



PRUDENTIAL SUPERVISION OF THE SAMOA NATIONAL PROVIDENT FUND ("SNPF")

CBS

PRUDENTIAL STATEMENTS



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Overview of the Supervision of Samoa National Provident Fund (SNPF)

1. The Need for Supervision

- 1.1. 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.
- 1.2. Greater supervision protects the interests of members and aims to ensure that SNPF is always in a financially sound position by maintaining sound solvency standards there-by promoting the health and stability of the financial system.
- 1.3. However, greater prudential oversight by the CBS 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.

2. The CBS Approach to Supervision

- 2.1. 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.
- 2.2. The ultimate responsibility for the affairs and performance of SNPF resides solely with its Board of Directors and management. CBS can neither guarantee its soundness nor can it provide complete protection for the Fund's members, creditors, and others with claims on SNPF. The CBS's focus is towards satisfying itself that the Fund follows sound management practices and internal controls, prudent standards are kept under review to take account of changing circumstances, promote public confidence in the Fund and help to maintain a sound financial system. 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.
- 2.3. The CBS has an integrated, risk-based system of supervision that uses both off-site monitoring and on-site inspections, to examine the business of a supervised SNPF, evaluate its condition, quality, effectiveness and compliance with legislation and supervisory requirements. 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 CBS collects and evaluates 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.
- 2.4. The CBS 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 CBS will, if necessary, assume the role of final arbiter.

- 2.5. The CBS 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 CBS 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 CBS.
- 2.6. The CBS approach to supervision has the advantage of flexibility in administration which can be adapted quickly if necessary to meet changing conditions. The CBS is also provided with discretion under the Financial Institutions Act 1996 (and any related amendments) for handling special situations.

3. Some Specific Issues

3.1. Legislative Arrangements

- 3.1.1. Part 4A of the Financial Institutions Act 1996 provides the CBS with responsibilities for the prudential supervision of non-bank financial institutions, including the SNPF.

3.2. Prudential Guidelines

- 3.2.1. Guidelines will be developed by the CBS, in consultation with the SNPF and most will require reporting data to the CBS. 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.

3.3. Role of External Auditor and Actuary

- 3.3.1. 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 CBS.

3.4. Prudential Developments

- 3.4.1. The CBS 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 STATEMENT (PS) 1: GOVERNANCE

1. Introduction

- 1.1. This prudential statement (PS) sets out the CBS requirements for observance by the SNPF regarding corporate governance.

2. Outline of the Approach

- 2.1. The objective of this statement is to ensure that the SNPF establishes a transparent framework for the division of responsibilities in the operation and oversight of the Fund, and the accountability and suitability of all parties involved in the Fund process.
- 2.2. The SNPF has a statutory mandate to collect contributions from all members of defined categories of employees. It is therefore not subject to market disciplines, effectively enjoying a monopoly in the provision of retirement benefits.
- 2.3. The CBS will monitor the governance structure of the Fund by offsite ongoing perusal of copies of the Fund's policies. The CBS will conduct regular on-site visits which may include interviews with relevant Senior Management and more detailed investigation of areas of operation that appear to merit it.

3. Fit and Proper

3.1. Background

- 3.1.1. The criteria for selection and procedure for appointment of directors of public bodies, like the SNPF, are set out in Schedule 3 of the Public Bodies (Performance and Accountability) Act 2001.
- 3.1.2. The National Provident Fund Act 1972 largely governs the operations of SNPF. Part 2 of the NPF Act provides for the constitution, powers and functions of the Board of Directors (the "Board"). The appointment of members of the Board is the prerogative of the Head of State on the advice of Cabinet.

3.2. Propriety

- 3.2.1. The Board and their representatives must act in good faith and in the best interests of Fund members, beneficiaries and other stakeholders of the Fund when carrying out their fiduciary responsibilities. The Fund's responsibilities in its fiduciary role shall include:
 - treating members and beneficiaries impartially;
 - acting with the care, skill and diligence of a prudent person;
 - interpreting the plan terms fairly, impartially and in good faith;
 - preventing personal interests from conflicting with those of the Fund; and
 - within the scope of its authority, ensuring that members and beneficiaries receive promised benefits.

3.2.2. Before appointing new Senior Managers, the Board must be satisfied that the persons concerned are fit and proper persons: a full curriculum vitae should be included in board papers.

3.3. Conflicts of Interest

3.3.1. Conflicts of interest arise in a related party transaction, which is a transfer of resources or obligations between related parties, regardless of whether a price is charged. Parties are considered to be related if one party has the ability to exercise significant influence over the other party in making financial or operating decisions. Examples include, but are not limited to the following:

- personal loans from the Fund;
- the sale or purchase of assets from the Fund; and
- direct or indirect relationships with service providers.

3.3.2. Any case of conflict of interest is not acceptable. The Board should ensure that all potential conflicts are disclosed. The Board, Senior Management and relevant investment staff must provide a register of any investments they or their immediate family members have in assets that are also owned by the Fund. The register must be kept up-to-date, and its existence recorded and consulted at every normal meeting of the Investment Committee, and meeting of the Board when potential investments are discussed.

4. Delegations

4.1. The Board

4.1.1. The Board is expected to:

- a) establish sub-committees with appropriate charters for the following:
 - Audit and risk management; and
 - Investments and property;
- b) delegate operational management roles to Senior Management, while retaining responsibility for selecting, compensating, monitoring, replacing key executives, and overseeing succession planning;
- c) ensure that the Fund's governance structure, roles and responsibilities, accountability and reporting relationships are clearly documented and communicated to all relevant stakeholders of the Fund; and
- d) ensure that it receives timely, accurate and complete information to ensure that delegated responsibilities are fulfilled.

5. Key Approvals

5.1. Strategic Plan

5.1.1. The Board must consider and approve the Fund's long-term strategic objectives, including the means of attaining these objectives and procedures for monitoring and evaluating the achievement of these objectives.

5.1.2. The long-term corporate strategy should be reviewed at least every three financial years, and the performance results or outcomes are officially summarized in the Board Minutes.

5.2. Annual Plans and Budget

5.2.1. The Board must consider and approve annual business plans and budgets, setting performance objectives and monitoring the implementation of the plans and budget variances. They must give explicit written approval – after due diligence - for major capital expenditures, new initiatives, acquisitions, and divestitures.

5.2.2. The Board must meet at intervals to consider progress against the plans and budgets.

5.3. Fund Policies and Standards

5.3.1. The Board must approve written policies on risk management, accounting and audit, investments, pricing, remuneration and procurement including outsourcing.

5.3.2. The Board must approve written standards for client servicing and disclosure to members and issue a code of conduct for personnel, setting out disciplinary procedures.

6. Risk Management and Audit

6.1. The Board shall approve the establishment of a risk management strategy. The risk management strategy should include procedures for the identification, monitoring and controlling of risks to the Fund.

6.2. The Board shall ensure that a properly resourced and independent audit function be established, and an Internal Auditor for the Fund is appointed. The Internal Auditor will report directly to the Board's Audit Committee.

6.3. The members of the Audit Committee are required to meet annually with the Internal Auditor and External Auditors without members of management being present.

6.4. For the purpose of this Notice, the responsibilities of the Internal Auditor include, but are not limited to the following:

- evaluating the reliability, adequacy, and effectiveness of the Fund's internal controls and risk management processes;
- regular review of information processes, operational software systems, and accounting and financial reporting systems;
- ensuring that the Fund's internal controls result in prompt and accurate recording of transactions (including a delinquency control program for collecting unpaid contributions, and the proper safeguarding of assets); and
- determining whether the Fund complies with all statutory requirements, and adheres to established policies, and whether the management of the Fund is taking appropriate steps to address any control deficiencies.

- 6.5. There should be an annual internal audit plan. Issues raised in internal audit reports should be clear and prioritised, and recommendations of these reports must be dealt with in a timely manner. Outstanding exceptions or recommendations should be closely monitored.

