BANK OF PAPUA NEW GUINEA

PRUDENTIAL STANDARD 5/2003

LIMITS ON INTER-BANK PLACEMENTS

Arrangement of Paragraphs

PART I: PRELIMINARY

1: **<u>Short Title</u>** – Inter-bank placements.

2: **<u>Authorization</u>** - The Bank of Papua New Guinea (Bank) is authorized to issue prudential standards under Section 27 of the Banks and Financial Institutions Act 2000 (Act) in relation to prudential matters to be complied with by all Authorized Institutions.

3: **<u>Application</u>** - All financial institutions licenced by the Bank to conduct banking business in Papua New Guinea (PNG).

4: **<u>Definitions</u>** - Terms used within this standard are as defined in the Act, as defined below, or as reasonably implied by contextual usage:

1) **"bank" -** means all banks and other licenced financial institutions authorized under the Act to carry on banking business.

2) **"capital base"** - means Total Capital as defined in Prudential Standard 1/2003 Capital Adequacy.

3) **"exposure"** - means the following:
(a) all deposits in another bank;
(b) all loans or advances to another bank;
(c) all purchases of securities or other assets from another bank subject to an agreement to repurchase;
(d) all guarantees, acceptances, or letters of credit issued on behalf of another bank;
(e) all purchases of or investments in securities issued by the other bank or institution;
(f) all securities issued by the other bank or institutions and accepted as collateral.

4) **"inter-bank placement"** - means any transaction between banks licenced to conduct business in PNG which results in an exposure as defined above.

PART II: STATEMENT OF POLICY

1: **<u>Purpose</u>** - This standard is intended to limit the potential for contagion risk posed when a bank fails or is otherwise unable to repay its obligations to other banks in a timely manner.

2: **<u>Scope</u>** – This standard applies to all banks licenced and operating in PNG and to any inter-bank placement between the banks which results in an "exposure" as defined in ¶4.

3: **<u>Responsibility</u> –** It is the responsibility of the board of directors of each bank to establish policies and procedures to ensure that all exposures resulting from inter-bank placements (a) fully comply with the limitations set forth in this standard, and (b) are made and administered according to prudent lending and investment practices.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Limits and Requirements** – An inter-bank placement exposure having a term or settlement period of more than 7 calendar days shall not exceed 50% of a bank's capital base. Furthermore, any amount of such exposure exceeding 25% of a bank's capital base must be fully secured at all times as defined ¶2 below.

For an inter-bank exposure having a term or settlement period of 7 calendar days or less, the 50% exposure limitation and security requirement shall not apply. However, if such exposure is renewed, rolled-over or extended, and it is determined by the Bank that such renewal, roll-over or extension is, in substance, an exposure having a settlement period of more than 7 days, then it will be treated as the latter and be subject to the requirements above.

2: **Security** - For purposes of ¶1 above, eligible security shall include bills, notes, bonds, or other similar evidences of indebtedness issued by the Government of PNG, or which an agency or instrumentality of the Government of PNG has unconditionally agreed to purchase or has unconditionally guaranteed as to payment of both principal and interest.

3: **Nonconforming exposures** - (a) If an inter-bank exposure complies with the limit in ¶1 when made but later fails to comply because (i) the exposed bank's capital base declines, or (ii) the other bank merges with another bank to which this bank is also exposed, or (iii) the lending limit or capital base rules change, or iv) the collateral securing the exposure fails to qualify, then the exposure will be treated as 'nonconforming'.

(b) if an inter-bank exposure becomes 'nonconforming' for reasons (i-iii) above, then the bank must promptly take all reasonable actions to bring the exposure into compliance unless doing so would be inconsistent with safe and sound banking practices.

(c) if an exposure becomes 'nonconforming' for reason (iv), then the bank must bring the exposure into compliance within 10 calendar days, unless judicial proceedings, regulatory actions, or other circumstances beyond the bank's control prevent taking action.

4: **Bank Policy** – To assist the board of directors with fulfilling its responsibility in ¶3 of Part II above, the directors of each banking institution shall adopt a policy that sets forth the terms and conditions for all inter-bank placements, including any internal limitations that may be equivalent to or more stringent than those specified in this standard. The policy shall further establish the criteria for selecting which banks are acceptable for inter-bank placements and which are not.

5: **Reporting Requirements** - Each bank shall submit to the Bank such returns as the Bank may require and in the form and frequency as the Bank may prescribe.

PART IV: CORRECTIVE MEASURES

1: **Remedial measures and sanctions** - If a bank breaches any provision of this prudential standard in a flagrant manner which results, or threatens to result, in an unsafe or unsound condition, or fails to comply with the instructions and reporting requirements, or if there is risk that the existing capital base will be impaired and result in a condition that threatens the interests of depositors or the general public, the Bank may pursue appropriate corrective actions and sanctions by imposing or varying conditions on the bank's licence as provided in Section 14 of the Act.

Such conditions imposed on a bank's licence under Section 14 may include, but are not limited to, the following –

a) Require the bank to take certain steps or to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way, including a prohibition from engaging in any further foreign exchange activities for a specified period of time;
b) Impose limitations on the acceptance of deposits, the borrowing of money, the granting of credit or the making of investments;
c) Prohibit the bank from soliciting deposits, either generally or from persons who are not already depositors;
d) Prohibit the bank from entering into any other transaction or class of transactions;
e) Suspend access to the credit facilities of the Bank; or
f) Suspend or require the removal of any directors, managers or chief executives.

PART V: EFFECTIVE DATE

1: **Effective date** - The effective date of this prudential standard shall be **1st October 2003.**

Questions relating to this prudential standard should be addressed to the The Manager, Financial System Supervision Department, Bank of PNG, Tel: 322-7200.