks not to implement material changes in these policies without prior discussion with the Regulator. Significant departures from a bank's stated policy, in particular those involving breaches of agreed levels, will lead the Regulator to consider whether the bank continues to meet the statutory minimum criteria for licensing.

2 MEASUREMENT OF A LARGE EXPOSURE

2.1 WHAT SHOULD BE INCLUDED?

An exposure is defined as the amount at risk arising from a reporting bank's assets and off-balance sheet items.

The measure of exposure to a single counterparty or group of connected counterparties should reflect the maximum loss should a counterparty fail. Consistent with this, an exposure should encompass the amount at risk arising from the reporting bank's:-

- claims on a counterparty including actual claims, and potential claims which would arise from the drawing down in full of undrawn advised facilities (whether revocable or irrevocable, conditional or unconditional) which the bank has committed itself to provide, and claims which the bank has committed itself to purchase or underwrite; and
- contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities (whether revocable or irrevocable, conditional or unconditional) which the bank has committed itself to provide; and
- assets, and assets which the bank has committed itself to purchase or underwrite, whose value depends wholly or mainly on a counterparty performing his obligations, or whose value otherwise depends on that counterparty's financial soundness but which do not represent a claim on the counterparty.

The amount at risk should be taken as the full amount (i.e. the book value of the reporting bank's claims and contingent liabilities, and potential claims and liabilities in the case of undrawn facilities), unless stated otherwise by written notice from the Regulator. In general, exposures should be reported on a gross basis, meaning that credit balances should not be offset against debit balances. Any deviance from reporting exposures gross will only be by prior agreement with the Regulator.

The amount at risk arising from interest rate contracts (including interest rate swaps, forward rate agreements and interest rate options purchased), foreign exchange rate contracts (including cross currency swaps, forward foreign exchange rate contracts and foreign exchange options purchased) and other derivative contracts such as commodity and equity derivatives, is not taken to be the nominal

amount of a contract but rather, a credit equivalent amount. The method for calculating the credit equivalent amount is the same as that used in the calculation of the credit risk capital requirement as set out in Module 1 of the Regulator's guidance notes on completion of the BSL/2 return.

Should a bank be involved in securities underwriting activities, the measure of exposure will not be the nominal amount, but will be a credit equivalent amount. The risks involved in underwriting differ substantially from those involved in lending activities typically undertaken by banks. A bank must seek prior approval from the Regulator before entering into any such exposure, at which point the approach to measuring and controlling the exposure will be agreed.

2.2 WHAT SHOULD BE EXCLUDED?

The following transaction types should be excluded from the measurement of an exposure:-

- items deducted from capital base (both for the calculation of the Adjusted Capital Base and for large exposure purposes);
- in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement (i.e. the reporting institution has its side of the transaction but has not received the countervalue) during the two working days following payment. After this period such claims will constitute an exposure;
- in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement (i.e. payment has been made or securities delivered, but the countervalue has not yet been received) during five working days following payment or delivery of the securities, whichever the earlier. Where neither counterparty to the transaction has settled, there will be no reportable exposure until 21 calendar days after due settlement date, after which the replacement cost of the transaction will be considered to be an exposure;
- in the case of the provision of money transmission (including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients), delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day; or
- in the case of the provision of money transmission (including the execution of payment services, clearing and settlement in any currency and correspondent banking), intra-day exposures to institutions providing those services.

Note that a bank's exposure arising from securities trading operations should be calculated as its net long position in a particular security; a short position in another security should not be used to offset this long position.

Note that the risks arising from the settlement of transactions other than those mentioned above are not included within this Large Exposure Policy. However, the Commission expects that the control of such exposures needs to be carefully considered by banks since inadequate controls could be a cause of substantial loss for a bank. The Commission will therefore pay particular attention in the course of its supervision to how individual banks control such risks.

In the case of loans to clients or groups of connected clients in excess of 25% of the net capital base where a Nevis bank originated loan is subject to a sub-participation agreement such that there is no possibility of the credit risk returning to the balance sheet of the bank, the element of the loan subject to the sub-participation agreement should be included in the initial notification to the Regulator but should not then be included in the measurement of an exposure for ongoing BSL/2 reporting purposes. See section 7.7 for further information.