7. Accountability to Members

- 7.1. The Board must ensure that it develops policies to ensure dealings with the members, the media and the public are conducted fairly, responsibly, and professionally. These policies should be established to avoid unfair practices, misrepresentation through false and misleading statements, and misconduct of staff.
- 7.2. Fund members and beneficiaries have a right to voice their concerns and have them addressed in a timely manner. The Board must arrange for capable parties to address member inquiries and complaints and create effective conflict resolution procedures to handle disagreements.
- 7.3. The SNPF shall disclose information to all its stakeholders/members. Such disclosure shall include the following:
- a) On joining the Fund, all members must receive:
 - a summary of the Fund rules including the contribution rates payable by the member and his/her employer;
 - the method by which benefits are calculated including any investment guarantees and promises, and fees to be paid by members; and
 - details of the Fund's dispute resolution process and names, responsibilities, and contact details of relevant personnel.
 - b) Fund members must be provided with statements, at least annually, showing their account balances and summary details of the performance of the Fund in a standardised format;
 - c) Fund members, or beneficiaries in the case of a deceased member, must be informed of material changes to their potential or existing benefits;
 - d) on request, members are entitled to receive, at no charge, one copy of the Fund's by-laws, rules, regulations, and Annual Reports. These documents should clearly state the objectives of the Fund and the rights of members and beneficiaries. Publication of these required documents on the website is one way to make it affordable for public access;
 - e) the Board must ensure that all relevant information with respect to the Fund's corporate governance objectives and procedures is disclosed in its Annual Reports; and
 - f) where the Board makes a decision that could have a material impact on future pension benefits, such decisions must also be disclosed to members and beneficiaries in the case of a deceased member, as soon as possible.

8. Governance Review

- 8.1. The Board is to undertake an annual assessment of its own functioning, and the performance of each of its Senior Management.
- 8.2. The Board is to conduct a review, at least every three years of the Fund's:
 - governance framework to determine its adequacy;
 - performance against its overall objectives; and
 - compensation mechanisms, to ensure that they provide the correct incentives for those responsible for the operation and oversight of the Fund.
- 8.3. After such assessments, the Board is required to provide, in its Annual Report, its assessment of compliance against its governance objectives, and any changes resulting from such assessments.



PRUDENTIAL STATEMENT (PS) 2: ASSET INVESTMENT MANAGEMENT

1. Introduction

- 1.1. This Prudential Statement outlines the CBS minimum requirements for the management of assets of the Fund. The objective of this statement is to ensure that the Fund's assets are managed in a sound and prudent manner and available to pay members' benefits when they fall due.

2. Background and Outline of the Approach

- 2.1. The CBS will not take the approach of imposing quantitative limits on the investments carried out by the Fund. The establishment of prudent limits in the Fund's investment policy and any other policies that pertain to the investment of the Fund's assets will be the responsibility of the Fund and the Board as stipulated under section 18 of the SNPF Act 1972 and regulation 3 of the SNPF Regulations 2010 respectively. The Board and their representatives are subject to a standard of fiduciary responsibility and must invest the Fund's assets in the best interest of the Fund members.
- 2.2. For assets to be managed effectively, the Fund must take account of its liability profile and the risks that it faces. The assets underpin the ability of the entity to meet its financial obligations as they fall due and must therefore be aligned to the underlying liabilities.
- 2.3. The Board is required to delegate the operation of the Fund's investment function to fit and proper individuals. The CBS does not prescribe precise allocations of responsibility, but ultimate accountability remains with the Board. It would be acceptable for most of the functions below to be delegated to the Board's Investment Committee, if it is appropriately resourced and reported at every Board Meeting.

3. Investment Objectives and Investment Strategy

3.1. Investment Objectives

- 3.1.1. The Board, in compliance with its investment duties as specified under regulation 3, must approve the Fund's investment objectives and impose such limitations as it believes necessary to ensure an appropriate balance between risk and return.
- 3.1.2. The investment objectives for the Fund must:
 - specify the desired investment outcome for the Fund;
 - be capable of being clearly communicated so that the members can understand the investment approach of the Fund; and
 - be such that the extent to which the investment objective has been met can be easily determined, that is, measurable.
- 3.1.3. The Board must approve and have written record of the Fund's investment objectives.

3.1.4. There must be procedures and criteria by which the Board periodically reviews the effectiveness of the Fund's investment objectives to determine whether there is a need to change them.

3.2. Board Determinations Relating to Investment Strategies

3.2.1. To formulating an investment strategy, the Board must determine:

- a) the level of risk, and the level of volatility of returns, that it considers the members are prepared to accept in connection with investments of the Fund; and
- b) the desired level of liquidity for the Fund.

3.2.2. A determination under paragraph 3.2.1 must be recorded in writing.

3.2.3. In deciding under paragraph 3.2.1, the Board must have regard to all the circumstances of the Fund.

3.2.4. In deciding under paragraph 3.2.1 (b), the Board must also consider:

- the amount it considers should be invested in cash or in assets readily convertible to cash;
- the expected timing of investment income and contributions; and
- the actual or contingent expenditure requirements, for example, taxation or payment of member entitlements.

3.3. Investment Strategies

3.3.1. An investment strategy for the Fund must be recorded in writing.

3.3.2. An investment strategy for the Fund must specify each of the following and in line with its investment capabilities specified under section 18 of the SNPF Act 1972 and regulation 3 of the SNPF Regulations 2010:

- performance benchmarks for the returns the Board is seeking to achieve;
- Board determinations relating to the investment strategies;
- the diversification to be maintained within the asset classes and between asset classes;
- if there are to be restrictions or prohibitions on investing in assets of a particular category – what those restrictions and prohibitions are;
- any restrictions on the Fund holding investments in a single entity or group of companies;
- any minimum liquidity standards for categories of investments;
- factors that are peculiar to the Fund; and
- the use of derivatives or hedges.

3.3.3. In formulating and reviewing an investment strategy for the Fund, the Board must consider the following:

- the membership profile of the Fund;
- the reasonable expectations of members;
- the nature and expected timing of members' entitlements;
- the size of the Fund;
- limitations and constraints on investments;

- any report from experts or other qualified professionals;
- any actual or potential conflicts of interest involving the Board or an associate of the Board.

3.3.4. The investments of the Fund must be consistent with the Fund's investment strategy and the statutory requirements under section 18 of the SNPF Act 1972 and regulation 3 of the SNPF Regulations 2010 respectively.

3.3.5. An investment strategy for the Fund must be clearly expressed so that members and prospective members can easily understand it and can assess the investment performance and management of the Fund.

3.3.6. There must be procedures and criteria by which the Board periodically reviews the effectiveness of the Fund's investment strategies to determine whether there is a need to change them.

3.4. Target Range and Benchmarks

3.4.1. The Fund's Investment Policy Statement must state the target range for the proportion of assets to be held in each asset class and in local and foreign currencies, after having considered the risks for each asset class.

3.4.2. The Fund must set a benchmark against which investment performance for the Fund will be measured as a whole and for each asset class.

3.4.3. The Fund's Investment Policy Statement must also state how the Board determined the target ranges and the benchmarks and all the necessary factors that were considered in the process.

3.4.4. The Board must ensure that there is appropriate diversification of the Fund's assets within each asset class.

3.4.5. The Fund must develop policies outlining its:

- maximum exposure per investment; and
- exit strategy and stop loss strategy.

3.5. Appropriate Skills

3.5.1. The Fund must not enter into investment contracts for instruments it is unable to evaluate expertly and independently through approved due diligence proceedings. Such evaluation includes the expected return, the risks and all charges that are likely to be incurred.

4. Due Diligence Process

4.1. When assessing investment proposals, the Fund must consider the following factors:

- the purposes of the Fund and the needs and circumstances of the members of the Fund;
- the desirability of diversifying the investments of the Fund;

- the nature of existing Fund investments;
- the need to maintain the real value of the capital or income of the Fund;
- the risk of loss or depreciation of capital or income;
- the potential for capital appreciation;
- the likely income returns and the timing of the income return;
- the length of the term of the proposed investment;
- the liquidity and marketability of the proposed investment during, and on the determination of, the term of the proposed investment;
- the aggregate value of the Fund;
- the likelihood of inflation affecting the value of the proposed investment or other Fund investments;
- costs in respect of making proposed investments including commissions, fees, charges and duties; and
- the outcome of a review of existing Fund investments.

