



PRUDENTIAL SUPERVISION OF SAMOA HOUSING CORPORATION

PRUDENTIAL STATEMENTS

**SEPTEMBER 2018
APIA
SAMOA**

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CENTRAL BANK OF SAMOA

Prudential Statement No. 1

Supervision of Samoa Housing Corporation

This note outlines the Central Bank of Samoa's (the "Bank") overall approach to the supervision of the Samoa Housing Corporation (SHC).

The need for Supervision

1. SHC is a Government-owned financial institution granting significant loans in the housing sector of the Samoan economy funded by the Government and long term borrowings from domestic agencies. Extending prudential oversight to SHC provides another layer of supervision to an institution which has significant funding and provides substantial credit facilities at the higher risk-end of the market to help stimulate and provide economic growth and development. Hence, SHC plays a significant role in ensuring that stability of the financial sector as a whole is maintained.

The Central Bank of Samoa (the "Bank") approach to supervision

1. Prudential supervision is being extended to SHC to strengthen market discipline by applying standards to maintain risk-taking at prudent levels and enhance the institution's capacity to absorb any adverse developments that may occur.
2. The ultimate responsibility for the affairs of SHC rests solely with Board and senior management. The Bank focus is towards satisfying itself that SHC follows sound management practices and internal controls consistent with a developmental financial institution and that prudent standards are kept under review to take account of changing circumstances. In this process the role of external auditors will also be important in the overall supervisory framework.
3. The Bank continuously assesses the performance of SHC through its off-site surveillance activities. Hence particular attention is given to capital and liquidity adequacy; asset concentration and risk exposure; asset quality and adequacy of provisions for losses and interest suspension; in-house ("insider" or "connected") lending and activities, operational and risk management policies. The Bank will collect and evaluate statistical returns mainly on a monthly and quarterly basis and discuss with senior management of SHC operations and lending policies from a prudential point of view.
4. The Bank prefers to develop, in consultation with SHC, prudential standards that serve as triggers for discussion with senior management on critical aspects of its operations. In the main, the objective is to develop a consensus on reporting requirements but the Bank will, if necessary, assume the role of final arbiter.

5. The Bank envisages the involvement of external auditors as appropriate. Annual external audits are used to ascertain the reliability of information provided and additional assurance to the Bank that prudential standards and other requirements are being observed; that SHC's asset quality, provisions for losses, competence of management and accounting and external controls are satisfactory. The audit process is also a vehicle for external auditors to raise matters of serious concern immediately to the attention of the Bank.
6. Supervision that embraces both off-site surveillance and on-site examination has been found to be more effective than off-site surveillance only and many countries now give increased emphasis to on-site examination to complement their off-site reviews and external audits. Onsite examination provides a useful view of the true financial position of an institution. The focus is to ascertain or confirm an institution's capital adequacy, its asset quality, liquidity, compliance with laws and regulations and the quality of management. The frequency, scope and techniques that will be used in on-site examinations will vary depending on the overall condition and the level of sophistication of the institution.
7. The Bank's approach to supervision has the advantage of flexibility in administration which can be adapted quickly, if necessary, to meet changing conditions. The Bank is also provided with discretion under the Financial Institutions Act 1996 for handling special situations.

Some Specific Issues

Legislative Arrangements

1. The Financial Institutions Act 1996 provides the Bank with its responsibilities for the prudential supervision of non-bank financial institutions including the Samoa Housing Corporation (SHC).

Prudential Guidelines

2. Guidelines will be developed by the Bank in consultation with the SHC and most will require reporting data to the Bank. The information provided should be accurate, timely and on a regular basis.

Capital Adequacy

1. The broad outline of the Bank's current approach in measuring SHC's level of capital is covered under Prudential Statement No.2.
2. The Samoa Housing Corporation must maintain at all times a level of capital which is prudent in relation to the size and nature of its business. The following ratios apply to the operation of SHC:
 - a. Total capital as a minimum percentage of SHC's risk-weighted exposures shall be no less than fifteen percent (15%).

- b. Tier one capital or core capital as a minimum percentage of the Corporation's risk weighted exposures shall be no less than seven and a half percent (7.5%).
- c. Tier two capital or supplemental capital shall not exceed hundred percent (100%) of core capital.

