GOVERNMENT GAZETTE

OF THE

REPUBLIC OF NAMIBIA

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General Notice

BANK OF NAMIBIA

No. 100 2007

DETERMINATION UNDER THE BANKING INSTITUTIONS ACT, 1998 (ACT NO. 2 OF 1998): COUNTRY RISK MANAGEMENT

In my capacity as Governor of the Bank of Namibia (Bank), and under the powers vested in the Bank by vitue of section 71(3) of the Banking Institutions Act, 1998 (Act No. 2 of 1998) I hereby issue **this Determinatin on Country Risk Management (BID-17).**

T. K. ALWEENDO
GOVERNOR

DETERMINATION NO. BID-17

COUNTRY RISK MANAGEMENT

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PART I: PRELIMINARY

1. **Short Title** - Country risk

2. **Authorization** - Authority for the Bank to issue this Determination is provided in Section 71(3) of the Banking Institutions Act, 1998 (Act No 2 of 1998).

3. **Application** - This Determination applies to all banks authorized by the Bank to conduct banking business in Namibia.

4. **Definitions** - Terms used within this Determination are as defined in the Act, as further defined below, or as reasonably implied by contextual usage:

4.1 **“bank”** - means banking institution as defined in Section 1 of the Act.

4.2 **“country risk”** refers to the possibility or risk that a foreign borrower may be unable or unwilling to fulfil its foreign obligations due to country-specific conditions, which may be underlying economic, political, social, and natural or other events and trends.

4.3 **“country exposure”** refers to a bank’s or group of related bank’s exposure in terms of claims on borrowers/investees in individual cross-border countries.

4.4 **“country exposure limit”** means limit placed by a bank on the amount of money it is willing to lend to all borrowers, both public and private, in one country.

4.5 **“risk transfer”** refers to the shifting of risk, as with insurance or the securitization of debt.

PART II: STATEMENT OF POLICY

5. **Purpose** - This Determination is intended to ensure that banks maintain effective and ongoing country risk management systems. It is also intended to ensure that timely and appropriate provisions are made in respect of country exposure.

6. **Scope** - This Determination applies to all banks authorized and operating in Namibia.

7. **Responsibility**- The board of directors of each bank shall be responsible for developing policies and procedures and for implementing risk management programs that accurately identify, assess, measure and control exposure to country risk on solo and consolidated basis.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

8. **Types of country risks**

Country risk refers to the possibility or risk that a foreign borrower may be unable or unwilling to fulfil its foreign obligations due to country-specific conditions, which may

be underlying economic, political, social, and natural or other events and trends. A wide variety of factors may prevent borrowers from a given country from fulfilling their foreign obligations. These may include the consequences of exchange control, currency devaluation, official government actions or other socio-political changes in the borrowing country, largely unpredictable events such as natural disasters or external shocks. Unlike other forms of risk, banks can exercise little direct influence over country risk.

Banks should ensure that they have adequate systems in place and expertise to manage their cross-border exposures and avoid taking undue concentration risks on such exposures. As such banks should be aware of the different types of country risk to which they may be exposed and tailor their risk management framework accordingly.

There are six main types of country risk:

8.1 **Sovereign Risk**. The risk that a foreign government's ability and willingness to repay it's direct and guaranteed foreign currency obligations is impaired;

8.2 **Transfer Risk**. The risk that a borrower may not be able to secure foreign exchange to service its external debt due to drainage in the country's foreign currency reserves;

8.3 **Contagion Risk**. Adverse developments in one country leads to a ratings downgrade or a credit squeeze for other countries in the region, notwithstanding that those countries may be more creditworthy and that the adverse developments do not apply to them;

8.4 **Currency Risk**. The risk that a borrower's domestic currency holdings and cash flow become inadequate to service its foreign currency obligations because of devaluation;

8.5 **Macro-economic Risk.** The risk that the borrower in a country may, for example, suffer from the impact of high interest rates due to measures taken by the government of that country to defend its currency; and

8.6 **Indirect Country Risk**. The risk that a domestic borrower's ability to repay a loan is compromised by the deterioration of the economic, social, or political conditions in a foreign country where the borrower has substantial business interests. Governments may also decide to nationalize or expropriate foreign assets.