4.2. The Fund must develop a due diligence and risk assessment process to be used when deciding on its investments. This process must be recorded in writing and must be approved by the Board.

5. Monitoring

5.1. Valuation of Fund Assets

5.1.1. Fund assets are to be valued on a basis that is adequate for accounting and reporting purposes.

5.1.2. For purposes of investment performance measurement, all assets must be valued at market or fair value at least quarterly. If the Fund wishes to use any other method for the valuation of its assets, the Fund must first seek written approval from the Samoa Institute of Accountants and must provide the CBS with written notification of this approval, no later than 30 calendar days from the date of approval. Independent confirmation of the methodology and assumptions used for the quarterly estimates must be made at least every two years.

5.2. Reporting of Net Investment Returns

5.2.1. The investment returns for each class of asset must be reported to the Board at least quarterly.

5.2.2. The Board must stipulate all that is necessary to be submitted to them to enable them to make the right decision.

5.2.3. The returns for each class of assets must be compared with the relevant benchmark. An attribution analysis must show the relevant contribution of asset allocation to the Fund's investment performance.

5.2.4. The reports must include the cost of all relevant expenses, including payments to stockbrokers and other service providers, whether such payments are made directly or by other service providers.

6. Operations

6.1. Outsourcing

6.1.1. The Fund may use the services of suitably qualified investment consultants for investment strategy design, research, and implementation; however, the Fund must retain full control of the outsourced activity.

6.1.2. The Fund is advised to use independent custodians for the safekeeping of assets and may also use them for other services such as clearing, settlement, investment administration and reporting.

6.1.3. Where the Board outsources a function, it must ensure proper selection processes and its due diligence examinations are adhered to and are documented. The appointment must be in writing and must clearly specify the functions to be outsourced and address issues such as:

- functions that may not be sub-contracted;
- performance standards and benchmarks;
- regular reporting processes;
- fees and charges;
- termination clauses;
- ownership of books and records; and
- dispute resolution procedures and indemnification conditions.

6.1.4. The Board must ensure that the appointment enables them to seek information from the service provider at any time.

6.1.5. The service provider must be a body corporate and must not be a disqualified person. Broadly, a body corporate may be disqualified because of insolvency, being wound up or where the body corporate knows or has reasonable grounds to suspect that a disqualified person is acting as a director, secretary or an executive officer of the body corporate that is involved in this outsourcing arrangement.

7. Conflicts of Interest

7.1. A conflict of interest arises where a responsible person influences the Fund's decisions in ways that could result in their personal gain, benefit, or advantage of any kind. Examples of conflicts of interest include, but are not limited to, situations where Fund member interests are neglected or made secondary to the interests of a responsible person, as a result of:

- the allocation of the Fund's assets;
- the terms and conditions of related party transactions that are not made on an arm's length basis; or
- any other instances that may be determined by the Central Bank of Samoa

- 7.2. A responsible person must disclose, in writing, to the Chair of the Board or his/her proxy, all his/her business and other interests. These disclosures are to be renewed within 30 calendar days of the commencement of the Fund's financial year. A subsequent change in the interest of a responsible person must be disclosed immediately.
- 7.3. The Board must identify all conflicts of interest of a responsible person, where the responsible person may be a director, officer, or shareholder of, or may have a relationship with, an entity that the Fund intends to do business with.
- 7.4. The Board must make certain that there are procedures in place to ensure that those involved with implementing the investment strategies understand where conflicts of interest could arise and how they must be addressed.
- 7.5. Members of the Investment Committee and the Board must leave meetings for the duration of a discussion where they may have a conflict of interest. They may not indicate their views on the merits of the investment, nor return until a decision is made.
- 7.6. The Fund must establish policies and procedures on related party transactions. These must include limits applied, terms of transactions and the authorities and procedures for approving and monitoring these transactions.

8. Communication

- 8.1. Achievement of the Fund's objectives requires communication and cooperation between the parties involved in setting and carrying out the investment policy. Therefore, copies of the investment policy must be sent to custodians, investment managers, investment consultants, internal and external auditors, and any appointed actuary, if requested by these parties. The parties must treat this information as strictly confidential.
- 8.2. The Fund must provide members with investment information at least annually. This investment information includes, but is not limited to the Fund's:
- investment policy; and
 - investment performance.

9. Reporting to the Central Bank of Samoa

- 9.1. For purpose of this Prudential Statement, the Fund is required to provide the CBS with copies of the following (for information):
- the Fund's Investment Policy Statement containing the Fund's investment objectives and investment strategies;
 - the Fund's due diligence and risk assessment process that is to be used when deciding on its investments;
 - an attribution analysis of the Fund's performance over the past year;

- detailed copies of the Fund's 100% owned subsidiaries' asset allocation strategy, for their investment portfolio, including the:
 - a) local and offshore equities portfolio;
 - b) offshore term deposits; and
 - c) summary of fixed interest securities
- copies of the Fund's outsourced activity agreements; and
- details on appointment of professional investment consultants, custodians and investment managers (i.e. their CVs, evidence of experience in performing the required tasks, justification for selection and all expenses that the Fund is required to pay for receiving their services).

9.2. For the purpose of paragraph 9.1, reports on changes to bullet points 1 to 4 above must also be provided to the CBS, no later than 30 calendar days from the date of Board approval.



PRUDENTIAL STATEMENT (PS) 3: CREDIT RISK

1. Objectives and Key Requirements of this Prudential Statement

- 1.1. This Prudential Statement aims to ensure that SNPFs controls credit risk by adopting a prudent credit risk management framework, centered on policies and procedures. These policies and procedures must particularly apply to the recognition, measurement, reporting of, and provisioning for impaired facilities.
- 1.2. SNPF must establish and implement an in-house Credit Risk Policy approved by the Board.
- 1.3. The key requirements of this Prudential Statement are that SNPF must:
 - have an effective credit risk framework that is supported by a robust system for the prompt identification, monitoring, measurement, and control of its credit risk;
 - be commensurate with the nature, scale, and complexity of the Fund;
 - maintain a portfolio of high-quality assets (loans and investments) that are well diversified and does not present undue risk;
 - regularly review its credit risk management systems, taking account of changing operating circumstances, activities, and risks;
 - have systems to recognize and report impaired facilities and;
 - maintain provisions and reserves adequate to absorb credit losses in the portfolio.

2. Authority

This Prudential Statement is made under Section 3 (2), of the Financial Institutions Act 1996 (the FI Act and any related Amendments).

3. Definitions

Facilities – all loans and other financial products and services provided by a SNPF to an entity which give rise to a credit exposure on the entity.

Large Exposure – exposure to a counterparty or a group of related counterparties which is greater than or equal to 10% of a SNPF's capital base.

Non-Performing – loan is nonperforming when payments of interest and/or principal are past due by 90 days or more, or payments must be capitalized, refinanced, or delayed by agreement, due to inability to repay; or any loan that is current or past due that shows deterioration such that the likelihood of past due or default status is very high and warrants recognition of the deterioration. In addition, external events such as bankruptcy, debt defaults elsewhere and similar tangible signs of financial distress would likely lead to nonperforming status recognition. Similarly, at any time where there is doubt that payments will be made in full.

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 SNPF from loss.

4. Key Principles

- 4.1. Credit risk – the risk of counterparty default – usually represents the single largest risk facing SNPF. The presence of a well-functioning credit risk management system is, therefore, fundamental to the safety and soundness of SNPF.
- 4.2. It is the responsibility of the Board of Directors (Board) and senior management of SNPF to oversee the nature and level of credit risk undertaken by SNPF. This responsibility includes ensuring that SNPF has in place:
 - a) credit risk management policies, procedures, and controls appropriate to the complexity, scope and scale of its business;
 - b) appropriate controls to ensure adequate provisions in compliance with the SNPF's stated policies and procedures, applicable accounting framework and the requirements of this Prudential Statement; and
 - c) a realistic assessment of asset quality.