Role of External Auditor

- 1. External auditors will have an important role in prudential supervision similar to banks and other financial institutions.

Prudential Developments

- 1. The Bank will continue to undertake appropriate measures to strengthen prudential supervision of the SHC and will hold regular discussions with senior management on prudential matters.

Prudential Returns

- 1. For the purpose of collecting financial information and evaluating SHC's financial performance and condition on a regular basis, the following returns must be completed and submitted to the Bank on a timely manner.

CBS Form 1 – HC	-	Statement of Assets, Liabilities and Capital Accounts (Monthly)
CBS Form 1.2-HC	-	Distribution of Domestic Claims by Industry (Monthly)
CBS Form 1.3-HC	-	Interest Rate Structure of Domestic Claims (Monthly)
CBS Form 1.4-HC	-	Interest Rate Structure of Borrowings (Monthly)
CBS Form 1.5 – HC	-	Classification of Borrowings by Institutions (Monthly)
CBS Form 1.6 – HC	-	Computation of Capital Adequacy Ratio (Monthly)
CBS Form 2-HC	-	Summary of Non-Performing Loans/Assets (Quarterly)
CBS Form 2.1 – HC	-	Summary of Past Due, Arrearages & NPLs (Quarterly)
CBS Form 3-HC	-	Schedule of Ten Large Exposures (Quarterly)
CBS Form 4-HC	-	Statement of Profit and Loss (Quarterly)

CENTRAL BANK OF SAMOA

Prudential Statement No.2

Supervision of the Capital Adequacy of the Samoa Housing Corporation

This paper outlines the Central Bank of Samoa's (the "Bank") framework for the supervision of the capital adequacy of the Samoa Housing Corporation ('SHC' or the "Corporation").

1. The Bank attaches great importance to ensuring that SHC maintain adequate capital in relation to the size and nature of its business. Capital represents a Corporation's own funds and provide SHC with its core of resources for operations and for its fixed assets. More importantly, capital primarily serves as a cushion against unexpected losses. Thus, it provides protection to creditors of SHC.
2. Having a minimum capital standard and compliance with that standard does not ensure that SHC maintains an appropriate amount of capital. The amount of capital that is appropriate for SHC depends on the level of the various risks it assumes, the quality of the management of those risks, the extent and nature of their concentration, the projected increase in risk assets and other factors. Moreover, capital adequacy is not the only measure of the overall strength of SHC. Prudential assessments also need to consider, among other things, asset quality, adequacy of liquidity, quality of management and earning performance.
3. The Bank's approach to the assessment of the capital adequacy of SHC centers on a risk-based capital ratio that expresses capital as a percentage of risk-weighted assets and off-balance sheet exposures. This is the preferred method for assessing capital adequacy because it recognises the importance of the quality of capital elements and the different levels of relative riskiness of both on and off-balance sheet exposures of banks.
4. The following are the basic elements involved in the computation of the risk-based capital ratio:
 - a. The capital of SHC has been defined to include among other things, paid-up capital, disclosed reserves and retained earnings, asset revaluation reserves and hybrid capital, term subordinated and other similar instruments. Also, the capital elements have been classified into two (2) distinct categories with the **first tier of capital**, also referred to as "**core**" capital, incorporating the highest quality elements, i.e. permanently and freely accessible funds available to absorb unexpected losses. The **second tier of capital**, also known as "secondary" or "**supplemental**" capital incorporates elements that have the capacity to absorb unexpected losses but that are less permanent in nature.
 - b. The computation of the risk-based capital ratio focuses primarily on the level of credit risk (i.e. the risk of counterparty default) whether arising from on-balance sheet or off-balance sheet activities. It takes account of the varying levels of risk by categorising and assigning risk weights to every on and off-balance sheet exposure based on the type of obligor, the strength of the

underlying collateral, the existence of government guarantees and the maturity of the item. It also takes account of the likelihood that the off-balance sheet items will result in credit exposures.

