

**Proposed Amendment to Prudential Regulation 2017**

<b>Current provision of PR 2017/Provisions in Directives</b>	<b>Proposed Amendment</b>
<p><b>Section 1; Capital Adequacy Requirement</b></p> <p><b>150 Percent Risk- Weighted Assets</b> Loans and overdrafts to counterparties, that are overdue by 91 days and more, (net of specific provisions and interest in suspense)</p>	<p><b>Risk-Weighted Assets for NPLs</b> The department proposed to reduce risk weight for NPL from 150% to 100% in line with the issued directive of March 2022</p>
<p><b>Section 2; Related party transactions</b> 2.2 Definition of related party; 2.2.1 For the purpose of these regulations, any natural or legal person is considered to be a related party if that person has a relationship with a financial institution, and includes the following:</p> <ul style="list-style-type: none"> <li>(a) significant owner</li> <li>(b) a member of the Board of Directors;</li> <li>(c) employees of the financial institution;</li> <li>(d) spouse and economically dependent children of persons specified in (a) if it is a natural person and (b);</li> <li>(e) spouse and economically dependent children of persons specified in (c);</li> <li>(f) any individual for whom a director or significant owner is a guarantor;</li> <li>(g) any individual for whom an employee is a guarantor; (To be deleted)</li> <li>(h) any firm or company in which a significant owner or director has an interest as partner, or has a direct or indirect equity interest equal to or exceeding 10 percent of the paid-up equity capital;</li> <li>(i) any firm or company in which an employee has an</li> </ul>	<p><b>Section 2; Related party transactions</b> The department proposed to edit the definition of related party as follow;</p> <p>For the purpose of these regulations, any natural or legal person is considered to be a related party if that person has a relationship with a financial institution, and includes the following:</p> <ul style="list-style-type: none"> <li>a. significant owner</li> <li>b. a member of the Board of Directors;</li> <li>c. Key Responsible Person of Financial Institution (excluding board of directors)</li> <li>d. spouse and economically dependent children of persons specified in (a) if it is a natural person and (b);</li> <li>e. spouse and economically dependent children of persons specified in (c);</li> <li>f. any individual for whom a director or significant owner is a guarantor;</li> <li>g. any firm or company in which a significant owner or director has an interest as partner, or has a direct or indirect equity interest equal to or exceeding 10 percent of the paid-up</li> </ul>

<p>interest as partner, or has a direct or indirect equity interest equal to or exceeding 10 percent of the paid-up equity capital;</p> <p>(j) parent/holding company of a financial institution;</p> <p>(k) subsidiary of the parent/holding company specified in</p> <p>(l) companies in which the parent/holding company specified in (j) has a direct or indirect equity interest equal to or exceeding 10 percent;</p> <p>(m) subsidiary or associate company, fellow subsidiary or affiliate of the financial institution;</p> <p>(n) another financial institution with cross-shareholding in, or a high degree of influence over the financial institution;</p> <p>Reporting of the related party transaction; In the context of this regulation, related party transactions shall be reported to the RMA as per the format prescribed by RMA. The report shall contain details of all loans, including overdraft facilities and other extensions of credit.</p>	<p>equity capital;</p> <p>h. any firm or company in which an employee has an interest as partner, or has a direct or indirect equity interest equal to or exceeding 10 percent of the paid-up equity capital;</p> <p>i. parent/holding company of a financial institution;</p> <p>j. subsidiary of the parent/holding company specified in</p> <p>k. companies in which the parent/holding company specified in (j) has a direct or indirect equity interest equal to or exceeding 10 percent;</p> <p>l. subsidiary or associate company, fellow subsidiary or affiliate of the financial institution;</p> <p>m. another financial institution with cross-shareholding in, or a high degree of influence over the financial institution;</p> <p>Reporting of the related party transaction; In the context of this regulation, related party transactions shall be reported to the RMA as per the format prescribed by Authority through an independent review process. The report shall contain details of all loans, including overdraft facilities and other extensions of credit.</p>
<p><b>Section 3; Single Largest borrower</b></p> <p>The RMA hereby issues the following regulation to the financial institutions on maximum amount of credit exposure including off-balance sheet exposures as may be made by</p>	<p>The department proposed to amend the provision in line with the issued directive of August 2022. The main objective is to provide relaxation of the SLB limit</p>

financial institutions:

(i) to an individual or to any single company, firm; or

(ii) In aggregate to:

(a) an individual, his/her spouse and economically dependent children and a company or a firm in which individual, his/her spouse, economically dependent children has a shareholding of more than 50 percent; or

(b) a company and one or more of

the following: (aa) its

subsidiaries;

(bb) its holding company;

(cc) its associate company;

(dd) a subsidiary of its holding company; or

(ee) a company in which such company or its subsidiary, or its holding company, or a subsidiary of its holding company, has a direct or indirect equity interest equal to or exceeding 10 percent of the

paid-up equity capital.

based on the determination of "connected" on the basis of control and economic interdependence.

Two or more natural or legal persons shall be deemed a group of connected counterparties if at least one of the following criteria is satisfied.

(a) Control relationship: one of the counterparties has control over the other(s) whether directly or indirectly, through shareholding, shared management or directorship;

(b) Economic interdependence: if one of the counterparties were to experience financial problems, in particular funding or repayment difficulties, the other(s), as a result, would also be likely to encounter funding or repayment difficulties

(a) Determination of "connected" on the basis of control

In assessing whether there is a control relationship between counterparties, financial institutions must automatically consider that this criterion is satisfied if one entity owns more than 10% significant owner as per Financial Services Act) of the shareholding of the other entity.

When the percentage of shareholding falls below 10%, financial institutions must assess connectedness between counterparties based on control using the following criteria:

- i. is able to appoint or remove the majority of board of directors or management of the other;
- ii. is able to cast the majority of votes at meetings of the board, general meeting or equivalent governing body of the other;
- iii. is able to direct the activities of the other so as to obtain benefits from its activities;
- iv. Commonality of ownership and management

(b) Determination of “connected” on the basis of economic interdependence

In establishing connectedness based on economic interdependence, financial institutions must consider, at a minimum, the following criteria:

- i. having the same expected source of repayments;
- ii. an individual, his/her spouse and economically dependent children;
- iii. Where one counterparty has fully or partly guaranteed the exposure of the other counterparty;
- iv. where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparty in terms of full and timely repayment of liabilities;
- v. Where the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other.

Where persons are connected by virtue of a control relationship, financial institutions may disaggregate its exposures to such connected person from the computation of the large exposure limit if the following criteria are met:

- (i) a large exposure or such connected person has sufficient financial resources of its own to obtain credit facilities and to fully service its liabilities; and
- (ii) a large exposure or such connected person is not relied upon to support the liabilities of the other or other persons connected to the counterparty out of its financial resources.

1.2 Exposures to connected persons that are disaggregated shall be treated separately by the financial institutions in computing an exposure to that connected person and be regarded as a separate single borrower. Financial institutions need to demonstrate to the RMA that such control relationship does not necessarily result in the counterparties concerned constituting a group of connected counterparties.

1.3 Financial institutions must document the assessments to support such disaggregation. The documentation must be accessible at all times to the internal control and risk management functions at all times.

Reporting; In the event of a breach to the single borrower limit, financial institutions shall