5. Board and Senior Management Responsibilities

- 5.1. The Board and management are responsible for the sound management of SNPF's credit risk and must ensure SNPF has a robust credit risk management framework to manage this risk accordingly.
- 5.2. The Board must establish a credit risk appetite and adopt a credit risk strategy and risk management framework commensurate with the credit risk appetite.
- 5.3. The Board and management must have a sound credit granting process that is properly communicated throughout the organization. Approval and authorizations must be well developed and provide the necessary controls to mitigate risk.
- 5.4. The Board and management must establish a system of independent ongoing credit review that provides the Board with regular information about the credit risk, asset quality, trends in individual credits, portfolio segments, and the portfolio in aggregate.
- 5.5. SNPF's senior management must, at a minimum:
 - a) develop the credit management strategy, policies, and processes in accordance with the Board-approved risk appetite;
 - b) ensure that SNPF always maintains sufficient credit quality;
 - c) determine the structure, responsibilities, and controls for managing credit risk and for overseeing the credit portfolio;
 - d) ensure that SNPF has adequate internal controls to safeguard the integrity of its credit risk management processes;

- e) establish a set of reporting criteria specifying the scope, manner, and frequency of reporting for various recipients (such as the Board, senior management and the risk and credit committees) and the parties responsible for preparing the reports;
 - f) establish the specific procedures and approvals necessary for exceptions to policies and limits, including the escalation procedures and follow-up actions to be taken for breaches of policy limits;
 - g) closely monitor current trends and potential market developments that may present challenges for managing credit risk, so that appropriate and timely changes to the credit risk management strategy can be made as needed; and
 - h) continuously review information on SNPF's credit developments and report to the Board on a regular basis.
- 5.6. SNPF must identify and manage credit risk inherent in all products and activities. The Fund must ensure that the risks of new products and activities are subject to adequate procedures and controls before being introduced or undertaken and approved in advance by the Board or its appropriate committee.
- 5.7. The Board and senior management must be able to demonstrate a thorough understanding of the links between credit risk and other risks within SNPF, including liquidity, market, operational and reputation risks.

6. Credit Risk Management Framework

- 6.1. SNPF's credit risk management framework must include, at a minimum:
- a) A statement of SNPF's credit risk appetite, representing the amount of credit risk that the Board is willing to accept in SNPF to meet its strategic objectives;
 - b) a robust management information system that produces data and other information required for adequately assessing the credit risk exposure of the Fund, including levels of impairment, accounting for asset impairment and reporting to CBS;
 - c) a defined organizational structure;
 - d) the credit management strategy and policy;
 - e) operating standards in the form of policies, procedures, and controls, for identifying, measuring, monitoring, and controlling its credit risk in accordance with its credit risk appetite;
 - f) senior management and other relevant personnel that have the necessary experience to manage credit risk;

g) regular reporting on the existing credit risk of the SNPF and, information on new or emerging credit risks; and

h) annual review and approval by the Board.

6.2. SNPF's credit risk management framework must include comprehensive documented policies, procedures and controls addressing at a minimum the following:

- a) board and senior management responsibilities;
- b) credit policies;
- c) credit granting;
- d) credit administration;
- e) concentrations;
- f) credit risk monitoring;
- g) internal credit risk rating system;
- h) portfolio review system;
- i) collateral role, purpose, and valuation;
- j) asset classification including the write-off of uncollectible facilities;
- k) provisions for loans losses and the adequacy of reserves for current and future losses;
- l) interest suspension;
- m) renegotiated or restructured loans; and
- n) managing problem credits.

6.3. SNPF's credit risk management framework must clearly set out the organizational structure as it relates to credit for the SNPF and define the roles and responsibilities of management and staff involved in managing credit risk. It must be well integrated into SNPF's overall risk management process.

6.4. SNPF's credit risk management function must be staffed with personnel who have the skills and authority to challenge SNPF's credit risk management practices.

6.5. The credit management strategy must be appropriate for the nature, scale, and complexity of SNPF. In formulating this strategy, SNPF must consider its legal structure, key business lines, the breadth and diversity of markets, products, and regulatory requirements.

6.6. The credit management strategy, key policies for implementing the strategy, and the credit risk management structure must be communicated throughout the organisation by senior management.

6.7. SNPF must have adequate policies, procedures, and controls in place to ensure that the Board and senior management are informed immediately of new and emerging credit concerns. These include a significant decline in the quality of underwriting, high or increasing exceptions to policy, noncompliance with policy, material or persistent breaches of limits, or changes in external market conditions that could signal future difficulties.

- 6.8. The credit risk management framework must be subject to effective and comprehensive independent review on an ongoing basis. In most cases, the independent reviews could be facilitated by SNPF's internal audit function but may require the engagement of independent parties outside of this function.

7. Credit Policies

- 7.1. The Board must adopt credit policies that clearly outline SNPF's view of business development priorities and the terms and conditions that are necessary for loans to be approved.
- 7.2. The credit policies must be updated at a regular interval to reflect changes in the economic outlook and the evolution of SNPF's loan portfolio.
- 7.3. The credit policies must be communicated timely and be implemented by all levels of SNPF through appropriate procedures. It should be distributed to all lending authorities and credit officers.
- 7.4. At a minimum, credit policies must include:
- a) the identification of credit risk, both on and off the balance sheet, by investments, portfolio, products, sectors, and geographic segments;
 - b) areas of credit in which the Fund plans to lend and not lend (acceptable and unacceptable types of credit);
 - c) target market within each lending segment and level of diversification/concentration;
 - d) clear guidelines for each of the various types of credits/lending;
 - e) terms and conditions under which it will consider an application for each type of credit facility that SNPF will provide, including acceptable loan tenor, type of acceptable collateral security, maximum loan to value ratio (LVR), and types of borrowers, geographies, industries, and sectors;
 - f) specified acceptable and unacceptable financial quality and repayment performance measures, such a debt service coverage ratio, cash flow, liquidity, and debt to worth ratios;
 - g) SNPF's formal credit approval process - detailed and formalized credit evaluation and appraisal process, administration, and documentation;
 - h) credit approval authority;
 - i) concentration and diversification limits for connected counterparties, industries or economic sectors, geographic regions, and products;
 - j) credit pricing strategy;

- k) roles and responsibilities of staff involved in credit;
- l) guidelines on monitoring and reporting system;
- m) internal risk grading criteria;
- n) criteria for past due, non-accrual, and restructuring of loans;
- o) guidelines on management of problem loans;
- p) authority for approval of allowance for losses and write-offs;
- q) identification, reporting, and approvals of exceptions to policy and procedures,
- r) internal control systems for disbursement of funds that require completion of all legal and required actions and conditions be met prior to authorization to disburse funds; and
- s) quantitative and qualitative targets.

8. Credit Granting

- 8.1. SNPF must have a well-defined credit granting strategy, in line with its stated credit risk appetite, and well-defined criteria for granting of credit.
- 8.2. Before granting credit, SNPF must receive sufficient information to enable a comprehensive assessment of the true risk profile of the counterparty, including up to date financial information.
- 8.3. At a minimum, the factors to be considered and documented in approving credits must include:
 - a) the purpose of the credit, the source of repayment and the consistency between these two elements;
 - b) the integrity and reputation of the counterparty;
 - c) the current risk profile (including the nature and aggregate amounts of risks) of the counterparty and its sensitivity to economic and market developments;
 - d) the counterparty's repayment history and consistency, financial trends, current capacity to repay, the stated source of repayment, and financial and cash flow projections;
 - e) a forward-looking analysis of the capacity to repay based on various scenarios;
 - f) the legal capacity of the counterparty to assume the liability;

- g) for commercial credits, the counterparty's business expertise and the status of its economic sector and position within that sector;
- h) the proposed terms and conditions of the credit, including covenants designed to identify early signs of deterioration and allow SNPF to take preemptive action to protect its loan; and
- i) the adequacy and enforceability of collateral or guarantees.

8.4. The assessment of a borrower's ability to repay must include at a minimum analysis of common financial ratios of current and historical financial condition along with full analysis of financial position or net worth of the borrower, and financial performance or income and expenditure of the borrower.