- c. When assessing capital adequacy, the Bank must be satisfied that specific reserves have been established by SHC for known or foreseeable losses. If specific provisions for losses are inadequate, the amount of capital is overstated. Only when specific reserves are maintained at acceptable levels can compliance with the minimum capital standard be assessed. And in this regard, it is expected that SHC has the capability to assess all risks but more importantly the ability to perform a detailed credit analysis of its loan portfolio and to determine the appropriate level of reserves for specific assets or classes of assets.
5. The Bank will establish procedures with SHC which will define the circumstances in which SHC will be expected to discuss their capital position with the Bank. In general, these procedures will begin with formal notification to SHC that its current level of capital seems inadequate to support an increase in risk assets. The Corporation's management will then be required to develop a plan acceptable to the Bank designed to achieve an adequate level of capital. SHC may require that the plan include measures such as reducing the level of risk in the Corporation, infusing fresh capital or undertaking institutional strengthening to improve the quality of management and management practices. The procedures will also include a series of enforcement proceedings in the event that the Corporation's management fails to develop an acceptable plan or to adhere to an approved plan.

The appropriateness of particular capital ratios and the prudential arrangements for the supervision of SHC's capital generally, will be kept under review.

These guidelines are accompanied by an attachment that specifies the minimum capital ratio and outlines the method for computing the risk-based capital ratio of SHC.

(Attachment)

CENTRAL BANK OF SAMOA

Attachment to Prudential Statement No.2

Supervision of Capital Adequacy of Samoa Housing Corporation (SHC)

This attachment sets out the minimum capital standards and outlines the method of computing the risk based capital adequacy ratio of Samoa Housing Corporation ('SHC' or the "Corporation"). This attachment is accompanied by a worksheet for the computation of the capital adequacy ratio.

Minimum Capital Ratio

1. SHC must maintain at all times a level of capital which is prudent in relation to the size and nature of its business and, in any event:
 - a. **Total capital** as a minimum percentage of the bank's risk-weighted exposures shall be no less than fifteen percent (15%).
 - b. **Tier one capital** or "core" capital as a minimum percentage of the bank's risk weighted exposures shall be no less than seven and a half percent (7.5%).
 - c. **Tier two capital** or supplemental capital shall not exceed hundred percent (100%) of core capital.

Capital

2. Total capital, for the purposes of these requirements is defined as the sum of tier one capital and tier two capital.
3. Tier one capital is made up of the most important elements of capital. It includes issued share capital and other net worth items which meet all of the following requirements:
 - a. In the case of a capital instrument, it must be issued and fully paid-up; it must be permanently and freely available to absorb unexpected losses (i.e. there should be no specified redemption or repayment date, not repayable or redeemable at the option of the holder); it must not be encumbered in any way or earmarked to particular assets or to particular categories of banking activities;
 - b. It should not impose a fixed charge on the Corporation's earnings i.e. interest obligations must be allowed to be waived if the financial condition of the Corporation would not support payment and interest obligations so waived must not cumulate;
 - c. In a winding-up, must constitute a residual interest such that no distributions may be made unless and until all actual and contingent obligations to all creditors have been discharged.

Based on the foregoing, tier one capital includes:

- a. Permanent shareholders' equity in the form of:
 - i. issued and fully paid-up ordinary share capital; and
 - ii. irredeemable non-cumulative preference shares;
 - b. Disclosed reserves in the form of:
 - i. non-repayable share premium arising from the issuance of tier one capital instruments;
 - ii. general reserves created by appropriation of earnings; and
 - iii. prior years' audited retained profit, net of any appropriations such as tax payable, dividends, transfers to other reserves or provisions.
4. **Deductions** from tier one capital: The following items must be deducted from tier one capital:
- a. Current year's losses.
 - b. Good will and other intangible assets such as organization expenses and amounts paid for franchises to operate the bank.
 - c. All future income tax benefits not deducted elsewhere (e.g. under Item 5c below) net of deferred tax liabilities (i.e. the amount of tax obligation on the current year's and the previous year's income). This means that these future income tax benefits should be deducted only to the extent that the amount exceeds the amount of tax obligation on the current year's and the previous year's income. If the current year's assessable income is negative, the full amount of the future income tax benefits should be deducted.
5. Tier two capital consists of equity and other net worth items that can also serve as a cushion for unexpected losses but do not meet the requirements stated in item 3 above. Tier two capital includes:
- a. Unaudited retained profit, net of any appropriations such as tax payable, dividends, transfers to other reserves or provisions.
 - b. Asset revaluation reserves arising from a formal revaluation of tangible fixed assets where the revaluations have been subject to audit or review by the bank's auditors.
 - c. General provisions for bad and doubtful debts net of any associated future income tax benefits provided that the net amount to be included in tier two capital should not exceed 1.25% of SHC's total risk-weighted exposures.
 - d. Hybrid capital instruments i.e. hybrid forms of debt and preference shares (and associated share premium) such as perpetual cumulative preference shares, mandatory cumulative convertible debt and perpetual subordinated debt which meet the following requirements:
 - i. they are unsecured, subordinated and fully paid-up;
 - ii. they are not redeemable at the option of the issuer or without the prior consent of the Bank;
 - iii. they are available to participate in losses without the Corporation being obliged to cease trading;