3 IDENTITY OF A COUNTERPARTY

The identity of a counterparty will normally be the borrower (client or group of connected clients), the person on whose behalf a guarantee has been issued, the issuer of a security in the case of a security held or the party with whom a contract was made in the case of a derivatives contract.

3.1 DETERMINING WHETHER A TRANSACTION RELATES TO A PERSON

For the purposes of this Large Exposure Policy, a transaction entered into by an institution relates to a person if it is:

- a transaction under which that person incurs an obligation to the institution or as a result of which he may incur such an obligation, where the risk of loss attributable to the transaction is the risk of the person concerned defaulting on the obligation;
- a transaction under which the institution will incur, or as a result of which it may incur, an obligation in the event of that person defaulting on an obligation to a third party; where the risk of loss attributable to the transaction is the risk of the person concerned defaulting on the obligation;
- a transaction under which the institution acquires or incurs an obligation to acquire, or as a result of which it may incur an obligation to acquire, an asset the value of which depends wholly or mainly on that person performing his obligations or otherwise on his financial soundness, and where the risk of loss attributable to the transaction is the risk of the person concerned defaulting on the obligations there mentioned or of a deterioration in his financial soundness.

3.2 EXPOSURES TO RELATED PARTIES

Exposures to companies or persons related to the lending bank, its managers, directors or controllers are exposures to related parties.

For the avoidance of doubt, the following are considered to be related parties:

- group undertakings as defined by section 2 of the Ordinance or;
- associated companies as recognised by current accounting standards followed in Nevis, or;
- any party (including their subsidiaries, affiliates or special purpose entities) that the bank exerts control over or that exerts control over the bank that are not included in the above two definitions, or;
- directors, controllers and their associates as defined by section, and close family members of such persons or;
- non-group companies with which the reporting bank's directors and controllers are associated. A director (including an alternate director) and controller of the reporting bank is deemed to be associated with another company, whether registered or domiciled in Nevis or overseas, if he holds the office of a director (or alternate director) with that company (whether in his or her own right, or as a result of a loan granted by, or financial interest taken by, the reporting bank to, or in, that company, or even by virtue of a professional interest unconnected with the reporting bank), or if he and/or his associates, as defined above, together hold 10% or more of the equity share capital of that company, or;
- an employee of the lending bank who is not a director, but who is appointed by the lending bank to be a director of another company.

Exposures to related parties require special care to ensure that a proper objective credit assessment is undertaken. Such exposures may be justified only when undertaken for the clear commercial advantage of the lending bank, and when they are negotiated and agreed on an arms' length basis. Exposures to related parties should not be undertaken on more favourable terms (i.e. credit assessment, tenor, interest rates, fees, amortisation schedules, requirement for collateral, etc.) than corresponding exposures to non-related counterparties. Reference should be made to the provisions of section 20(1)(c) and (d) of the Ordinance.

Policies and procedures must be in place to identify exposures to related parties and to monitor and report on these through an independent credit review or audit process. Exceptions to policies, processes and limits should be reported to senior management and, if necessary, the Board.

The Commission will examine particularly closely all exposures to companies or persons related to a lending bank and will deduct them from the bank's capital base if they are of the nature of a capital investment or are made on particularly concessionary terms.

Exposures to related parties are subject to the exposure limits set out in sections 4.

3.3 GUARANTEED EXPOSURES

Where a third party has provided an explicit unconditional irrevocable guarantee, banks may be permitted to report the exposure as being to the guarantor. As a condition for permitting banks to report in this way, the Regulator will require banks to include a section on guaranteed exposures in their large exposures policy statement. The Regulator does not expect banks to report exposures to guarantors unless the banks have first approved the credit risk on the guarantor and the type of the exposure under the bank's normal credit approval procedures. It would be expected that any guarantees to a locally licensed bank, from a parent or any other bank, would be declared on the guarantors' reports to their regulators.

4 EXPOSURE LIMITS – EXPOSURES TO PARENT AND GROUP ENTITIES AND OTHER RELATED PARTIES

4.1 UPSTREAMING AND RELATED PARTY LIMIT

Section 20 of the Ordinance prescribes a statutory limit of 1% of capital on unsecured exposures to the following persons:

- Directors;
- Any person in whom a bank or any of its directors is interested as a director, partner, manager or agent or as a guarantor; or
- A bank's holding company, any subsidiary or affiliate or any director thereof.

Section 20 further restricts the aggregate of the secured and unsecured portion of an exposure to 40% of capital.