8.5. For non-retail counterparties, financial ratios should be analyzed to demonstrate adequate debt serviceability, evidence of liquidity and adequate security coverage; and any other relevant indicators.

8.6. For retail counterparties, the analysis should include consideration of debt service coverage ratio, loan-to-value ratio, and credit scores where applicable.

8.7. SNPF must not substitute collateral for a comprehensive assessment of the counterparty's capacity to repay the facility, nor can it compensate for insufficient information. The Fund may utilize collateral and guarantees to help mitigate risks inherent in individual credits, but transactions should be entered primarily on the strength of the counterparty's repayment capacity.

8.8. SNPF must have policies covering the acceptability of various forms of collateral, procedures for the ongoing valuation of such collateral, and a process to ensure that collateral is, and continues to be, enforceable and realizable.

8.9. Regarding guarantees, SNPF must evaluate the level of coverage being provided in relation to the credit-quality and legal capacity of the guarantor.

8.10. SNPF must have ongoing access to borrower's financial information, including the submission of financial statements where applicable. For non-retail borrowers, this requirement should include the audited financial statements by a Chartered Practicing Accountant for the last financial year, cash flow statements and any other report where applicable.

9. Credit Administration

9.1. Credit administration is a critical and independent function in maintaining the safety and soundness of SNPF. The credit administration function provides the physical aspects of granting and maintaining credit.

- 9.2. A typical credit administration unit should perform the functions of credit documentation, disbursement, and monitoring; loan repayment; and maintenance of credit files, collateral and security documents. Once a credit is granted, it is the responsibility of Credit Administration to ensure that the credit is properly maintained.
- 9.3. Credit administration must ensure completeness of documentation (loan agreements, guarantees, transfer of title of collaterals etc.) in accordance with approved terms and conditions. This includes keeping the credit file up to date, obtaining current financial information, sending out renewal notices and preparing various documents such as loan agreements.
- 9.4. SNPF must ensure:
- a) the efficiency and effectiveness of credit administration operations, including monitoring documentation, contractual requirements, legal covenants, collateral recordation;
 - b) the accuracy and timeliness of information provided by management information systems;
 - c) the adequacy of controls over all credit administration procedures; and
 - d) compliance with prescribed management policies and procedures as well as applicable laws and regulations.
- 9.5. Senior management must understand and demonstrate that it recognizes the importance of this element of monitoring and controlling credit risk, to help ensure the various components of credit administration to function appropriately.

10. Credit Risk Monitoring

- 10.1. SNPF's credit risk management framework must provide for the systematic and regular monitoring of credit risk, to assist the Board and senior management in obtaining, on a regular basis, a view of trends and other changes in the overall nature and levels of credit risk, and in assessing the adequacy of provisions, and capital.
- 10.2. SNPF's credit risk monitoring must include measures that:
- a) enable the Board and senior management to readily understand the current (and changing) financial condition of its borrowers, individually and in aggregate;
 - b) ensure that all credits are in compliance with existing covenants;
 - c) allow management to view customer credit lines usage and to take timely action when these lines are not used as approved;
 - d) ensure that the projected source of repayment, including cash flow and sale of assets, meet debt servicing requirements on an ongoing basis;

- e) ensure that, where applicable, collateral provides adequate coverage relative to the obligor's current condition;
 - f) identify and classify potential problem credits on a timely basis;
 - g) ensure the accuracy of the information submitted to the Board and management.
- 10.3. SNPF's credit risk monitoring must comprise a full suite of asset quality indicators including qualitative and quantitative quality reports. Examples of quantitative credit risk ratios are listed in **Attachment A**.

11. Internal Credit Risk Rating System

- 11.1. SNPF must develop an internal credit risk rating system for its credit risk assets. The risk rating should categorise all credits into various classes based on underlying credit quality and ability to repay.
- 11.2. All facilities should be assigned a risk rating. When deterioration in repayment ability is noted, the risk rating should be changed within the earlier of 30 calendar days or quarter end. The rating system should be consistent with the nature, size and complexity of SNPF's activities.
- 11.3. The risk rating system must have the following parameters at a minimum:
- a) covers a broad range of SNPF's credit exposure, including on and off-balance sheet exposures, investments, and other credit exposure assets;
 - b) covers both performing and non-performing assets;
 - c) has several grades covering exposures, with the lowest rating accorded to those where losses are expected;
 - d) has more than one risk grade for performing credits;
 - e) can be readily mapped to the regulatory classifications ("standard" or "current", "special mention", "substandard", "doubtful" and "loss");
 - f) is consistent with the nature, size, and complexity of SNPF's activities; and
 - g) provides ongoing updated risk ratings at renewals and when borrower financial condition changes.

12. Portfolio Review System

- 12.1. SNPF must have an established portfolio review system that is aimed at identifying credit quality in the portfolio by risk rating the individual credits and reviewing the accuracy of those ratings over time.

- 12.2. SNPF's portfolio review system should ensure that timely and adequate management action is taken to maintain the quality of the loan portfolio and that adequate provisions for losses are established and maintained.
- 12.3. SNPF must recognise that maintaining loss provisions is a stabilising factor and that failure to make adequate provisions may result in misrepresentation of SNPF's financial condition.
- 12.4. The portfolio review system should include an annual risk-based review of portfolio quality and condition, including a reassessment of the internal credit rating of individual exposures, with a minimum sample review ratio of sixty percent (60%) of outstanding loan volume.
- 12.5. The portfolio review system should include a summary report presented to the Board (at least annually) that contains the scope and results of the review, risk rating downgrades and upgrades, conclusions regarding documentation, policy and procedure compliance, and adequacy of provisioning.
- 12.6. The portfolio review system must sample various portfolio segments, sectors, and types of loans, as well as size of loan.
- 12.7. The portfolio review and asset classification are predicated on the ability of SNPF staff (or as necessary external service providers) to perform appropriate financial analysis of the counterparty's ability to repay the debt as structured. The analysis must include assessment as specified in paragraphs 9.4, 9.5 and 9.6 of this Prudential Statement.

13. Asset Classification

- 13.1. SNPF must assign credit classifications to all direct and indirect extensions of credit including loans and advances, accounts receivable, property acquired in settlement of loans, equity investments, contingent items in direct credit substitutes and miscellaneous asset accounts.
- 13.2. SNPF must classify assets for regulatory reporting and provisioning in the following categories:

13.2.1. Special Mention

- 13.2.1.1. A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Fund's credit position at some future date. Special mention assets are not adversely classified and do not expose the Fund to sufficient risk to warrant adverse classification.

13.2.2. Standard /Pass/Acceptable

- 13.2.2.1. 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 contributions with the SNPF or by securities issued by the Government or by the CBS, are exempted from classification regardless of arrears or other adverse credit factors.
- 13.2.2.2. The standard category includes assets which are not considered to have problems. Assets falling into the latter three categories below possess various degrees of well-defined weaknesses and are collectively referred to as “classified” assets.
- 13.2.2.3. SNPF should begin to develop a grading system with multiple “standard” ratings based upon capacity to repay, level and liquidity of collateral support, tenor, and other financial metrics. When pricing loans these same attributes are used to determine the necessary risk, premiums required of an approved loan. The grading system is complementary to the pricing system of SNPF.

13.2.3. Substandard

- 13.2.3.1. Substandard assets are not protected by the current financial soundness and paying capacity of the counterparty. Substandard assets are those whose primary sources of repayment are insufficient to service the debt and SNPF 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.
- 13.2.3.2. 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.
- 13.2.3.3. Non-performing assets which have been “past due” for at least 90 days should be, at a minimum, classified as substandard.

13.2.4. Doubtful

- 13.2.4.1. 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, based on currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important, reasonably, and timely specific pending 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 must be classified as doubtful.
- 13.2.4.2. Because assets in this classification are pending specific and timely events it is not appropriate to continue a doubtful classification for more than 12 months.

13.2.5. Loss

13.2.5.1. Assets classified as loss are considered uncollectible and their continued inclusion in the Fund's books as SNPF 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 affected in the future. SNPF should not retain assets on the books while attempting long-term recoveries. Losses should be considered 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 commenced and timely realization of the collateral or successful enforcement of the guarantees can be expected.

