

CENTRAL BANK OF SAMOA

PRUDENTIAL SUPERVISION OF SAMOA NATIONAL PROVIDENT FUND

PRUDENTIAL STATEMENTS

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CENTRAL BANK OF SAMOA

Prudential Statement No. 1

Supervision of Samoa National Provident Fund

This Statement outlines the Central Bank of Samoa's overall approach to the supervision of the Samoa National Provident Fund (SNPF).

The need for supervision

1. SNPF is the largest non-bank financial institution operating in Samoa. It provides pensions, lump sum payments and other benefits to members and contributes to the economic and social development of the country. There is an underlying principle that, in the operations of the Fund, the interest of members is paramount. Greater supervision protects the interests of members and aims to ensure that SNPF is in a financially sound position at all times by maintaining sound solvency standards thereby promoting the health and stability of the financial system. However, greater prudential oversight by the Central Bank of Samoa does not guarantee the liabilities of the Fund and its members' benefits but provides a further layer of assurance to the Authorities on the Fund's financial operations.

The Central Bank's approach to supervision

2. Prudential supervision focuses on prudential standards to reduce the likelihood of liquidity problems and broader solvency issues by limiting risks to prudent levels and ensuring SNPF has the capacity to absorb any adverse developments that may occur.

3. The ultimate responsibility for the affairs of SNPF rests solely with its Board of Directors and senior management. The Central Bank's focus is towards satisfying itself that the Fund follows sound management practices and internal controls and that prudent standards are kept under review to take account of changing circumstances. In the process, the role of external auditors and actuaries will also be important in the overall supervisory framework. Transparency and information available to members about the management and performance of the Fund will also be regularly examined.

4. The emphasis is off-site supervision. On-site inspection is not planned for the foreseeable future. Hence, particular attention is given to overall solvency reserves, prudent management of liquidity and mismatches of assets and liabilities, asset quality and provisioning, concentration of exposures, connected lending, 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 the Fund its operations from a prudential point of view.

5. The Bank prefers to develop, in consultation with the SNPF, 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.

6. The Central Bank of Samoa envisages the involvement of external auditors and actuaries as appropriate. Annual external audits are used to ascertain the reliability of information provided and adequacy of technical provisions and asset valuations and to provide additional assurance to the Bank that prudential standards are being observed and competence of management and accounting and internal controls are satisfactory. The audit process is also a vehicle for external auditors (and actuaries) to raise matters of serious concern immediately to the attention of Bank.

7. The Central 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 for handling special situations.

Some specific issues

Legislative arrangements

The Financial Institutions Amendment Act 2001 provides the Central Bank of Samoa with responsibilities for the prudential supervision of non bank financial institutions, including the SNPF.

Prudential Guidelines

Guidelines will be developed by the Central Bank of Samoa, in consultation with the SNPF and most will require reporting data to the Bank. The information provided should be accurate, timely and on a regular basis. Valuation of assets and liabilities should be compatible with internationally accepted accounting standards.

Role of External Auditor and Actuary

External auditors will have an important role in prudential supervision similar to banks and other financial institutions. The role of a well qualified external actuary on solvency and pension liabilities is also important from a prudential point of view. Actuarial reviews and reports should be discussed with the Bank.

Prudential Developments

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

Prudential Returns

- CBS Form 1-PF - Statement of Assets, Liabilities and Contribution Accounts (Monthly)
- CBS Form 1.2-PF - Distribution of Domestic Claims by Industry (Monthly)
- CBS Form 1.3-PF – Interest Rate Structure on Domestic Claims (Monthly)
- CBS Form 1.4 – PF – Interest Rate Structure on Contributions Account (Monthly)
- CBS Form 2 – PF - Summary of Non-Performing Loans /Assets (Quarterly)
- CBS Form 3 – PF - Large Exposures (Quarterly)
- CBS Form 4 – PF - Statement of Profit and loss (Quarterly)
- CBS Form 5 - PF - Analysis of Changes in Contribution Accounts (Quarterly)
- CBS Form 6-PF - Schedule of Deposits with the Commercial Banks by Residual Maturities (Quarterly)

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Prudential Statement No. 2

Asset Concentration and Risk Exposure

Undue concentration of risks 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.

In developing a large credit exposure policy for the Samoa National Provident Fund (SNPF), the following concepts will apply:

- exposures will apply to any individual borrower or group of related clients deemed as a single borrower. Group relations include companies with common ownership and borrowers linked by guarantees and cross guarantees or which share the same collateral;
- large exposures relate to large loans and advances but exclude any small loan schemes. **Exposures** encompass all credit facilities, **equity participations** 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;
- 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.