4.2 PRUDENTIAL REPORTING OF EXPOSURES TO PARENT OR GROUP BANKS.

The BSL/2 prudential reporting forms enable all exposures to the parent and other banks within the parent Group and any other relevant exposures to non-bank entities within the parent Group to be detailed.

5 EXPOSURE LIMITS - EXPOSURES TO THIRD PARTY BANKS

5.1 EXPOSURE LIMITS

Section 20 of the Ordinance prescribes a statutory limit of 10% of capital on unsecured exposures to third party banks and corporates.

Section 20 further restricts the aggregate of the secured and unsecured portion of an exposure to 40% of capital.

5.2 WHAT IS INCLUDED IN THE LARGE EXPOSURE LIMIT?

The large exposure limit would include all types of exposure, including money market placements, holding of debt securities, exposures under funded risk participation agreements and silent or non-silent loan sub-participation agreements, and all off balance sheet exposures, including third party bank guarantees of client exposures and unfunded risk participation agreements.

Note that the transactions referred to in section 2.2 should not be included in the measurement of an exposure to a third party bank.

5.3 MONITORING AND REPORTING

There would be no requirement to notify the Regulator before entering into a large exposure with a third party bank.

All exposures to third party banks and corporates that are greater than or equal to 10% of the net capital base should be reported on the appropriate sheet in the BSL/2 return.

6 EXPOSURE LIMITS - EXPOSURES TO SOVEREIGNS

"Sovereigns" includes sovereign governments, central banks, rated supranational authorities (e.g. the European Bank for Reconstruction and Development) and those government agencies that have an unconditional guarantee from a sovereign government (e.g. GNMA or "Ginnie Mae").

The Regulator may also be willing to consider as sovereign exposures some exposures to sovereign government sponsored enterprises. These enterprises do not have the "full faith and credit" of the underlying government however, and they will not therefore be subject to the exposure limits set out in section 6.1. Instead, the Regulator will discuss exposures to government sponsored enterprises on a case by case basis, in advance of any exposure being entered into. Such enterprises include FHLMC ("Freddie Mac"), FNMA ("Fannie Mae"), or SLMC ("Sallie Mae").

6.1 EXPOSURE LIMITS

Section 20 of the Ordinance prescribes a statutory limit of 10% of capital on unsecured exposures and this limit applies to sovereign exposures.

Section 20 further restricts the aggregate of the secured and unsecured portion of an exposure to 40% of capital.

These limits can, of course, be reduced by individual banks where the risk appetite calls for lesser or even no exposure to a particular sovereign. Indeed, banks may decide not to enter into exposures with domestic sovereigns or multilateral development banks. The Regulator expects a Board to set and maintain a prudent credit policy, particularly in respect of exposures to counterparties rated as non-investment grade or counterparties that are not rated.

6.2 WHAT IS INCLUDED IN THE LARGE EXPOSURE LIMIT?

All on-balance sheet exposures to sovereigns and, although unlikely, any off-balance sheet exposures calculated at a credit equivalent amount should be included in the limit.

6.3 MONITORING AND REPORTING

There would be no requirement to notify the Regulator before entering into a large exposure with a sovereign.

All exposures to sovereigns that are greater than or equal to 10% of net capital base should be reported on the appropriate sheet in the BSL/2 return.

7 EXPOSURE LIMITS - EXPOSURES TO CLIENTS

7.1 EXPOSURE LIMITS – INDIVIDUAL EXPOSURES

Section 20 of the Ordinance prescribes a statutory limit of 10% of capital on unsecured exposures and this limit applies to client exposures.

Section 20 further restricts the aggregate of the secured and unsecured portion of an exposure to 40% of capital.

7.2 EXPOSURE LIMITS – AGGREGATE EXPOSURES

A bank may not incur exposures which exceed 10% of net capital base to clients or groups of connected clients which in aggregate exceed 800% of the bank's net capital base without the prior agreement of the Regulator.

7.3 GROUPS OF CONNECTED CLIENTS

The definition of a group of connected clients is as follows:

"*A group of connected clients means (a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly has control over the other or others; and (b) two or more natural or legal persons between whom there is no relationship of control as set out in (a) but who are to be regarded as constituting a single risk because they are so interconnected that if one of them were to experience funding or repayment problems, the other or all of the others would be likely to encounter funding or repayment difficulties*". Further guidance on the interpretation of the above definition and the calculation of exposure to a group of connected clients is provided in Appendix 2.