9. COUNTRY RISK MANAGEMENT PROCESS

9.1 Board of Directors and Senior Management oversight

Effective oversight by a bank's board of directors is critical to a sound country risk management process. The board of directors shall be responsible for periodically reviewing and approving policies governing the bank's cross-border activities to ensure that they are consistent with the bank's existing risk framework and overall strategic plans and goals. The board shall also be responsible for reviewing and approving limits on country exposures and ensuring that management is effectively controlling the risk. When evaluating the adequacy of the bank's capital and provisioning, the board should take into account the volume of cross-border exposures and the ratings of the countries to which the institution is exposed. Furthermore, the board should ensure that the bank adheres to this Determination.

9.2 Policy and Procedures

9.2.1 Banks should have a clearly defined policy, documented in writing and approved by the board of directors for country risk management. This policy may be subsidiary to, or should form part of, a bank's overall credit policy.

9.2.2 The details to be included in the policy, and any procedures drawn up in respect of them, depend on the nature and scope of a bank's cross-border activities.Generally, they should set out the bank's business strategy in cross-border countries, the parameters under which such business is carried out, its risk appetite and risk tolerances in the light of available financial resources, staff skills and systems for country risk identification, measurement, monitoring, reporting and provisioning.

9.2.3 The policy and any corresponding procedures should normally include, but is not limited to the following:

i) clear lines of authority (including approval of cross-border lending and exceptions), responsibility and accountability for country risk management;

ii) types of country risk which the bank may face (see subsection 8 above) and the policies and procedures for managing them;

iii) the overall limits and sub-limits for cross-border exposures;

iv) the standards and criteria which the bank will use to analyse the risk of particular countries;

v) the internal country rating system or how the country risk elements are factored into the bank's exising loan classification system;

vi) the method to be use in measuring country risk exposures; the country risk provisioning policy and methodology;

vii) types of and criteria for acceptable collateral and guarantees for the mitigation of country risk;

viii) lists of designated lawyers for evaluating the legitimacy of documentation and perfection of collateral;

ix) procedures for dealing with deteriorating situations in a country, with clear contingency plans and exit strategies; and

x) types of management reports on country risks in line with this Determination

xi) authorized activities, investments and instruments

xii) desirable and undesirable activities.

9.3 Policy review

The board of directors shall cause a review of the policy to be made at least annually to determine if it is still appropriate for the bank's business and compatible with changing

market conditions. Reports of such reviews shall be made on a timely basis directly to the board of directors.

9.4 Lending Principles

9.4.1 Banks should ensure that facilities granted to cross-border borrowers are subject to the prudent credit granting criteria that shall not be less strict than those applicable to domestic exposures.

9.4.2 There are many ways in which exposures can become related to countries and thus create risk concentrations. Banks should therefore ascertain the identity and the ultimate ownership of the borrowers, regardless of their place of incorporation and the complexity of their group structure. Banks shall obtain written evidence or confirmation from relevant parties of the identity of borrowers and their shareholder structure in name and percentage terms.

9.4.3 Credit should only be granted to creditworthy borrowers and due diligence should be carried out. Banks should not simply lend on the basis of the name or official status of a borrower or rely on any implicit governmental guarantee. Banks should satisfy themselves that the borrowers have sufficient assets or income streams to service their foreign currency obligations.

9.4.4 Banks should not grant facilities to a particular economic sector purely based on government direction or benefits provided by the government such as tax concessions. Banks should place greater weight on borrowers' repayment ability and the risks of and return from each transaction.

9.4.5 As with all lending, banks lending to cross-border entities should verify what the funds are being used for and assure themselves that the proceeds are not being diverted to speculative investments. Where funds are being used for a project, banks should satisfy themselves that funds are not used for purposes other than financing the project. Frequent site visits and drawing by installments can help to prevent the misapplication of funds.