- iv. interest obligations should be allowed to be deferred whether the profitability of the corporation would not support payment.
- e. Term subordinated debt and similar instruments (e.g. cumulative redeemable preference shares) which meet the following requirements:
 - i. the claims of holders in respect of payment of both principal and interest are fully subordinated to those of all unsubordinated creditors; and
 - ii. the debt instruments have a minimum original fixed term to maturity of over five years and will be subject to a straight line amortisation in the last five (5) years of its life so that no more than twenty percent (20%) of the original amount issued shall be included in capital in the final year before redemption is possible.

Any proposed issue of hybrid capital and term subordinated debt or similar instruments (described above) must be structured so that they meet in substance as well as in form the requirements of the particular category of capital where they are proposed to be included as stated in the Basle capital measurement framework. Any proposal to issue these instruments must therefore satisfy the Bank that these requirements have been met prior to making the issue.

Risk Weighting

6. The following is a summary of risk-weighting categories, (weighted on the basis of the relative degree of riskiness) that will apply to SHC's on and off-balance sheet exposures:

0%

- a. Cash (including foreign cash).
- b. Claims on the Central Bank of Samoa.
- c. Claims on the Central Bank of Samoa.
- d. Claims on central governments and central banks denominated in national currency and funded in that currency.
- e. Loans which are explicitly, irrevocably and unconditionally guaranteed by the Government of Samoa or the Central Bank of Samoa except that in the case of claims covered by partial guarantees, only that part which is fully covered by the guarantee will have a 0% risk weight.
- f. Securities issued by Government-owned or controlled institutions the repayment of which is explicitly and unconditionally guaranteed by the Government of Samoa.
- g. Loans which are fully and formally collateralised by:
 - i. cash deposited with the lending bank or,
 - ii. securities issued by the Government of Samoa or by the Central Bank of Samoa or,
 - iii. securities issued by Government-owned or controlled institutions the repayment of which is explicitly and unconditionally guaranteed by the Government of Samoa.

20%

- a. Claims on banks which are registered or licensed in the country of domicile by the appropriate banking supervisory authorities (includes cash items in process of collection).

50%

- a. Refers only to loans relating to housing where the property is or will be occupied by borrower or is rented and where the loan is fully secured by mortgage against the residential property.

Off-Balance Sheet Items

7. The following is a list of credit conversion factors that will be applied to take account of the credit risk on the different types of off-balance sheet exposures. The credit conversion factor will be multiplied by the risk weight applicable to the nature of the counterparty for on-balance sheet transactions (Item 6 above).
 - a. **100%:** Direct credit substitutes, i.e. general guarantees of indebtedness where the Corporation undertakes to carry out the financial obligations of a counterparty which fails to do so (e.g. loan guarantees and standby letters of credit serving as financial guarantees for loans or securities)
 - b. **50%:** Transaction-related contingent items, (e.g. performance bonds, bid bonds, warranties and performance-related standby letters of credit which fulfil the same function as a performance bond).
 - c. **20%:** Trade-related contingent items, e.g. documentary letters of credit (where the Corporation guarantees payment in favour of an exporter against the presentation of shipping documents) and other trade financing transactions e.g. shipping guarantees or bill of lading bonds (which are secured against underlying shipments of goods).

CENTRAL BANK OF SAMOA

Prudential Statement No. 3

Asset Concentration and Risk Exposure

Undue concentration of risk, expose banks and other financial institutions to losses and a reduction of capital. Diversification of risks is one of the fundamentals of prudent lending and other transactions.