7.4 WHAT IS INCLUDED IN THE EXPOSURE LIMIT?

All on and off-balance sheet exposures to a client or group of connected clients must be included.

For loans originated by the bank that are subject to a sub-participation agreement, that portion of the loan subject to the agreement should not be included in the measurement of the exposure once the sub-participation agreement has been executed. However, there is a reporting requirement; please see section 7.5 for details.

7.5 MONITORING AND REPORTING

Prior notification of exposures in excess of 25% of net capital base.

Exposures in excess of 25% of net capital base must be notified to the Regulator prior to entering into any exposure. Please see section 9.1 for details of the notification process.

Reporting sub-participated exposures.

Exposures to a client in excess of 25% of net capital base that will be subject to a sub-participation agreement should also be notified to the Regulator in advance. Please see section 9.1 for details. The gross amount of the exposure to the client (i.e. ignoring the effect of the sub-participation) should be reported along with details of the arrangements for sub-participation and an explanation of how the Board has satisfied itself that there is no possibility of the credit risk for the sub-participated element returning to the balance sheet of the bank. Once the Regulator has acknowledged the gross exposure and the sub-participation agreement has been executed, only the net exposure should be reported for ongoing BSL/2 reporting purposes.

A copy of the sub-participation agreement should be included with the initial notification to the Regulator.

Reporting exposures with multiple beneficial owners.

In respect of reporting an exposure to an entity that has multiple beneficial owners, the reporting depends on whether the exposure is to the entity alone, or whether there are other exposures to the beneficial owners. Further guidance on reporting exposures with multiple beneficial owners is provided in Appendix 3.

7.6 ADDITIONAL SUPPORTING EVIDENCE FROM GROUP COMMITTEES

For some large exposures, the Regulator will want to see evidence that the parent is aware of and has sanctioned the exposure being entered into by the Nevis bank. For the following exposures a relevant extract from Group Credit Committee minutes or Group Risk Committee minutes, signed by the Chair of that committee, or other evidence as agreed in advance with the Regulator should be provided to the Regulator prior to the exposure being entered into:

- Client exposures subject to a funded sub-participation agreement such that no more than 25% of the exposure remains on the Nevis bank's balance sheet;
- Ad hoc occasions as the Regulator may require.

8 SECURITY SUPPORTING EXPOSURES

Whether an exposure is secured by cash deposit or other security the lender's legal title to the security should be fully protected. In the case of:

- an exposure secured by a cash deposit with a legal right of set off, the deposit should have identical or longer maturity than the exposure. Alternatively, a legally binding commitment should be in place to ensure the deposit cannot be repaid before the relevant exposure matures. Where the cash deposit is in a different currency from the exposure, an appropriate margin over the amount of the exposure should be maintained to cover fluctuations in the relevant exchange rates. The margin should take account of the nature of the arrangements for ensuring that any resulting deficiency in the margin following an exchange rate change is made up and, in any case, the total cover should be no less than 115% of the exposure.

- an exposure secured by other securities should have an appropriate margin to cover fluctuations in the market value of the securities. The margin should inter alia, take account of the maturity of the exposure, in the case where the security is denominated in a different currency from the exposure, fluctuations in the exchange rate, and the arrangements for marking to market the security and for ensuring that any resultant deficiency in the margin is made up.

9 LARGE EXPOSURE REPORTING REGIME

9.1 PRIOR NOTIFICATION

8.1.1 Exposures to parent and group banks, to third party banks and to sovereigns

There is no requirement to notify the Regulator in advance of exposures exceeding 25% of net capital base that are made to parent and group banks, third party banks or sovereigns. However, where a proposed transaction with one of these types of counterparty will result in an exposure which represents a significant departure from the bank's statement of policy on its large exposures submitted to the Regulator, the Regulator will expect the proposed transaction to be discussed with it in advance of the bank entering into the exposure.

8.1.2 Exposures to clients or to groups of connected clients

For exposures to clients and groups of connected clients, there is a prior notification regime. When a bank proposes to enter into an exposure which either alone or together with other existing exposures to the same client or group of connected clients exceeds 25% of net capital base, details must be notified to the Regulator before the bank becomes committed to the exposure. This can be done via letter and guidance on what detail to include in the letter is given in Appendix 1. The Regulator will acknowledge the exposure and provide a unique large exposure number which must be used to report the exposure on subsequent BSL/2 returns.