9.4.6 Before accepting collateral covering cross-border exposures, banks shall ensure that such collateral is enforceable. As such, for the purpose of this determination the eligible collateral that banks should consider is (a) Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposit with the bank which is incurring the counterparty exposure, (b) Gold, (c) Debt securities rated by a recognised external credit assessment institution where these are either: at least BB- when issued or guaranteed by sovereigns or PSEs that are treated as sovereigns by the national supervisor; or at least BBB- when issued by other entities (including banks and securities firms); or at least A-3/P-3 for short-term debt instruments and (d) Debt securities not rated by a recognised external credit assessment institution where these are: issued by a bank; and listed on a stock exchange (refer to paragraph 20).

10. Staffing and organization

10.1 Banks should dedicate adequate resources to the country risk management process, taking into account the extent of their involvement in cross-border business.

10.2 Banks should ensure that their internal control systems for country risk management are adequate and the staffs responsible for the function are competent and equipped with the necessary knowledge and skills to undertake their duties.

10.3 The staff concerned should familiarise themselves with the financial and monetary system and legal and regulatory framework of those countries (or different regions/provinces of a country if there is a lack of uniformity in laws and regulations among them) to which a bank has an exposure and should seek independent professional advice where appropriate.

10.4 Country risk should preferably be managed on a centralized basis and integrated with a bank's overall credit risk management. Responsibility for country risk may be assigned either to a senior executive or to an appropriate committee.

10.5 Irrespective of the structure adopted, the functions of analysing country risk, setting limits and monitoring the bank's cross-border exposures should be carried out by persons independent of the business development function.

11. Country Risk Analysis

Although the nature of the country risk analysis process and the level of resources devoted to it will vary from bank to bank, depending on the size and sophistication of its cross-border operations, when coming up with country risk analysis, the following should be taken into account:

11.1 Banks with cross-border operations should have robust systems for monitoring economic, social and political developments in the countries to which they have exposure. In assessing the risk of a country, banks should consider both quantitative and qualitative factors of that country.

11.2 In developing quantitative assessments of the risk of a country, banks may take into account the size and maturity profile of a country's external borrowing as well as its macro-economic variables (including forecasts), fiscal, monetary, exchange rate and financial sector policies and other relevant statistics.

11.3 Factors typically used in qualitative assessments of country risk include the quality of the policy-making function, social and political stability and the legal and regulatory environment of the country. In particular, banks should have regard to the country's compliance with international standards and codes, e.g. the 12 key standards and codes[1] for sound financial systems highlighted by the Financial Stability Forum. These standards and codes are broadly accepted as representing minimum requirements for good practice. Banks should give special attention to business dealings and transactions with counterparties from countries that do not sufficiently comply with international standards, e.g. those on the list of "Non-Cooperative Countries/Territories" published by the Financial Action Task Force on Money Laundering ("FATF") from time to time.

[1]The key standards and codes cover a range of areas including macroeconomic policy and data transparency, institutional and market infrastructure and financial regulation and supervision. Information on individual key standards is available from the Financial Stability Forum or relevant standard-setting bodies (See Annex A)

11.4 Banks should be aware of the impact of changes in governmental strategy and policies. This is particularly important if banks have substantial credit exposures to a particular business sector or region in a country. The reduction or withdrawal of governmental support for a sector or region or changes in governmental policies may severely weaken the repayment ability of borrowers in that sector or region. Banks should therefore keep abreast of economic policy in the countries in which they do business so as to identify the right sectors for business development, to avoid those which are out of favour and to adjust their country business strategies in an appropriate and timely fashion.

11.5 In times of instability and impending crisis, banks should consider taking appropriate actions, such as updating their analyses more frequently and expanding the scope of their country risk analysis.

11.6 Banks should maintain formal country risk analysis files. These files should be centralised at head office, with supplemental files in branches or subsidiaries.