1. In developing a large credit exposure policy for the Samoa Housing Corporation ('SHC' or the "Corporation") the following concepts will apply:
 - a. Exposures will apply to any individual borrower or group of related clients deemed as a single borrower. Single customer means any single person (whether comprising a legal or natural person) that is a borrower. A group of closely related borrowers (legal, natural or both) is also to be regarded as a single customer. This means that SHC's exposure to each borrower which belongs to a group will be combined and the combined exposure will be deemed to be in respect of a single customer. The general test to be applied is whether the combined exposure represents a single risk to the Corporation, i.e. the borrowers are so interconnected that if one borrower experiences financial difficulties, the other borrower or borrowers are also likely to encounter payment difficulties. Indications (and examples) of such interconnections or group relations which are generally classified as a single risk are as follows:
 - i. Companies with common ownership or cross ownership (e.g. a parent or holding company and its subsidiaries);
 - ii. Borrowers linked by guarantees or cross-guarantees or which share the same collateral.
 - b. Large exposures relate to large loans and advances and other exposures but exclude any small loan schemes. Exposures encompass all credit facilities, equity participation and other transactions, on balance sheet as well as off balance sheet items in the form of direct credit substitutes e.g. guarantees and other off balance sheet transactions.
 - c. Collateral will not affect any concentration limit except for loans guaranteed by the Government of Samoa or Central Bank of Samoa and where cash or bank deposits are used as collateral.
2. In addition, SHC proposes to implement a policy in respect of large exposures as follows:
 - a. Any exposure in the form of loans, equity investment and guarantees to any **individual borrower** would not exceed **20 percent** of SHC's total capital. A limit of **30 percent** would apply to any **group of related interests**.

- b. The above limits would also apply to exposures to "connected" interests such as directors, management, staff and affiliate interests (defined in Prudential Statement No. 4). However more stringent criteria may be applied by SHC as it sees fit.
- c. The Board shall undertake to keep all large exposures under close review to show that excessive risks are not being undertaken including exposures to sectors and industry groups. If SHC maintains a high level of large exposures, a much higher level of capital and provisioning for doubtful loans may be necessary.
- d. Details of large exposures above 10 percent of the capital base will be included in Prudential Return (CBS Form 3-HC) and submitted to the Bank each quarter.

CENTRAL BANK OF SAMOA

Prudential Statement No. 4

“Connected” Lending

This Statement sets out the guidelines on the matter of “connected” lending of financial institutions.

1. **General Policy** Dealing with any “connected” individual or entity should be in the regular course of business; credit investments and other claims should be assessed on the same credit worthiness and under substantially the same assessment procedures as is normally required by the other clients for investment purposes.
2. **“Connected” lending** refers to all forms of direct and indirect risk exposures to individuals or to parties which are connected to an institution through ownership or control. In the context of direct exposure, it includes exposures to any director, officer or shareholder of an institution and any exposure where a director, officer or shareholder is liable jointly or severally or as a guarantor. It also includes exposures to any company where it has an equity interest.

“Connected” lending in the context of indirect exposure includes exposures to any immediate family member of any director, officer or shareholder and to any company, partnership, association or group of individuals whether incorporated or not, wherein any director, officer or shareholder of an institution has an interest or is a director, partner, manager, member, shareholder, agent or otherwise.

3. **Exclusion** “Connected” lending excludes loans that provide financial assistance to officers which are part of an institution’s fringe benefit programme.
4. **Officer** includes Managing Director, Chief Operating or Chief Executive Officer, Vice Presidents, Managers, Secretary and others who are generally known to be officers of the institution (or any of its branches or offices).

A financial institution should be able to provide the Bank (if and when it so requires) with data in respect of financial exposures by way of equity, loans and other claims with “connected” parties and associates.