If an exposure which exceeds 25% of net capital base has been entered into without prior notification to the Regulator, notification must be made within two working days of entering into the exposure in order to avoid a breach, and the reason for not reporting the exposure in advance of entering into it must be given. The Regulator would expect late notification to be for exceptional reasons only.

Note that the regime is a notification regime, not an approval regime. The decision to enter into any exposure, large or small, is a matter for the commercial judgement of the management of the bank concerned. The Regulator for its part is concerned to ensure that management has exercised this judgement responsibly and advisedly. An acknowledgement from the Regulator should not in any sense be regarded as permission or approval.

Any increases in an exposure beyond that notified to the Regulator must be further notified in writing before entering into the increase.

Similarly, if an exposure with an LE number is repaid such that it no longer exists, the Regulator should be informed so that it can amend its records accordingly.

8.2 QUARTERLY NOTIFICATION OF EXPOSURES

8.2.1 Reporting for locally incorporated banks

Locally incorporated banks are required to report on their large exposures on a quarterly basis in the Regulator's BSL/2 prudential returns. Separate spreadsheets are available for the reporting of (i) exposures to parent and group banks,(ii) exposures to third party banks, (iii) exposures to sovereigns and (iv) exposures to clients or groups of connected clients.

All exposures greater than or equal to 10% of net capital base must be reported on these forms. The one exception to this is the spreadsheet for exposures to parent and group banks, on which all exposures, regardless of size, must be reported.

8.2.2 Reporting for branches of banks incorporated outside of the Jurisdiction

Branches of banks will also be required to report on the ten largest market loans (which may be to a parent or group bank or to a third party bank) and on the ten largest credit exposures, on a quarterly basis using the Regulator's BSL/2 prudential returns.

9 BREACHES OF LIMITS

Any breach in large exposure limits must be reported in writing to the Regulator immediately the bank becomes aware. A breach would be deemed to have occurred if there was:

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- A breach of statutory large exposure limits under section 20 of the Ordinance; or
- A failure to notify the Regulator in advance of an exposure to a client or group of connected clients in excess of 25% of net capital base.

The Regulator would expect prior notification of exposures to clients or groups of connected clients that are in excess of 25% of the bank's net capital base. However, in exceptional circumstances, a bank may notify the Regulator within two working days of entering into an exposure. Post-exposure notification from the third working day onwards would therefore be classed as a breach of the requirement to notify the Regulator in advance of exposures in excess of 25% to clients or groups of connected clients. Clearly, the longer the period between entering into an exposure and notifying the Regulator, the more serious the breach. The situation will be compounded if it is shown that, on discovering that a report should have been made, the bank fails to alert the Regulator within 7 calendar days of it becoming aware of this fact.

Each breach will be discussed with the reporting bank as a separate case and the Regulator will take into account the nature and extent of the breach, the circumstances in which it occurred and the time necessary to regularise the position. The extent of any action taken in response to a breach will depend on these factors and on any history of previous breaches.

Banks are asked to pay particular attention to the effect of any proposed reductions in net capital base, such as the proposed payment of a dividend for example, in order to ensure that exposure limits are not inadvertently breached by such a reduction.

APPENDIX 1 – NEW CLIENT LARGE EXPOSURE NOTIFICATION

When a bank proposes to enter into an exposure which either alone or together with other existing exposures to the same client or group of connected clients exceeds 25% of net capital base, details must be notified to the Regulator before the bank becomes committed to the exposure. A notification letter from the bank will suffice, but it should contain as much of the detail below as is applicable.