11.7 Country risk analysis files should include but is not limited to:

a) analyses of political, economic and social issues of the country concerned;

b) situation reports submitted by country managers and credit officers;

c) reports from visits to the country concerned;

d) reports from outside economic research services and rating agencies;

e) published economic data and analysis; and

f) copies of documentation approving limits and exceptions to such limits.

11.8 The results of country risk analysis should be integrated closely with the process of formulating marketing strategies, approving credits, assigning country ratings, setting country exposure limits and provisioning.

12. Country Risk Ratings

12.1 Country risk ratings summarize the conclusions of the country risk analysis process. The ratings are an important component of country risk management because they provide a framework for establishing country exposure limits that reflect the bank's tolerance for risk. Therefore, banks should have a system in place to integrate the results of their country risk analysis into their internal ratings of borrowers.

12.2 Banks that have cross-border exposures or operations should develop detailed written procedures for analyzing, recommending and approving country credit risk ratings. The sophistication of such systems should be consistent with the size and complexity of a bank's cross-border exposures and operations.

When developing country risk rating systems, banks should consider the following key issues below:

i) Country risk ratings should be assigned at least annually to every country where banks have substantial exposures. Banks should conduct an interim review of such ratings whenever a potential change occurs in the economic, political and social conditions of a particular country;

ii) Banks should not solely rely on ratings assigned by external rating agencies but they may have regard to these ratings in forming their own assessment and for validating, on a regular basis, the effectiveness of their existing system. In this regard, an independent unit (e.g. an economics department) or committee within the bank should assign country risk ratings. Such ratings should reflect the results of their country risk analysis;

iii) Banks should clearly define their country risk rating categories (e.g. numerical or alphabetical) and the characteristics and coverage (e.g. types of country risk included and types of exposure covered) of each rating category under their rating framework;

iv) Banks should integrate the country risk rating system with their loan classification framework. For example, if a bank assigns an unfavourable rating to a country, it may need to downgrade all its exposures relating to that country to “special mention” or below under the loan classification system. However, in such a case, banks should also consider reducing their country exposure limits to that specific country; and

v) Banks should also use their country risk rating system to determine the appropriate level of provisioning.

13. Country Exposure Limits

13.1 As part of their country risk management process, banks should have a system for establishing, maintaining and reviewing country exposure limits. Country exposure limits should be approved annually and revised during the year in response to substantive changes in a country’s risk profile.

13.2 Country exposure limits should be set based on prudential grounds. They should not be viewed as business targets to be met. To ensure objectivity, banks should maintain a clear division of responsibility by separating the business development functions from the limit setting and monitoring function.

13.3 Banks should ensure that the limits set for their cross-border lending are compatible with their overall strategic goals and that they have the requisite resources to administer lending levels at the targets set. For exposures in excess of 30 percent of capital funds, the requirements of BID-4 shall be observed.

13.4 Banks should set exposure limits for individual countries and geographical regions to manage and monitor country risk. Country exposure limits should apply to all on- and off-balance sheet exposures to foreign obligors.

13.5 Banks should consider whether their cross-border operations are such that they should supplement their aggregate exposure limits with more discrete

controls such as limits on the different lines of business in the country, limits by type of counterparty, or limits by type or tenor of exposure.

14. Country Exposure Measurement

Systems for measuring country exposures need to be tailored to the size and complexity of individual banks' cross-border lending and investing operations. There is no single method of measuring exposure which is appropriate for all banks. However, as a general principle, banks should ensure that the system is comprehensive enough to capture all significant exposures and detailed enough to permit adequate analysis of different types of risk. To achieve this, banks' measurement systems, as a minimum, should:

a) be capable of making two separate calculations of their country exposure, with and without risk transfer;

b) measure country exposure on both a solo and a consolidated basis;

c) be able to measure different types of exposures (e.g. foreign exchange and interest rate contracts); and

d) provide a sufficient breakdown (e.g. by type of borrower, exposure, collateral, residual maturity, etc.) for analysis by country.