CENTRAL BANK OF SAMOA

Prudential Statement No. 5

Asset Quality, Provisions for Losses and Suspension of Interest

The broad outline of the Central Bank of Samoa's (the "Bank") current approach to the classification of asset quality, provisions for losses and suspension of interest for financial institutions is included in Prudential Statement No.7 for banks. There are important principles included in Prudential Statement No. 7 which are relevant to all financial institutions and will be applied by the Bank in prudential supervision, including the Samoa Housing Corporation ('SHC' or the "Corporation"). **Six** areas are emphasized:

1. Credit Risk Management and Portfolio Review

1. Managing credit risk and undertaking regular portfolio reviews are important components of internal management systems for identifying and monitoring existing and potential problem loans and other assets. Financial institutions are expected to have a well-established credit grading system of loans and other relevant assets which include all the pertinent factors to assess overall quality of assets for the prudent management of risk and reward and managing credit risks across a variety of considerations.
2. No particular model is proposed by the Central Bank of Samoa but each institution is expected to provide a statement to the Bank on current policy and some breakdown of risk categories. In addition, systems would be expected to cover:
 - a. A broad range of assets including on-balance and off-balance sheet items.
 - b. Both performing and classified/impaired assets.
 - c. Regular reviews of risk grades.
 - d. Poor performing facilities and other investments would include at least four categories such as standard; substandard; doubtful and loss.
3. For some time, the Central Bank has adopted the above grades of asset quality. Assets falling into the latter three categories have various degrees of weakness. The first category does not have problem characteristics.

Explanation for each asset classification category is given below:

1. **"Standard"** – Assets in this category are not subject to criticism. In general, performing loans, loans and other assets which are fully and formally collateralised, both as to principal and interest, by cash or by deposits with the lending bank or by securities issued by the Government or by the Central Bank, are exempted from classification regardless of arrears or other adverse credit factors.
2. **"Substandard"** – "Substandard" assets are not protected by the current financial soundness and paying capacity of the obligor. In essence, "substandard" assets are those whose primary sources of

repayment are insufficient to service the debt and the corporation is constrained to look to secondary sources (e.g. collateral, sale of fixed assets, refinancing or fresh capital) for the repayment of loan. "Substandard" assets display well-defined credit weaknesses that jeopardise the full settlement of the debt. "Substandard" assets may also include assets which carry more than a normal degree of risk due to the absence of current and satisfactory financial information or inadequate collateral documentation. "Non-performing" assets which have been "past due" for at least 90 days should be, at a minimum, classified as being "substandard".

3. **"Doubtful"** – "Doubtful" assets exhibit all the weaknesses inherent in assets classified as "substandard" with added characteristics that the assets are not "well-secured". These weaknesses make collection in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific factors which may strengthen the asset, its classification as an estimated loss is deferred until a more precise status is obtained. "Non-performing" assets which have been "past due" for more than 180 days are usually classified as "doubtful".
4. **"Loss"** – Assets classified as "loss" are considered uncollectible and such little value that their continued inclusion in the corporation's books as assets is not warranted. This classification does not mean that the asset has no recovery or salvage value. Rather, that it is neither practical nor desirable to defer writing off the asset even though it is possible that partial recovery may be effected in the future. SHC should not retain assets on the books while attempting long-term recoveries. Losses should be taken into account in the period in which they are identified as uncollectible. "Non-performing" assets which have been "past due" for at least one year are also classified "loss" unless such assets are "well-secured", legal action has actually commenced and timely realisation of the collateral or successful enforcement of the guarantees can be expected.

Nothing contained above prevents SHC from making a more conservative classification if such is warranted based upon the corporation's own analysis of the borrower's financial condition, ability and willingness to repay.

2. Collateral

1. Over reliance on collateral should be avoided in determining asset quality. Effective realisable values should be used and collateral support is to be considered only when determining the severity of the classification for provisioning purposes. In other words, collateral is not automatically used to determine the net amount of a loan or other assets used for provisioning purposes.

3. Provisioning

1. The Bank considers minimum provisions as follows:

i. Substandard	-	20 percent
ii. Doubtful	-	50 percent
iii. Loss	-	100 percent

2. General provisions are set at a minimum of 2 per cent of the remaining portfolio.
3. Nothing contained above prevents a financial institution from maintaining larger provisions or additional provisions for loan losses, if it feels this is warranted based on the condition of the financial institution's portfolio, changes in lending practices, economic trends and loss experience.
4. All financial institutions must maintain an adequate level of provisioning against all problem or classified assets if their earnings and solvency ratios are to be measured correctly. In addition, institutions must ensure its provisioning is in line with any changes as required by international accounting standards (e.g. IFRS 9). Normally, provisions should take account of the net current market value of security or collateral. However, the above ratios ignore collateral in the computation of provisions. While the Central Bank of Samoa does not want to exclude collateral entirely, it is up to each institution to implement its own policy on the treatment of collateral within its credit risk management system.

