Appendix II

REPORTING INSTRUCTIONS FOR NRBT QUARTERLY FORM FID 4

General Instructions

1. The report, showing the position at the last business day of each calendar quarter, should be furnished to the Reserve Bank within 15 business days of the quarter end. Figures reported should be after any related adjustments have been completed in the financial accounts for the reporting date.

2. Certain items in the report should reconcile to amounts reported in other relevant returns at the same date. Reference will be made in the instructions for those returns where appropriate, when revised by the Reserve Bank.

Specific Reporting Instructions

For the purpose of reporting to the Reserve Bank, the following definitions should be observed, consistent with Prudential Statement No. 2 *Revised 2007*; 'CREDIT RISK GRADING SYSTEM' dated 24 December 2007.

1. "Credit Facilities" includes Loans and Advances, Leases, all other on balance sheet credit exposures to customers, acceptances and bills of exchange, and off balance sheet commitments contingencies and other transactions which have the potential to expose the institution to a loss if the counterparty fails.

   Guarantees and standby letters of credit are usually converted into on-balance sheet exposures (at full value) if the counterparty they are supporting fails. There may also be circumstances where the institution is reasonably certain that the instrument will be called upon at a future date because of uncertainty about the customer. Loan commitments, which are irrevocable, should also be classified as Impaired Assets if the creditworthiness of the customer has deteriorated to such an extent that full repayment of any drawdown (or interest payments thereon) is considered uncertain. Interest rate and exchange rate contracts should be reported at their credit equivalent amount as in the 'Capital Ratio Return' (FID 12).

2. "Classification of Credit Facilities". Each institution is to classify and report all credit facilities (as defined above), into the following categories: -
   - Standard
   - Special Mention
   - Substandard
   - Doubtful
   - Loss

The definition and examples of expected characteristics of each of these categories of exposures are given below. While references are mainly made to loans, the factors given are also applicable to exposures arising from other items specified in the definition of credit facilities.

Standard

This refers to loans where borrowers are current in meeting commitments and full repayment of interest and principal is not is doubt.

Special Mention

This refers to loans where borrowers are experiencing difficulties, which may threaten the institution's position. Ultimate loss is not expected at this stage but could occur if adverse conditions persist. Such borrowers should be subject to special monitoring.

It is not envisaged that specific provisions will be required for these loans at this stage. Interest may continue to be accrued to the Profit and Loss account.

These loans exhibit one or more of the following characteristics.

(a) Early signs of liquidity problems such as delay in servicing loans.

(b) Inadequate loan information such as annual audited financial statements not obtained or not available within a reasonable time.

(c) The condition of, and control over, collateral is questionable.

(d) Failure to provide proper documentation or non-cooperation by the borrower or difficulty in keeping contact with him.

(e) Slowdown in business or adverse trends in the borrower's operations that signal a potential weakness in the financial strength of the borrower but which has not reached a point where a servicing of the loan is jeopardised.

(f) Volatility in the economic or market conditions which may in the future affect the borrower negatively.

(g) Poor performance in the industry in which the borrower operates.

(h) Some management weakness is evident, or the borrower, or in the case of corporate borrowers, a key executive, is in ill health.

(i) The borrower is the subject of a litigation, which may have a significant impact on his financial position.

(j) Repayment of principal or interest on a fully secured loan or facility (or period continually in excess of limits or authorised excesses in the case of overdrafts, etc) is Past Due by more than 30 days and up to 90 days past due.

(k) For acceptances and bills of exchange held, a bill, which is overdue, should at least be classified as Special Mention.

Substandard

This refers to loans where borrowers are displaying a definable weakness, which is likely to jeopardise repayment. The institution is relying heavily on available security. This would include:

(i) loans where some loss, either of principal or interest, (including future interest), is possible after taking account of the market value of security;

(ii) restructured loans – where concessions have formally been agreed with a customer on interest or principal such as to render the loan "non-commercial" to the bank;

Specific provisions (which may be maintained on a portfolio basis for all substandard facilities and not allocated to individual loans) should be set-aside at an average of at least 20% of the uncollateralised balance for accounts included in this category. Where for example security is not considered sufficient to recover both principal and accrued interest, the lending institution should consider accruing interest to suspense account rather than Profit and Loss account, or if interest has been overdue for a significant period of time, not accruing interest at all.

These loans exhibit one or more of the following characteristics: -

(a) Repayment of principal and/or of interest has been overdue for more than one month and principal, accrued interest and/or future interest is unsecured or only partially secured by the current market value of collateral, or other serious deficiencies are observed.

(b) Even where principal, accrued interest and future interest appear to be fully secured, a "substandard" classification should be made where repayment of principal and/or interest is overdue for more than 3 months.

(c) Inadequate collateral.

(d) Credit history or performance record is not satisfactory

(e) Material documentation exceptions, such as valuation of properties and collateral not properly supported in writing.

(f) Increased borrowings not in proportion with the borrower’s business.

(g) Borrower experiencing difficulties in repaying obligations to other creditors.

(h) Construction delays or other unplanned adverse events resulting in cost overruns that may require loan restructuring.

(i) Unemployment of the borrower.

(j) Deteriorating financial condition of the borrower.

(k) For acceptances and bills of exchange held, a bill, which is past due by more than 3 months, should at least be classified as Substandard.

Doubtful

This refers to loans where collection of principal and interest in full is improbable and the institution expects to sustain a loss of principal and/or interest, taking account of the market value of security. Specific provisions should be made against any expected loss. Accrual of interest on such loans should cease.

In addition to the characteristics mentioned for substandard loans, doubtful loans may have one or more of the following characteristics: -

(a) A prolonged overdue period of more than 6 months; but in the case of unsecured or partially secured loans or where serious deficiencies, such as death or bankruptcy of borrower, are detected, they should be classified as ‘doubtful’ if the overdue period exceeds 3 months. Loans for which all principal, accrued interest and future interest for an extended period is considered to be fully secured by the current market value of collateral should be regularly reviewed, but may not need to be classified as Doubtful until Past due by 2 years or more.

(b) Borrower’s operations have ceased or are about to cease because of poor business results.

(c) Borrower’s whereabouts unknown.

(d) Borrower in liquidation.

Loss

This refers to loans, which are considered uncollectable, or of minimal recoverable value, or are unable to be collected within a reasonable timeframe (usually not more than 1 year) after commencing legal proceedings; or where all collection efforts such as realisation of collateral and institution of legal proceedings etc have been exhausted. All outstanding principal and interest, which are not covered by the fair value of collateral, should be fully provided for or written off. Interest on accounts included in this category should cease to be accrued. Loans which are unsecured or only partially secured may be classified as Loss once the loan becomes Past Due by more than 6 months, and other than in exceptional circumstances, such loans must be classified as Loss when Past Due 1 year or more.

3. “Classified Credit Facilities”

Where reference is made to Classified credit facilities, it refers to those facilities falling within the definitions of Substandard, Doubtful or Loss as set out above and in the Guidelines for Credit Risk Grading Systems.

National Reserve Bank of Tonga
24 December 2007