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

13.4. When applying the risk grading to a counterparty that has more than one credit facility, SNPF must apply the rating consistently to all loans that are subject to the same source of repayment, obligor financial strength (or lack thereof) or other factors unless SNPF can prove that one or more of the other loans has a well-defined separate source of repayment that is not jeopardized.

14. Provisions for Loans Losses

14.1. SNPF must apply minimum regulatory provisions, as follows:

Special Mention	1%
Standard	10%
Substandard	20%
Doubtful	50%
Loss	100%

14.2. Nothing contained above prevents SNPF from maintaining larger provisions or additional provisions for loan losses if it feels this is warranted based on the condition of SNPF's portfolio, changes in lending practices, economic trends, and loss experience.

15. Interest Suspension

15.1. All "sub-standard", "doubtful" and "loss" assets must be placed on non-accrual basis within 30 days of such designation. All previously accrued but uncollected interest should be reversed from income by debiting the profit and loss account and crediting the interest in suspense account established for each asset placed on a non-accrual basis.

15.2. "Non-performing" assets should only be restored to an accrual basis upon the full settlement of all delinquent principal and interest and in accordance with the same performance requirements as renegotiated and restructured below. Funds for the repayment of delinquent principal and interest should not be obtained through the creation of new loans from SNPF.

16. Renegotiated or Restructured Loans

- 16.1. SNPF must have policies and procedures that address restructured or renegotiated loans. The restructured loan designation applies to loans which, because of weaknesses in the counterparty's financial condition or ability to pay, have been refinanced, rescheduled, rolled over or otherwise modified at favourable terms and conditions for the borrower. The modification may include lengthening of repayment schedules or lowering interest rates to meet the borrower's debt service abilities.
- 16.2. While loan restructuring can be considered a management tool to maintain or improve asset quality or the soundness of lending operations, troubled restructurings should be carefully analysed to ensure that the modification is not delaying or avoiding recognition of necessary risk rating classification, provisioning, non-accrual, non-performing, or write downs associated with the concessions. In this process, it is expected that SNPF will take all action to enhance the creditworthiness of the facility, including obtaining additional collateral, guarantors, control over borrower cash flows, ongoing interim and annual financial information submissions, and the implementation of loan covenants.
- 16.3. If the restructuring occurs after the counterparty has been graded as Substandard or worse, the supporting documentation for restructuring must be robust given the presumption that a substandard borrower exhibits well-defined weaknesses and financial difficulties. SNPF's analysis must reflect why this restructuring is in its best interest.
- 16.4. For restructurings that reflect a concession by SNPF to the counterparty, such as reduced interest rate, extended amortization schedules, and other similar concession criteria, SNPF must revalue the loan as if granted at current interest rates and repayment terms. The result may be a discount of the loan value and would require a write down in SNPF's accounts.
- 16.5. Restructured loans should be classified as Substandard until a sustained and satisfactory record of repayment performance has been achieved, for a minimum period of six months, under the new repayment program. Upon satisfactory completion of the minimum period SNPF can return the credit to accrual status.
- 16.6. Repeat loan restructuring should be avoided. If a second restructuring is approved the repayment history required before returning the credit to performing status and removal from substandard is increased to 12 months.
- 16.7. The restructuring of loans to "connected borrowers" (See the Prudential Statement – Connected Lending and Activities, and Direct Ownership Interests) must be on terms not less favourable to SNPF than those offered to other clients.

17. Managing Problem Credits

- 17.1. The credit risk policy must define SNPF's system of managing their problem assets. Once a loan is identified as a problem, it should be managed under a dedicated remedial process.

17.2. Responsibility for such credits may be assigned to the originating business function, a specialized workout section, or a combination of both, depending upon the size and nature of the credit and the reason for its problems.

17.3. When SNPF has significant credit-related problems, it is important to segregate the workout function from the credit origination function. The additional resources, expertise and more concentrated focus of a specialized workout section normally improve collection results. In such case, the "Recovery Unit", shall manage accounts with sustained deterioration (a risk rating of Substandard or worse).

17.4. The recovery unit's primary functions should be to:

- a) determine account action plans or recovery strategies;
- b) monitor compliance with the action plan, adjusting the plan as necessary;
- c) pursue all options to maximize recovery, including placing customers into legal proceedings or liquidation as appropriate;
- d) ensure adequate and timely loan loss provisions are made based on actual and expected losses;
- e) regular review of substandard or worse accounts; and
- f) regular reporting to the Board on the overall problem loan portfolio and in particular, the large and complex credits.

Attachment A

RATIO	INTERPRETATIONS
NPL ratio – that is nonperforming as a percentage of total loans and advances.	Level and severity of non-performing loans and advances. An assessment of the portfolio quality, credit analysis and management and level of potential future write-offs. This ratio also gives an indication of the quantum of non-income generating loans.
NPL minus provision for loan losses/ tier one capital	Gives an indication of the impairment to capital
Provisions for loan losses / NPL	Level and adequacy of provision made for portfolio losses
Past due loans/NPL	Level of unsatisfactory assets past maturity date - indicates severity of delinquency.
Total delinquency - all loans in arrears and nonperforming overdrafts compared to total loans and advances	Gives an indication of the total risk in the credit portfolio
Amount outstanding by sector/Total Loans	Portfolio concentration by sector. It is an indication of the SNPF's vulnerability to the performance of a sector.
Amount outstanding by largest borrower (group)/Total Loans	Portfolio concentration by individual or borrower group. It is an indication of the SNPF's vulnerability to the performance of a small group of customers.

PRUDENTIAL STATEMENT (PS) 4: LARGE EXPOSURES

1. Objective and Key Requirements of this Prudential Statement

- 1.1. The purpose of this Prudential Statement is to protect the safety and soundness of SNPF by preventing excessive investments in or loans to any one person or group of interrelated persons who are financially interdependent.
- 1.2. Excessive exposure to a single customer or group of customers is a significant risk for SNPF. The CBS seeks to promote diversification to reduce credit risk in SNPF's loan portfolio.
- 1.3. It is the responsibility of the Board of Directors and Management to adopt policies and procedures which ensure that all exposures comply with the limits set forth in this Prudential Statement. They must ensure that the policies and procedures are made and administered in accordance with prudent lending practices.

2. Authority

This Prudential Statement is made under Section 3 (2) of the Financial Institutions Act 1996 (the FI Act and related Amendments).

3. Definitions

Exposure – the aggregate of all actual and potential claims as well as, commitments and contingent liabilities arising from on-and off-balance sheet transactions, to single counterparties and groups of connected counterparties, or groups of related counterparties reflecting the maximum possible loss from their failure to perform on such exposures, and

a) includes, but is not limited to:

- i. outstanding balances of all loans and advances;
- ii. holdings of debt and/or equity securities;
- iii. inter-bank lending, derivative transactions, securities financing transactions and trading activities;
- iv. all unused advised off-balance sheet commitments whether revocable or irrevocable; and
- v. the credit equivalent amounts of all market-related contracts.

b) excludes:

- i. exposures to the extent that they are secured by contributions; and
- ii. exposures to the extent that they are guaranteed by, or secured against securities issued by, governments or central banks (being the Samoan government, foreign governments and central banks which receive a zero per cent risk-weight).

Group of Related Counterparties – where two or more individual counterparties are linked by cross guarantees; common ownership or management; the ability to exercise control over the borrower, whether direct or indirect; or other financial interdependency such that the financial soundness of any of them may affect the financial soundness of the other(s); or other connections or relationships which, according to SNPF's assessment, identify the counterparties as constituting a single risk. The definition

also includes persons who are family members that are financially inter-dependent upon one or more persons or companies within the group.

Control - when:

- a) one or more persons acting together directly or indirectly own or have power to vote 20% or more of the voting shares of another person; or
- b) one or more persons acting together control, in any manner, the election of a majority of the directors, trustees, or others exercising similar functions of another person; or
- c) any other circumstances exist which indicate that one or more persons acting together exercise a controlling influence, directly or indirectly, over the activities, management, practices or policies of another person.