4. Interest Suspension

1. Most institutions operate on an accrual basis taking interest to income when it is earned. The Central Bank considers that all classified loans and other assets that are non-performing and are therefore classified as "doubtful" and "loss" should be placed on a non-accrual basis so that profits and performance are not overstated.
2. Consequently, institutions should cease to recognise as income any interest earned but not yet received on non-performing loans and other assets in the above categories.
3. "Nonperforming" assets should only be restored to an accrual basis upon the full settlement of all delinquent principal and interest. Funds for the repayment of delinquent principal and interest should not be obtained through the creation of new loans from the same bank.

5. Renegotiated or Restructured Loans

1. Restructured loans or renegotiated loans which, because of weaknesses in the borrower's financial condition or ability to pay, have been refinanced, rescheduled, roll-over or otherwise modified at favourable terms and conditions for the borrower. The modification may include lengthening of repayment schedules and/or lowering interest rates to meet the borrower's debt service abilities.
2. SHC will have full discretion in the restructuring or renegotiation of loans in order to provide flexibility in arranging the repayment of loans without impairing or endangering the lending corporation's financial interests. However, the restructuring of loans to "connected borrowers" (as envisaged in Prudential Statement No.6) should be upon terms not less favourable to the Corporation than those offered to other clients. While loan restructuring should be considered as a management tool to maintain or improve asset quality or the soundness of lending operations, it should be arranged mainly to assist borrowers settle their loan obligations taking into account their capacity to pay.

3. In general, delinquent interest should be brought up-to-date by the borrower from payments made with his own funds before a loan is renegotiated or restructured. Also, renegotiated or restructured loans should normally be classified as “substandard” until a sustained satisfactory record of repayment performance (for a period of say, at least six months) under a realistic repayment program has been achieved.

6. Write-offs

1. Write-offs involve those assets which are classified “loss” and considered to be uncollectible, have minimal recovery value or are unable to be collected within a reasonable period after commencement of legal proceedings for recovery. While such assets may have some salvage value it is neither practical nor desirable to defer writing-off the asset and allow the portfolio to reflect an aging of loans that for all practical purposes will never be repaid.
2. It is a matter of judgement whether assets are written-off after all the necessary legal procedures have been completed and the amount of loss is finally determined. Or they are written off earlier when the borrower has not repaid regular principal amounts or interest after a specified period, for instance, 1-2 years.
3. Writing off assets earlier does not prevent legal and collection proceedings continuing but it provides a more realistic presentation of balance sheet and income/expenditure information to shareholders and policyholders.

Definitions

For purposes of these guidelines, the following definitions apply:

1. **“Past due”**: Loans are considered to be “past due” when, without prior arrangement, principal or interest or an amortisation (where loan is payable by instalment) is unpaid 90 days past its due repayment date or when, in the case of overdrafts, the account has been inoperative or stagnant or has expired for 90 days or more or the account has remained unpaid 90 days or more after the expiry date of the line. The principal balance outstanding (and not the amount of delinquent payments) is used in calculating the aggregate amount of “past due” obligations.

The initial recognition of credits as “past due” does not, in itself, provide sufficient cause for classification, loan loss provision, or suspension of interest unless such credits also exhibit well-defined credit weaknesses. “Past due” status does not signal the need for bank management to institute actions to strengthen or collect the credits so affected. To the extent that management is not successful in its collection efforts and the credits become “non-performing”, there is a presumption that well-defined credit weaknesses exist which should trigger classification and might cause a loan loss provision and interest suspension.

2. **“Non-performing”** means a loan (or a supposedly earning asset) is not generating income. A loan is considered to be “non-performing” when it has been “past due” for 90 days or more. The principal balance outstanding (and not the amount of delinquent payments) is used in calculating the aggregate amount of “nonperforming” obligations.
3. **“Well-secured”** assets mean that collateral is sufficient to protect the bank Corporation from loss of principal or interest through its timely disposition under a forced liquidation scenario. Sufficiency implies the existence of proper legal documentation, a net realisable market value which is adequate to cover the amount of principal and interest outstanding, as well as costs of collection, and the absence of prior liens on the collateral which could diminish its value or otherwise prevent the bank from acquiring clear title.