Basic details

Client name	The name of the client counterparty(ies).
Amount of new facility	The maximum amount that may be drawn under the new facility and the currency(ies) of the facility. If the loan is to be made available in tranches, please provide details. If the loan is to be subject to a sub-participation agreement, please report the gross amount of the facility to the client (i.e. ignoring the effect of any sub-participation).
Type of facility	E.g. mortgage, overdraft, temporary loan, etc.
Term of facility	Please state the term of the facility and the maturity date for the exposure. If the facility is a rolling facility or a revolving credit facility, please give details.
Date of anticipated drawdown	The earliest date on which the client is expected to draw down some or all of the facility.
Purpose of facility	Please provide as much detail as possible on the purpose of the facility.
Valuation (property only)	Where the exposure involves property please give the date and amount of the most recent professional valuation of the property.
Loan to Value	If applicable, please give the loan to value of the asset.
Collateral	Please give the type and value of the collateral, its currency and its location. *E.g. Cash to the value of USD 1,500,000 held in custody by the bank.* *E.g. US Treasury Bills to the value of USD500,000 pledged to the bank under a security interest agreement, and cash to the value of USD 250,000 held in custody by the bank.* *E.g. Parental guarantee to the value of USD 5,000,000.* If the collateral is encumbered in any way, please also provide details. For parental guarantees, a copy of a legal opinion on the enforceability of the guarantee must be provided to the Regulator with this notification.
Details of any sub-participation agreement	If the loan is subject to a sub-participation agreement please give details of the participating entity(ies), the nature of the agreement, the amount that will be sub-participated, and the exposure remaining on the balance sheet of the bank net of a sub-participated amount. Please also provide an explanation of how the Board has satisfied itself that there is no possibility of the credit risk covered by the sub-participation agreement returning to the balance sheet of the bank
Net capital base in GBP	Unless the capital has changed in the meantime, please give the net capital base of the bank as reported at the most recent BSL/2 quarterly prudential report.

% of net capital base this new facility represents	Please state the % of net capital base that this new facility represents.

Other exposures to the client/group of clients

If there are multiple exposures that are already held in a separate spreadsheet, please feel to supply a copy of this sheet. The information must however reflect the following:

Details of existing exposures to this client	Please use this section to provide details of all other exposures to this client. Please ensure that the following are included: • LE number (if applicable) • Amount of facility • Term of facility • Collateral held • Purpose of facility
Aggregate value of all exposures to this client, including the new facility	Please provide the aggregate value of all exposures to this client, to include all existing exposures, however small, and the new facility which is the subject of this notification.
% of net capital base this aggregate exposure represents	Please state the % of net capital base that this aggregate exposure, including the new facility, represents.
Connected party details	If this client is connected to other parties to which the bank already has an exposure, please provide details of (i) the parties, (ii) the nature of the connection and (iii) the exposure(s) to those clients, including the amount, term, and type of the exposure(s) and the associated collateral.

Risk assessment

Please identify the highest level at which this exposure has been sanctioned (e.g. individual lending officer, Bank Credit Committee, Group Credit Committee, Group Risk Committee, Group Chief Risk Officer, etc.).

Enclosures

For the following exposures a relevant extract from Group Credit Committee minutes or Group Risk Committee minutes, signed by the Chair of that committee, should be attached to this notification:

- Client exposures subject to a funded sub-participation agreement such that no more than 25% of the exposure remains on the Nevis bank's balance sheet;

For client exposures subject to a parental guarantee or unfunded risk participation agreement, please also provide a copy of the legal opinion on the enforceability of the guarantee or agreement.

For client exposures subject to a funded sub-participation agreement, please provide a copy of the agreement.

APPENDIX 2 – GROUPS OF CONNECTED CLIENTS

Interpretation of "control" in the definition of a group of connected clients:

Control means the relationship between a parent undertaking and a subsidiary, or a similar relationship between any natural/legal person and an undertaking.

Control is presumed to exist when the client owns directly, or indirectly through subsidiaries, more than half of the capital or voting power of an entity, unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.

A client owning 50% of the shares/voting power of another client may be able to exercise one or more of the powers mentioned below. This is even the case when there are two equal partners/owners who share the power and govern the entity jointly.

However, control may also exist when the client owns less than half of the voting power of an entity or does not hold any participating interest in the entity at all. In those cases, the institution should refer to indicators of control that are seen in cases where the client is able to exercise one or more of these powers:

- Power to direct the activities of the undertaking so as to obtain benefits from its activities;
- Power to decide on crucial transactions;
- Power to govern the financial or operating policies of the undertaking;
- Power to appoint or remove the majority of directors, the supervisory board, members of the board of directors or equivalent governing body of the undertaking, where control is exercised by that board or body;
- Power to cast the majority of votes at meetings of boards of directors, general assembly or other governing body of the undertaking, where control is exercised by that board or body; and
- Power to co-ordinate the management of an undertaking with that of other undertakings in pursuit of a common objective; i.e. where the same natural persons are involved in the management or board of two or more undertakings.