Corporate Group – a corporation plus all its subsidiaries and associates.

Holding company – a company is another company's holding company if that other company is its subsidiary.

Person – an individual or any legal entity.

Related Persons – two persons will be related if one person has the ability, directly or indirectly, to control the other person or to exercise significant influence over the financial and operating decisions of the other person, or if both persons are subject to common control or common significant influence.

Related Company – a company is related to another company if:

- a) the other company is its holding company or subsidiary; or
- b) more than half of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital is held by the other company and companies related to that other company (whether directly or indirectly, but other than in a fiduciary capacity); or
- c) more than half of the issued shares, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital, of each of them held by members of the other (whether directly or indirectly, but other than in a fiduciary capacity); or
- d) the businesses of the companies have been so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable; or
- e) there is another company to which both companies are related; and “related company” has a corresponding meaning.

Significant Influence – the ability to participate in a material way in the financial and operating policies and decisions of another person. The absence of absolute control does not preclude the ability to exert significant influence over the policies and decisions of another person. If one person holds, directly or indirectly through subsidiaries, 10% or more of the voting power over another person, it will be presumed that the first person exerts or has the ability to exert significant influence over the second person. Conversely, if a person holds, directly or indirectly through subsidiaries, less than 10% of the voting power over another person, it will be presumed that the first person does not exert or have ability to exert significant influence unless there are compelling circumstances to the contrary. A substantial or majority ownership in one person by a second person does not preclude a third person from having significant influence over the first person.

Subsidiary – a person in which another person owns, directly or indirectly, more than 50% of the outstanding voting stock. A company in which another company:

- a) controls the composition of the board of the company
- b) is able to exercise, or control the exercise of, more than one-half the maximum number of votes that can be exercised at a meeting of the company; or
- c) holds more than one-half of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital; or
- d) is entitled to receive more than one-half of any dividend paid on shares issued by the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital

Single Borrower – any single 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 SNPF'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 SNPF lending, 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:

- (a) Companies with common ownership or cross ownership (e.g., a parent or holding company and its subsidiaries);
- (b) Borrowers linked by guarantees or cross-guarantees or which share the same collateral, the proceeds from the credit facility are re-loaned or given to another person (i.e. accommodation);
- (c) the proceeds from the credit facility are used for the direct benefit of another person (the "use" test); or

(d) the two persons constitute a common enterprise, and the enterprise is expected to generate or provide the funds to repay the credit facility/ies (the "source" test). A common enterprise includes loans to borrowers who are related directly or indirectly through common control, provided that 50% or more of one borrower's gross receipts or gross expenditures are derived from transactions with the other borrower.

4. Control of Large Exposures and Risk Concentrations

- 4.1. SNPF must incorporate the management of risk concentrations to counterparties, industries, and asset classes into its risk management framework.
- 4.2. The Board is responsible for establishing and monitoring compliance with policies governing large exposures and risk concentrations of SNPF.
- 4.3. The Board and senior management of SNPF should ensure that:
 - a) adequate systems and controls are in place to identify, measure, monitor, and control large exposures and risk concentrations of SNPF in a timely manner; and
 - b) large exposures and risk concentrations of SNPF are kept under regular review.
- 4.4. The Board must ensure that these policies are reviewed regularly (at least annually) and that they remain adequate and appropriate for SNPF. Any material changes to established policies must be approved by the Board.
- 4.5. SNPF's large exposures and concentrations policy must, as a minimum, cover the following:
 - a) specific exposure limits to total investible funds for:
 - i. various types of counterparties (e.g., governments, corporate and individual borrowers);
 - ii. a group of related counterparties;
 - iii. individual industry sectors (where applicable);
 - iv. individual countries (where applicable); and
 - v. various asset classes (e.g., property holdings and other investments) that are commensurate with SNPF's balance sheet size;
 - b) the circumstances in which the above exposure limits may be exceeded and the authority required for approving such excesses; and
 - c) the procedures for identifying, measuring, monitoring, and reporting large exposures of SNPF.
- 4.6. SNPF must, where appropriate, conduct stress testing and scenario analysis of its large exposures and risk concentrations to assess the impact of changes in market conditions or key risk factors (e.g., economic cycles, interest rate, liquidity conditions or other market movements) on its risk profile and earnings.

5. Prudential Limits

- 5.1. 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.
- 5.2. The maximum aggregate exposure of SNPF to a counterparty or a group of related counterparties and any external parties (other than governments and central banks) unrelated to SNPF is five percent (5%) of total investible funds.
- 5.3. SNPF should treat the 5% limit as the upper limit for an exposure. The CBS expects SNPF to establish lower internal limits for its daily activities, in line with their risk appetite.
- 5.4. Family members are not considered to be connected where SNPF can demonstrate that any extension of credit is supported by a clearly defined and authenticated separation of family member financials. This includes separate financial statements, income sources, sources of repayment, and deposit accounts. Comingling of funds supports the conclusion that a connection exists. Notwithstanding the above, SNPF can choose to treat such exposures as connected should it consider appropriate to do so.

6. Prior Consultation Requirements

- 6.1. SNPF must consult with the CBS prior to committing to any proposed exposures to counterparties, other than governments and central banks, in excess of 5% of its total investible funds as specified under part 5.2.
- 6.2. The CBS may, in writing, set a higher consultation threshold or waive the prior consultation requirements for SNPF where the CBS is satisfied with the robustness of SNPF's credit risk management systems and controls.

7. Notification Requirements

- 7.1. SNPF must notify the CBS immediately of any breach of the prescribed limits under paragraph 6.2 or other specific limits imposed by the CBS, including remedial actions taken or planned to deal with the breach.
- 7.2. SNPF must inform the CBS immediately where it has concerns that its large exposures or risk concentrations have the potential to impact materially upon its total investible funds, along with proposed measures to address these concerns.

8. Concentration of Risk

- 8.1. Where SNPF has several large exposures (excluding any exposure to governments and central banks) or where in the CBS's opinion, the SNPF is exposed to a significant level of risk concentration, CBS may consider the following factors:
 - a) consistency with the SNPF's policy on large exposures and risk concentrations;

- b) the number of exposures, their individual and combined size and risk grading; and
- c) the characteristics of SNPF, including the nature of its business and the experience of its management.

8.2. The CBS may also direct SNPF to take measures to reduce its level of risk concentration.

9. Non-Conforming Exposures

9.1. Exposures which do not conform to the limits in paragraph 6.2 when this Prudential Statement comes into effect, or which subsequently become nonconforming, will be treated as follows:

- a) Exposures made prior to the date of this Prudential Statement which exceed the limits in paragraph 6.2 will not be cited in contravention of this Prudential Statement but will be noted as "nonconforming". SNPF may renew, extend the maturity of, or restructure a nonconforming exposure without contravening this Prudential Statement provided SNPF makes a documented good faith effort to bring the exposure into conformance with the requirements of this Prudential Statement, unless:
 - i. SNPF increases the exposure or otherwise advances additional or new funds to the person;
 - ii. a new borrower replaces the original borrower;
 - iii. the CBS determines that the renewal, extension, or restructuring of the exposure is designed to evade the limits in Prudential Statement; or
 - iv. the renewal, extension, or other modification of the maturity of the exposure exceeds one year.
- b) If an exposure conforms to the limits in paragraph 6.2 when made but subsequently exceeds the limits because:
 - i. SNPF's investible funds declines because of operating losses; or
 - ii. the borrower merges or forms a common enterprise with another borrower; or
 - iii. of changes to the lending limits; or
 - iv. an exception under paragraph 10.1 no longer applies then the exposure will be treated as "nonconforming".

9.2. If an exposure becomes "nonconforming", the Board or senior management are required to act promptly to bring the exposure into compliance unless doing so would adversely affect the ability of the SNPF to receive full repayment of the credit.

10. Other Matters

10.1. The limits in this Prudential Statement apply to all exposures, including any loans and advances which have been written off in whole or in part, or against which SNPF has raised specific provisions for losses. Loans and advances that have been discharged by a court or that are no longer legally enforceable shall not be included in the total for determining compliance with the limits.