In addition, the Samoa National Provident Fund proposes to implement a policy in respect of large exposures as follows:

- **loan exposure to any individual borrower or any group of related borrowers or clients will be limited to 5 percent of the Samoa National Provident Fund's total investible funds.**
- the above limits would also apply to exposures to "connected" interests such as directors, management, staff and affiliate interests (defined in Prudential Statement No. 3). However, more stringent criteria may be necessary.

The Board undertakes to keep all large exposures under close review to show that excessive risks are not being undertaken including exposures to sectoral and industry groups. If the Samoa National Provident Fund maintains a high level of large exposures, a much higher level of provisioning for doubtful loans may be necessary.

Details of large exposures at 5 percent of total investible funds and above will be included in Prudential Schedule No. 3 and submitted to the Central Bank of Samoa each quarter.

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Prudential Statement No. 3

“Connected” lending

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

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.

“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 exposure 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.

Exclusion “Connected” lending excludes loans that provide financial assistance to officers which are part of an institution’s fringe benefit programme.

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).

Shareholder refers to a shareholder who owns or who has authority to exercise power over ten percent (10%) or more of the institution’s voting stock.

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

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Prudential Statement No. 4

Asset quality, provisions for losses and suspension of interest.

The broad outline of the Central Bank of Samoa's 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 including an attachment. There are important principles included in Prudential Statement No.7 which are relevant to all financial institutions and will be applied by the Central Bank in prudential supervision, including the Samoa National Provident Fund. Five areas are emphasised:

1. Credit risk management and portfolio review

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.

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 broad range of assets including on-balance sheet and off-balance sheet items.
- Both performing and classified impaired assets.
- Regular review of risk grades.
- Poor performing facilities and other investments would include at least the following four categories:
 - a) standard;
 - b) substandard;
 - c) doubtful; and
 - d) loss.

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 and considered "classified", "impaired" assets or "non performing". The first category does not have problem characteristics.

2. Collateral

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

The Bank considers minimum provisions as follows:

substandard	-	20 percent
doubtful	-	50 percent
loss	-	100 percent

General provisions are set at a minimum of 2 percent of the remaining portfolio.

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 its loan portfolio, changes in lending practices, economic trends and loss experience.

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. 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

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 classified as “doubtful” and/or “loss” should be placed on a non-accrual basis so that profits and performance are not overstated. 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.

5. Write-offs

Write-offs involve those assets which are classified as “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 ageing of loans that for all practical purposes will never be repaid. It is a matter of judgement whether assets are written-off after all 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 say 1-2 years.

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.

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Prudential Statement No. 5

Accounting and internal control systems

This Statement outlines the Central Bank of Samoa's position on the accounting and internal controls of Samoa National Provident Fund.

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 Fund (e.g. auditors and supervisory authorities) the assurances and information they need regarding the true financial position of the organisation and whether the affairs are being conducted prudently.

The Fund'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 the Fund's operations and whether undertaken as a principal or agent.

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 Central Bank's prudential requirements and to identify possible adverse developments to the interests of members.

The systems should also enable the Fund to comply with the reporting and notification requirements of the Central Bank. Delays in providing information or inaccuracies in the information provided raises questions as to the adequacy of internal management systems.

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.

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Prudential Statement No. 6

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 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, 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 Central Bank during the course of the audit. It is a comprehensive section included in the Act.

3. The Central Bank's approach to the role of external auditors is as follows:

- annual reports of the Auditor should be submitted to the Central Bank as required by Legislation with a copy of any management letter commenting on any weaknesses and other relevant matters identified in the audit.
- confirmation from External Auditors that there is adequate evidence that information and statistical data reported to the Central 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.
- an assessment of any aspects of a financial institution's operations specifically nominated by the Central Bank or matters about individual institution's management practices in the opinion of the Auditor has the potential to prejudice materially the interests of members.
- all supervised institutions will keep their External Auditors fully informed of the Central Bank's prudential requirements.

4. The Central Bank proposes to hold tripartite meetings between each supervised institution, its External Auditor and the Central Bank as a group soon after the end of each financial institution's financial year to discuss:

- any matters arising from the Auditor's review and report which may include the strengths and weaknesses of risk management systems.
- any subjects, reviews that the Central Bank wishes to raise on a financial institution's operations; and
- with the institution's management and Auditors any impending changes to prudential policies.

5. Although meetings should occur on an annual basis, all three parties can propose additional discussions at any time.

6. The Central 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 managements systems and strengthening the Bank's supervisory skills.