In calculating the exposure to a group of connected clients the entire exposure to a connected client must be included in the calculation. The exposure should not be limited to, nor proportional to, the formal percentage of ownership.

In respect of control, the Regulator would expect that where any of the above examples exist, in order *not* to consider the clients to be connected clients, the bank should be able to document that what seems to be a control relationship truly is not. It is not relevant whether the client does or does not exercise control; it is the ability to do so that is key. Voluntary self-imposed limitations by a client on the exercise of control, such as legal ring-fencing or statements of a similar nature would not therefore suffice as valid documentation.

Interpretation of economic "interconnectedness" in a group of connected clients:

Two or more natural or legal persons between whom there is no relationship of control but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties.

Sharing the same trustee or investment manager does not automatically connect two clients. The key is whether financial problems affecting one client could also affect the other client in the same way. If a bank can evidence that the client would be able to experience such a situation without facing substantial, viability threatening repayment difficulties, then there is no requirement to consider such clients to be interconnected.

Examples of economic dependencies that a client may not be able to overcome without experiencing repayment difficulties can include:

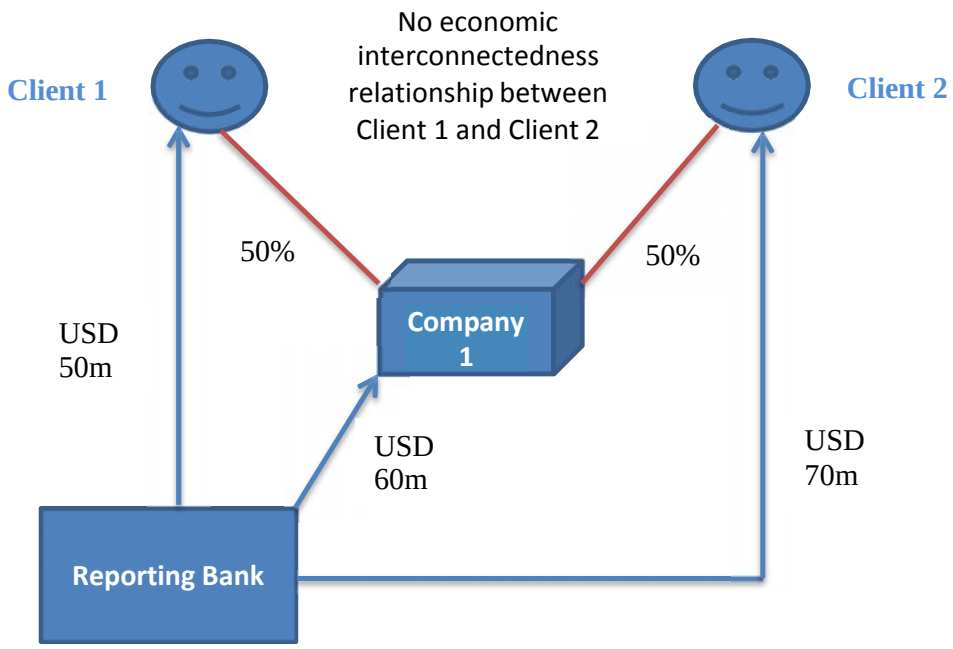
- Where one counterparty has guaranteed fully or partly the exposure of the other counterparty or is liable by other means;
- Where the bank has committed itself to provide credit facilities to more than one conduit or SPV under similar conditions, and where it is likely that those commitments may materialise into exposures at the same time because they are dependent on the same funder*;*
- Where the funding problems of one counterparty are likely to spread to another due to a one-way or two-way dependence on the same main funding source, which may be the Nevis bank itself;
- Where counterparties rely on the Nevis bank for their main funding source, for example through explicit or implicit liquidity support or credit support;
- Where the insolvency or default of one of them is likely to be associated with the insolvency or default of the other(s);
- Where the bank is exposed to the owner of a commercial/residential property and to the tenant who pays the rent;
- Where the bank is exposed to the sole producer of a product and the only buyer of that product.

Reporting exposures with connected clients.

In respect of reporting an exposure to an entity that has multiple beneficial owners, the reporting depends on whether the exposure is to the entity alone, in which case it is a single exposure to that company, or whether there are other exposures to the beneficial owners of that company.

These two examples deal with exposures to a company and to one or more of its beneficial owners.