Like the requirements in BID-2, exposure should take account of outstanding balances and undrawn commitments.

15. Monitoring

15.1 As part of the credit monitoring process banks should have a system in place to monitor their compliance with country exposure limits. Exceptions should be reported, approved and rectified as laid down in the country risk management policy.

15.2 Banks should perform periodic credit reviews and monitoring of their cross-border exposures to identify unusual developments and, if appropriate, initiate necessary actions to protect their interests.

15.3 Banks should have an effective system in place to generate management reports which are detailed enough for the senior management review and to identify exceptions in a timely manner.

16. Country Risk Reporting

16.1 Each bank must have a reliable system for capturing and categorizing the volume and nature of cross-border exposures. The reporting system should cover all aspects of the bank's operations, whether conducted through paper transactions or electronically.

16.2 The board of directors should regularly receive reports on the level of cross-border exposures. If the level of cross-border exposures in an institution is significant or if a country to which the bank is exposed is considered to be high risk, exposures should be reported to the board at least quarterly. More frequent reporting is appropriate when deterioration in cross-border exposures would threaten the bank's financial soundness.

17. Stress Testing

Banks should periodically conduct stress-testing analysis of their cross-border exposures and report the results to the board of directors. As used here, stress-testing does not necessarily refer to the use of sophisticated financial modelling tools, but rather to the need for banks to evaluate in some way the potential impact of different scenarios on their country risk exposures. The level of resources devoted to this effort should be commensurate with the significance of cross-border exposures in the bank's overall operations.

18. Internal Controls and Audit

Banks should ensure that their country risk management process includes adequate internal controls, and that there is an audit mechanism to ensure the integrity of the information used by senior management and the board to monitor compliance with country risk policies and exposure limits. The system of internal controls should, for example, ensure that responsibilities of marketing and lending personnel are properly segregated from the responsibilities of personnel who analyze and rate country risk, and set country limits.

19. Country Risk Provisioning

19.1 Country risk provisions are set aside to absorb potential losses arising from exposure to country risk. Banks may decide to assign provisions by either:

(a) reflecting country risk provisions earmarked against their aggregate exposure to a particular country after accounting for risk transfer and specific provision made against credit risk (i.e. on a country basis); or

(b) factoring in an element of provision for country risk into specific provisioning for each individual exposure (i.e. on an individual obligor basis).

19.2 Regardless of the approach banks adopt, they should ensure that they have adequate country risk provisions for their assessment of the probability of losses arising from their cross-border exposures.

19.3 Banks may not, however, need to make additional provisions solely for country risk if they are satisfied that the current level of specific and general provisions is already sufficient to absorb any potential losses due to both credit and country risks. In light of this, it is important that the risk management policy specifies criteria for when to provide and how to calculate country risk provisions.

19.4 Banks should adopt a rigorous process for determining the appropriate level of provisions for country risk. The process should be documented in the provisioning policy and should be approved by the Board of Directors, the Credit Committee or senior management with delegated authority.

19.5 Generally, there are three stages in the process of deciding an appropriate level of provision:

a) identifying countries with current or potential repayment difficulties;

b) analysing the nature of those difficulties and the extent of the country's problems; and

c) determining what proportion of exposures to that country is unlikely to be repaid in full.

19.6 The policy should specify criteria for when to provide and how to calculate country risk provisions. It should also clearly indicate which party has the authority to decide the level of country risk provision.

19.7 The policy should also describe the accounting policy adopted for recording and disclosing such provisions in the accounts. That policy should be applied consistently.

19.8 Any country risk provisions made should be justifiable and properly approved and documented by senior management with delegated authority.