10.2. Any exposure or portion thereof that has been sold as participation to another SNPF shall not count against the limits in this Prudential Statement. For this exception to apply, the participation must be covered by a written agreement which specifies that:

- a) the interest rate on the portion of the exposure sold under the participation agreement is equal to or less than the interest rate shown in the contract between the lending SNPF and the counterparty;
- b) the maturity of the portion of the exposure sold under the participation agreement is no longer than the maturity shown in the contract between the lending SNPF and the counterparty; and
- c) in the event of a default both SNPF and the counterparty will share in payments and recoveries on a pro rata basis according to their respective participation percentages at the time of default.

10.3. When two or more financial institutions (e.g. SNPF and another institution) grant an exposure to a single borrower under a single credit facility (e.g. a syndicated credit), the limits in this Prudential Statement apply only to the funds provided by SNPF and representing that SNPF's pro rata share of the total credit facility. For this exception to apply, the syndication agreement must be in writing and must specify explicitly the terms and exposures of SNPF in the syndicated credit.

10.4. Accrued but uncollected interest is not subject to the limits in this Prudential Statement. Capitalised interest (that is, interest which has been added to the outstanding principal balance of a credit facility as a result of a renewal or restructuring of the credit facility and which has not been reversed or otherwise suspended from income) however, will be considered when determining compliance with the limits.

11. CBS Final Authority

11.1. In cases of uncertainty for purposes of this Prudential Statement, the CBS has the final determination based on the particular facts and circumstances, when exposures nominally granted to one person shall be combined with credits to another person.

PRUDENTIAL STATEMENT (PS) 5: CONNECTED LENDING AND ACTIVITIES, AND DIRECT OWNERSHIP INTERESTS

1. Objective and key requirements of this Prudential Statement

- 1.1. This Prudential Statement requires SNPF to adopt policies and procedures to appropriately manage risks associated with:
 - financial transactions with insiders, individuals and other parties which are connected through ownership, employment, or control of SNPF; and
 - using its funds to make direct ownership interests in other financial entities.
- 1.2. The ultimate responsibility for the management of the above risks' rests with the Board of Directors.

2. Authority

This Prudential Statement is made under Section 3 (2) of the Financial Institutions Act 1996 (the FI Act and any related Amendments).

3. Definitions

Insiders – primarily directors, officers, employees, and those that can influence decision making in SNPF. It also includes in some cases, individuals who through contract, or circumstances can influence decisions or have access to confidential information within SNPF. Circumstances and situations may present additional situations where an individual or individuals could be considered insiders.

Connected Lending – all forms of direct and indirect credit (on and off-balance sheet, loans, investments, and claims) exposures of SNPF to individuals or to parties which are connected to SNPF through ownership or control. In the context of direct exposure, it includes SNPF's exposure where a director, officer, or shareholder of SNPF is liable jointly or severally or as a guarantor. It also includes SNPF's 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 SNPF has an interest or is a director, partner, manager, member, shareholder, agent or otherwise.

Officer – Chief Executive Officer, Senior Executives, Managers, Secretary, and others who are generally known to be representatives of the SNPF.

Shareholder – a person who owns or who has authority to exercise power over ten percent (10%) or more of SNPF's voting stock.

Connected Activities – all the elements contained in the definition of connected lending after substituting the language "direct and indirect lending exposures" with the term "non-lending financial transaction".

4. Board and Senior Management Responsibilities

- 4.1. The Board is ultimately responsible for the sound and prudent management of the risks associated with connected lending, connected activities, and direct ownership interests of SNPF.
- 4.2. The Board must ensure that SNPF has in place a risk management framework that incorporates the management of risk connected lending, connected activities, and direct ownership interests of SNPF. The Board must approve all aspects of the framework.
- 4.3. The senior Management must implement a connected lending and activities policy, approved by the Board. The policy must include appropriate processes to identify connected lending and activities; and the additional required steps and conditions under which insider's activities, both credit and non-credit, are handled. This includes the annual requirement for a conflict-of-interest statement from all significant parties within SNPF.
- 4.4. SNPF must define the term significant parties to include at a minimum senior Management, all directors, and majority shareholders.
- 4.5. The connected lending and activities policy must address the credit and non-credit approval process for insiders, which will include elevated approval authorizations for all aspects of credit management. Such approvals must include the same level of scrutiny and documentation that is required for non-insiders. The affected insider must not take part in any discussion or voting of the insider transaction.
- 4.6. The Board must ensure that terms and conditions provided to insiders are the same as those provided to non-insiders. The Board and management must establish a process that will ensure and demonstrate that insider interest rates, terms and conditions are not preferential.

5. Connected Lending

- 5.1. SNPF must not be used as a funding vehicle or "front" for the operations of "connected" borrowers or any of its associates. It must not give a general guarantee of the repayment of any liability of a "connected" borrower or an associate and should ensure that a "connected" borrower or an associate does not, to up-grade the status of its liabilities, seek to give an impression that SNPF's financial resources stand generally behind, or could be called upon to stand behind, its operations.
- 5.2. SNPF's financial dealings with any "connected" borrower or with an associate must be based on normal SNPF principles, i.e. SNPF would be expected to subject the financial position of a "connected" borrower or an associate to as close a scrutiny as it would in the case of an unrelated customer; and all transactions must be on commercial terms and conditions.
- 5.3. Any explicit financial commitment by SNPF to a "connected" borrower or to an associate should be limited as to amount, i.e. it should not be open-ended.

- 5.4. SNPF must be able to provide the CBS data in respect to any financial exposure to its “connected” borrowers and its associates.

6. Connected Non-Credit Activities

- 6.1. Connected non-credit activities (connected activities) include the purchase of services and supplies, rentals of equipment, real estate and SNPF promises, or any other transaction of a financial nature. Such activities require a higher level of transparency. Any proposed significant connected activities must be approved by a majority of the members of the Board, with any interested director abstaining. Where available and appropriate such proposals should reflect due diligence with other vendors or service providers to ensure and demonstrate that the actions taken are in the best interest of SNPF and not the insider.
- 6.2. It is the duty of every director and officer who has an interest in any proposal for connected activities to declare his or her relationship or interest in that proposal. The declaration should be recorded and should form part of the documents relating to the proposal. A director or officer who has made a declaration should not take part in any way in any evaluation, deliberations or decisions relating to that application.

7. Direct Ownership Interests

- 7.1. The Board must adopt a risk appetite statement for direct ownership interests. It must include acceptable and unacceptable SNPF ownership interests.
- 7.2. The aggregate total for all investments at any one time is limited to five percent (5%) of SNPF's total investible funds.

8. Dealings with Related Entities

- 8.1. For the purposes of this Prudential Statement, all entities where the SNPF has an equity investment in that entity is considered a related entity.
- 8.2. Where appropriate, the CBS may deem that other entities (and their subsidiaries) are a ‘related entity’ of SNPF.
- 8.3. The Board must establish, and monitor compliance with, policies governing all dealings with related entities. The policies, including any material changes thereto, must be provided to the CBS if requested.
- 8.4. SNPF's policies on related-entity dealings must, at a minimum, include:
- a) a requirement that SNPF address risks arising from dealings with related entities as strictly as it would address its risk exposures to unrelated entities;
 - b) prudent limits on exposures to related entities at both an individual and aggregate level;
 - c) procedures for resolving any conflict of interest arising from such dealings; and

d) requirements relating to the transparency of individual and third-party dealings associated with related entities.

8.5. Terms or conditions imposed by SNPF in relation to its dealings with related entities that are inconsistent with the benchmark for unrelated entities must be approved by the Board with justifications fully and clearly documented in a register. SNPF must make this register available for inspection by the CBS if so requested.

8.6. SNPF must not have unlimited exposures to related entities either in aggregate or at an individual entity level (i.e. a general guarantee of the obligations of a related entity).

9. Prior Approval Requirement

9.1. SNPF must request and receive prior approval from the CBS before entering into a credit exposure with a related party of more than five percent (5%) of total investible funds.

