

January 20, 2002

CIRCULAR BM/929

To: All Licensed Banks in Sultanate of Oman

Re: Provision for losses on Off-balance sheet items

1. Attention of the banks is drawn to circular BM 869 dated may 26, 1999 advising the banks to make necessary provisions for losses on assets and eventual liabilities. Article 1 of the Regulation BM/REG/45/2/99 annexed to the circular requires the banks to maintain adequate provisions ‘in the light of... the quality of its direct and contingent credit.’ Article 3 of the same Regulation requires that a bank shall at all times maintain specific provisions for asset depreciation as well as credit losses which shall be adequate to cover foreseeable losses as calculated with reference to assets, to credit risks, *whether direct or contingent* and to circumstances of an individual client which may arise from time to time....’
2. It has been observed that some banks in the Sultanate are not making provisions for the indirect facilities (e.g. guarantees) even if they demonstrate apparent signs of weaknesses. Banks are, therefore, advised to adhere to the following guidelines for a guarantee issued to another bank for a loan given by the latter:-
 - i) There should not be a change in the credit risk profile in the books of the guarantee issuing bank. The same factors that are taken into consideration in appraising a direct loan proposal should be taken into account while appraising a proposal for issuance of guarantee to evaluate the risk profile. In particular, the guarantee-issuing bank should be satisfied that the customer would be in a position to reimburse the bank in case the bank is required to make the payment under the guarantee. The exposure should be well within the prudential risk limits and the guarantee premium should correspond to the underlying credit risk profile.

- ii) The guarantee-issuing bank should undertake the necessary follow up as is done in case of direct facilities e.g. collecting the financial of the borrower, review of accounts etc. to monitor the credit quality of the borrower on an ongoing basis. It should maintain adequate up-to-date information on such borrower in such a manner as to enable a meaningful evaluation of the customer's overall creditworthiness in terms of Circular BM 869.
- iii) While the guarantee issuing bank is transferring the market risk, the beneficiary bank is in fact buying the credit protection to hedge itself from the credit risk. Therefore, while the guarantee issuing bank should be mandated to provide against possible loan losses, the beneficiary bank should also be mandated to place the credit facility on a non-accrual basis. For the purpose, beneficiary bank should also have the previous credit history of the borrowers.
- iv) In case the issuing bank is required to extend the tenure of the guarantee, it should be ascertained whether the loan quality has deteriorated and if needed, suitable provision should be made. Suitable provision should be made by the guarantee-issuing bank in other similar circumstances when the account starts showing signs of weaknesses.
- v) Although the beneficiary bank is not assuming credit risk vis-a-vis the borrower, it assumes an inter-bank exposure and therefore, such exposure as well should be within the overall limits.

All Licensed banks are directed to implement accordingly.

Best regards,

Hamood Sangour Al Zadjali
The Executive President