20. Acceptance Criteria for Collateral and Guarantees

Banks should ensure that assets accepted as collateral and guarantees to be accepted should at the minimum satisfy the following criteria:

20.1 Collateral

i) the collateral should cover the total exposure to customers of the country concerned after risk transfer;

ii) the market value of the asset is readily determinable or can be reasonably established and verified;

iii) the asset is marketable and there exists a readily available secondary market for disposing of the asset;

iv) the bank's right to repossess the asset is legally enforceable and without impediment;

v) the bank is able to secure control over the asset if necessary;

vi) the collateral accepted should be such that, in the event of default, a subsequent realization of the collateral in the market, would be able to recover the bank's claim.

20.2 Guarantees

20.2.1 For the purpose of credit risk mitigation, banks should ensure that guarantees accepted fulfil the following criteria:

i) the guarantee should represent a direct claim on the guarantor;

ii) the guarantee should be unconditional and irrevocable;

iii) the guarantee should be properly documented and legally enforceable;

iv) the guarantee should remain continuously effective until the facility covered by the guarantee is fully repaid or settled; and

v) the financial strength of the guarantor should be thoroughly assessed and considered as adequate for discharging the obligation under the guarantee.

20.2.2 The creditworthiness of a guarantor should not be linked to or affected by the financial position of the borrower.

20.2.3 Where a bank has accepted a guarantee, the financial strength of the guarantor should be reviewed where appropriate, to ensure that the guarantee remains valid for credit risk mitigation.

21. Disclosure in Annual Financial Statements

In submitting annual financial accounts to the Bank, banks with cross-border exposures shall disclose such exposures separately with an appropriate heading. Further, banks should also disclose whether such loans are secured or unsecured by collateral or guarantee.

22. Non-conforming

(a) If a bank does not meet the minimum requirements for country risk management as set forth in this Determination, then such a bank will be treated as ‘non-conforming’.

(b) If a bank becomes ‘non-conforming’ as described in (a) above, then the board and management of such a bank shall take all reasonable efforts to promptly bring it into compliance otherwise not doing so would be inconsistent with safe and sound banking practices.

23. Reporting Requirement

The bank shall, at the end of each calendar quarter submit to the Bank returns in terms of this Determination in the format, frequency and submission date as specified by the Bank.

PART IV: CORRECTIVE MEASURES

24. **Remedial measures** - if a bank fails to comply with this Determination, then the Bank may pursue any remedial measures as provided under the Act or any other measures the Bank may deem appropriate in the interest of prudent banking practice.

PART V: EFFECTIVE DATE

25. Effective date - The effective date of this Determination shall be 1st June 2007.

Questions relating to this Determination should be addressed to the Director, Banking Supervision Department, Bank of Namibia, Tel: 283 5040.

ANNEX A

Key standards for sound financial systems

The 12 standard areas highlighted here have been designated by the FSF as key for sound financial systems and deserving of priority implementation depending on country circumstances. While the key standards vary in terms of their degree of international endorsement, they are broadly accepted as representing minimum requirements for good practice. Some of the key standards are relevant for more than one policy area, e.g. sections of the Code of Good Practices on Transparency in Monetary and Financial Policies have relevance for aspects of payment and settlement as well as financial regulation and supervision.

Area	Standard	Issuing Body
	Macro-economic Policy and Data Transparency	
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial Policies	IMF
	Code of Good Practices on Fiscal Transparency	IMF
Data dissemination	Special Data Dissemination Standard General Data Dissemination System	IMF
	Institutional and Market Infrastructure	
Insolvency		World Bank
Corporate governance	Principles of Corporate Governance	OECD
Accounting	International Accounting Standards (IAA)	IASB
Auditing	International on Auditing (ISA)	IFAC
Payment and settlement	Core Principles for Systemically Important Payment Systems Recommendations for Securities Settlement Systems	CPSS/IOSCO
Market integrity	The Forty Recommendations of the Financial Action Task Force/ 9 Special Recommendations Against Terrorist Financing	FATF
	Financial Regulation and Supervision	
Banking supervision	Core Principles for Effective Banking Supervision	BCBS
Securities regulation	Objectives and Principles of Securities Regulation	IOSCO
Insurance supervision	Insurance Core Principles	IAIS

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