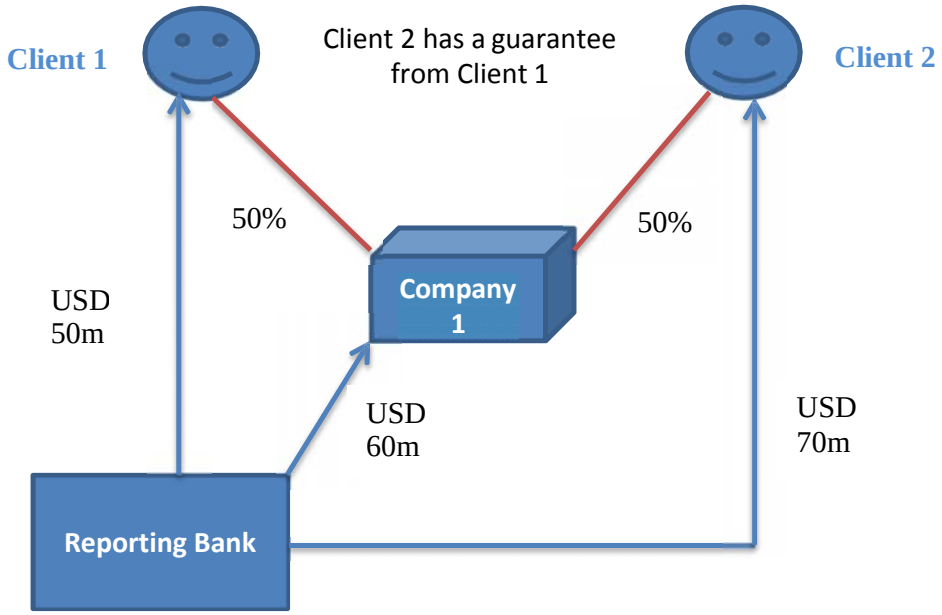
Example 1



Using the diagram above, consider the following example:

- The bank is asked to loan $60m to Company 1. This is Loan01.
- Two months later one of the shareholders, Client 1 who has a 50% shareholding in Company 1, asks for a loan for $50m for personal use. Since there is a control relationship between Client 1 and Company 1, these clients are connected. Loan01 increases therefore to $110m. Note that although Client 1 owns only half of Company 1, prudence dictates that the whole amount of the loan to Company 1 should be included in Loan01.
- Six months later, the other shareholder, Client 2 asks the bank for a loan of $70m, also for personal use. He is unconnected to Client 1 in any way other than through ownership of Company 1 and there is no economic dependence between the two shareholders.
- The control relationship between Client 2 and Company 1 makes them connected clients, but the lack of any other link to CL1 means that this connection can be treated separately. This is Loan02 therefore, with a value of $130m.
- This logic can be applied to multiple shareholders, provided that there is no economic dependence between them (i.e. the only link between the individuals is that they have shares in the same company).

Example 2



In this example, there is economic interconnectedness between the shareholders. The reporting would be as follows:

- The bank is asked to loan $60m to Company 1. This is Loan01.
- Two months later one of the shareholders, Client 1 asks for a loan for $50m for personal use. Since there is a control relationship between Client 1 and Company 1, these clients are connected. Loan01 increases therefore to $110m. Note that although Client 1 owns only half of Company 1, prudence dictates that the whole amount of the loan to Company 1 should be included in Loan01.
- Six months later, the other shareholder, Client 2 asks the bank for a loan of $70m, also for personal use. As collateral for the loan, he presents a guarantee from Client 1.
- The guarantee establishes an economic dependence; Client 1 and Client 2 are now connected not only indirectly from their ownership of Company 1, but also directly by the guarantee. It is now prudent therefore to consider the loan to Company 1 and the two exposures to Client 1 and Client 2 to be connected. Hiving off Client 2 and his ownership of Company 1 into a separate exposure (Loan02 in the previous example) is now not appropriate.
- Loan01 therefore becomes $180m

Assume that there is a third shareholder who now comes along and asks for a loan of $25m for personal use. If this person has an economic dependency with either Client 1 or Client 2, then the amount of his exposure will also need to be included in Loan01, which would now make Loan 01 $205m. If however his only connection to CL1 and CL2 is through ownership of Company 1, then he can be hived off into a separate exposure, which would have a value of $85m.