

BM Circular No. 1017

January 17, 2007

To: All Licensed Banks Operating in the Sultanate of Oman

After Compliments,

Sub: Prompt Corrective Action (PCA) Framework

Please refer to our Circular BM 987 dated May 23, 2005 introducing a Prompt Corrective Action (PCA) framework to deal with weak banks, based on BIS capital ratio and NPL ratio of banks. As you are aware, with the adoption of Basel II, the regulatory minimum for BIS Capital ratio of licensed banks has been revised to 10% of risk-weighted assets with effect from 1st January 2007, from 12% stipulated earlier. In view of this change, the trigger points of BIS Capital Ratio under the PCA framework have been suitably revised. The revised PCA framework provided hereunder in this circular supercedes Circular BM 987 dated May 23, 2005 and is implemented with immediate effect.

2. The existence of weak banks pose a continuing challenge for the supervisors and any delays in dealing with such banks has serious supervisory implications, besides potential disruptions to the financial markets. Accordingly, supervisors across various jurisdictions have robust methods – preventive measures, early identification, corrective action, resolution and exit strategies to ensure stability of the financial system. The corrective actions, one of the important methods, are designed to deal with the deficiencies and to bring about changes in the behaviour of banks.

3. The Banking Law 2000 provides for suspending the licenses or operations, liquidation or termination of business of banks, which fail to comply with the provisions of the Banking Law and directives, conduct business in an unsafe manner, have impairment in capital, fail to meet obligations, etc. While these provisions are sufficient to deal with banks showing serious supervisory concerns, specific rules are necessary to deal with early signs of weaknesses. Even though the Central Bank, as part of its off-site surveillance mechanism, has been taking suitable measures

where early signs of weaknesses are noticed, a formal framework is necessary to strengthen the supervisory oversight mechanism and to achieve greater transparency in the supervisory practices in the Sultanate.

4. Accordingly, the Central Bank has put in place a Prompt Corrective Action (PCA) framework, as an integral part of the supervisory oversight, in addition to the existing supervisory measures, based on pre-determined, rule-based and structured early intervention to enhance the existing supervisory practices. A schedule of corrective actions, as indicated in the **Attachment**, is provided, based on two important indicators - **Asset Quality** and **Capital Adequacy**. Certain trigger points have been determined for the PCA framework under these indicators, taking into account the practicability of implementation of the measures. The trigger points based on **Asset Quality** (Non Performing Loans (NPLs) net of reserve interest to Gross Loans net of reserve interest and the fresh NPLs to opening Standard and Special Mention loans, on an annualized basis) and **Capital Adequacy** (BIS Capital Ratio) are quantifiable and transparent.

5. For every trigger point, a set of corrective actions – mandatory and discretionary, is provided. The actions are designed to address both the symptoms and the causes of the weaknesses, so as to pre-empt any deterioration in the soundness of banks. If a bank's performance under any one of the indicators has breached the trigger point, the bank would automatically be placed under the PCA framework. The corrective actions would consist of specific mandatory actions and those of discretionary actions, which in the opinion of the Central Bank, should be applied to the concerned bank. The published balance sheets, off-site returns, on-site examination reports, external auditors / rating agencies reports, etc would be the primary sources of data for identifying the banks, which should be placed under the PCA framework.

6. The degree or the package of actions would be corresponding to the severity of the problem. In cases where banks do not show improvement, despite taking the corrective actions, more or severe actions might be considered if there is a heightened danger of insolvency. Further, the total PCA framework for a bank, on the basis of the severity of the position, would be determined by aggregating the corrective actions under different trigger points.

7. The corrective actions under the PCA framework would be enforced within 30 days of a bank breaching any of the trigger points. The mandatory and discretionary actions along with the timeframe for taking corrective actions will be communicated to the concerned bank, in writing and the progress would be monitored at quarterly or more frequent intervals, as deemed necessary.

8. Notwithstanding anything contained in the PCA framework, the Central Bank has the right to direct a bank to take any other action or implement any other direction, in the interest of the concerned bank or in the interest of its depositors or the public. Non-compliance with the recommended actions under the PCA framework would entail imposition of penalties and sanctions under the provisions of the Banking Law and other directions.

Best regards,

Hamood Sangour Al Zadjali
The Executive President

Prompt Corrective Action – Mandatory and Discretionary Actions – January 2007

Trigger Point	Mandatory Actions	Discretionary Actions
1) Actions based on Asset Quality		
i) NPLs of 10% and over but less than 15% or additions to NPLs of 1% or over but less than 3%	<ul style="list-style-type: none"> • Approved Action Plan to reduce the stock and flow of NPLs • Review of the loan policy • Revision of credit risk management policies, systems and procedures and prudential limits including credit concentrations • Strengthen follow-up of loans including loan review mechanism, corporate governance and internal control systems • Revision of business strategies and controls 	<ul style="list-style-type: none"> • Restriction on entry into new lines of business • Moderating particular lines of business and products • Reallocation and / or restriction on expansion of risk-weighted assets • Accelerated provisions on impaired assets that are not represented in the books at fair value
ii) NPLs of 15% and over but less than 20% or additions to NPLs of 3% or over but less than 5%	<ul style="list-style-type: none"> • All the mandatory actions stated in the earlier band • Review of the Action Plan with the bank's Board of Directors • Placing restrictions or conditions on business 	<ul style="list-style-type: none"> • Restriction on entry into new business lines • Downsizing of operations • Call for fresh equity infusion • Maintaining higher capital adequacy and liquidity ratios • Accelerated provisions over the regulatory norms on NPLs
iii) NPLs of 20% and over or additions to NPLs of 5% and over	<ul style="list-style-type: none"> • All the mandatory actions stated in the earlier bands • Maintaining higher capital adequacy and liquidity ratios • Accelerated provisions on NPLs over the regulatory norms 	<ul style="list-style-type: none"> • No entry into new business lines • Restrictions on borrowings from inter bank markets • Reduce or skip dividends • Call for fresh equity infusion • Mandate organizational and business restructuring

Trigger Point	Mandatory Actions	Discretionary Actions
2) Actions based on BIS Capital Ratio		
i) BIS Capital Ratio of less than 11%, but equal to or more than 10%	None	<ul style="list-style-type: none"> • Call for capital augmentation plan • Reallocation of risk weighted assets • Review of business strategy
ii) BIS Capital Ratio of less than 10%, but equal to or more than 8%	<ul style="list-style-type: none"> • Call for cash (equity) injection by shareholders • Restrictions on expansion and / or reallocation of risk-weighted assets • Entry barrier into new lines of business • Suspension of dividend payment • Restricting expansion of branches at home or abroad 	<ul style="list-style-type: none"> • Reduction of stakes in subsidiaries or affiliates • Restrictions on access to / renewal of costly deposits and Certificate of Deposits and Inter-bank market • Prior supervisory approval for any major capital expenditure, material commitment or contingent liability • Limitations on compensation to directors and senior executives • Banning principal or interest payments on subordinated debt • Bringing in new Management / Board • Bringing in a new shareholder who can contribute new capital • Appointment of Administrator • Merger or liquidation, if the call for equity has not been met, within such period as the Central Bank may stipulate.
iii) BIS Capital Ratio of less than 8%	<ul style="list-style-type: none"> • All mandatory actions in the earlier bands • Banning principal or interest payments on subordinated debt • Merger or liquidation if the ratio does not improve beyond 8% within the time approved by the Central Bank. 	None