Collateral such as specialised manufacturing facilities and equipment for ongoing operations would not normally be considered “well-secured” because of the difficulties of actual foreclosure or of disposing of the collateral in a timely manner at values sufficient to protect the bank Corporation from loss.

CENTRAL BANK OF SAMOA

Prudential Statement No. 6

Accounting and Internal Control Systems

This note outlines the Central Bank of Samoa's (the "Bank") position on the accounting and internal controls of the Samoa Housing Corporation ('SHC' or the "Corporation").

1. As part of prudential management, it is important that any financial institution has an adequate and effective accounting and internal control system in place for the orderly conduct of its operations and setting standards for managing risks, investments and asset and liability management. Basically, the system should be able to provide management, including its board of directors, and those overseeing the SHC (e.g. auditors and supervisory authorities) the assurances and information they need regarding the true financial position of the organization and whether the affairs are being conducted prudently.
2. The SHC's accounting and internal control systems should be commensurate with the nature, scope and particular needs of the business vis-à-vis the prevailing circumstances so that its affairs can be conducted prudently. In other words, it should take into consideration the size, nature, volume and complexity of its transactions, and the way in which the business is structured, organised and managed. The system should apply to all aspects of SHC's operations and whether undertaken as a principal or agent.
3. The accounting and internal control systems will not be considered adequate unless they enable the business to be prudently managed and to comply with statutory and regulatory requirements. In other words, the system should enable any financial institution to comply with the Bank's prudential requirements and to identify possible adverse developments to the interests of stakeholders.
4. The systems should also enable the SHC to comply with the reporting and notification requirements of the Bank. Delays in providing information or inaccuracies in the information provided raises questions as to the adequacy of internal management systems.
5. Internal systems should provide financial information that is based on generally accepted accounting principles. Financial statements generated by accounting systems for public disclosure purposes should also follow the requirements and guidance provided by internationally accepted accounting standards and should be able to provide in the prescribed manner any information that is required under any applicable legislation.

CENTRAL BANK OF SAMOA

Prudential Statement No. 7

Relationship between Financial Institutions, their External Auditors and the Central Bank of Samoa

This Statement outlines the procedures on the role of external auditors in the prudential supervision of financial institutions.

1. Under prudential supervision arrangements, the Central Bank of Samoa (the "Bank") follows procedures and practices to ensure that financial institutions are meeting prudential and statutory requirements and are following risk management practices to limit risks to prudent levels. These matters should be kept under review and adapted to changing circumstances.
2. Under Section 10 of the Financial Institutions Act 1996, every licensed financial institution must appoint an external auditor to undertake several responsibilities including the issue of a report on the financial condition of an institution and highlight any serious problems to the Bank during the course of the audit. It is a comprehensive section included in the Act.
3. The Bank approach to the role of external auditors is as follows:
 - a. Annual reports of the Auditor should be submitted to the Bank as required by Legislation with a copy of any management letter commenting on any weaknesses and other relevant matters identified in the audit.
 - b. Confirmation from external auditors that there is adequate evidence that information and statistical data reported to the Bank is accurate and reliable and that financial institutions are complying with all prudential requirements including items such as minimum capital adequacy ratio, large exposures, asset quality and non-performing loans.
 - c. An assessment of any aspects of a financial institution's operations specifically nominated by the Bank of matters about individual institution's management practices in the opinion of the Auditor has the potential to prejudice materially the interests of depositors.
 - d. All supervised institutions will keep their external auditors fully informed of the Bank's prudential requirements.
4. The Bank proposes to hold tripartite meetings between each supervised institution, its External Auditor and the Bank as a group soon after the end of each financial institution's financial year to discuss:
 - a. Any matters arising from the Auditor's review and report which may include the strengths and weaknesses of risk management systems.

- b. Any subject reviews that the Bank wishes to raise on a financial institution's operations; and
 - c. With the institution's management and auditor of any impending changes to prudential policies.
6. Although meetings should occur on an annual basis, all three parties can propose additional discussions at any time.
 7. The Bank also proposes to continue to coordinate and cooperate with external auditors in developing its 'on site' inspection capability initially with banks in evaluating risk-based audits and management systems and strengthening the Bank's supervisory skills.