	<p>immediately notify the Authority within one week from the date of such breach.</p>																		
<p><b>Section 4; Regulation on Asset Classification and Provisioning;</b>  4.8.1, Provisioning requirement; Financial institutions shall allocate provisions as a percentage of the principal amount of each risk exposure as follows:-</p> <table border="0"> <thead> <tr> <th></th> <th style="text-align: left;"><u>Category</u></th> <th style="text-align: left;"><u>Provisioning Requirement</u></th> </tr> </thead> <tbody> <tr> <td>i.</td> <td>Standard</td> <td>- 1 percent;</td> </tr> <tr> <td>ii.</td> <td>Watch</td> <td>- 1.5 percent;</td> </tr> <tr> <td>iii.</td> <td>Substandard</td> <td>- 20 percent; <b>30 percent for Sector with highest exposure</b></td> </tr> <tr> <td>iv.</td> <td>Doubtful</td> <td>- 50 percent; <b>60 percent for Sector with highest exposure</b></td> </tr> <tr> <td>v.</td> <td>Loss/litigation/suspended</td> <td>- 100 percent.</td> </tr> </tbody> </table> <p>Section 4.3.2; Where a financial institution has more than one exposure to a single borrower under various account titles, if one or more of the accounts should experience repayment problems and the outstanding loan amount of these problematic accounts are equal to or more than 50 percent of the total exposure, then the <b>total exposure</b> shall be classified into the <b>classification category</b> with the highest risk level exposure. If the total outstanding amount of the NPL accounts is less than 50 percent of the total exposure, then under such a situation, the non-defaulting accounts may be classified</p>		<u>Category</u>	<u>Provisioning Requirement</u>	i.	Standard	- 1 percent;	ii.	Watch	- 1.5 percent;	iii.	Substandard	- 20 percent; <b>30 percent for Sector with highest exposure</b>	iv.	Doubtful	- 50 percent; <b>60 percent for Sector with highest exposure</b>	v.	Loss/litigation/suspended	- 100 percent.	<p>Based on the FIAB concerned, relaxation on <b>Section 4.8.1 of PR 2017 i.e</b> additional provision of 10% on the highest sector in the sub-standard and doubtful category was waived of as per the directive of September 2023.</p> <p>New provision to add on ECL Provisioning; Provisioning shall be done based on ECL provisioning as required under Bhutanese Financial Reporting Standard (BFRS – 9)”</p> <p>The department proposed to edit the provision as;  Where a financial institution has more than one exposure to a single borrower under various account titles, if one or more of the accounts should experience repayment problems and the outstanding loan amount of these problematic accounts are equal to or more than 50 percent of the total exposure; <b>then the provisioning rate on the total exposure shall be based on the rate of highest risk classification. However, if the total outstanding amount of the NPL</b></p>
	<u>Category</u>	<u>Provisioning Requirement</u>																	
i.	Standard	- 1 percent;																	
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<p>where they need to be categorized based on the circumstances of each account. <b>However, if all accounts are NPL, the outstanding NPL amount shall be classified into the classification category with the highest risk level exposure.</b></p> <p>4.7.4. General and Specific Provisions for loan losses shall also be allocated to cover classifications of contingent liabilities recorded as off-balance-sheet items</p>	<p><b>accounts is less than 50 percent of the total exposure, then the loan classification shall be based on the actual category.</b></p> <p>The department proposed to add new provision for requirements for OBS items since the current PR has no provision</p> <ul style="list-style-type: none"> <li>✓ Provision for OBS items shall be 1 percent</li> <li>✓ Provision rate for off-balance sheet items that are revoked and restructured into loans shall be 100 percent.</li> </ul>
<p><b>Granting of new loan for a non-performing account</b></p> <p><b>Observation period;</b> The regulated entity shall adhere to the following:</p> <ol style="list-style-type: none"> <li>a. If a NPL account is closed through court proceedings/foreclosure, the borrower or transfer of the remaining loan outstanding to another borrower, the borrower/loan transferor shall be subject to 6 months observation period;</li> <li>b. NPL under the doubtful and loss category that have become performing through repayment made by the borrower shall subject to 6 months observation period.</li> </ol>	<p>The department proposed to amend the provisions in line with the issued directive of September 2023;</p> <p><b>Curing period;</b> The regulated entity shall adhere to the following:</p> <ol style="list-style-type: none"> <li>a. If a NPL account is closed through court proceedings/foreclosure, the borrower or transfer of the remaining loan outstanding to another borrower, the borrower/loan transferor shall be subject to 6 months observation period;</li> <li>b. NPL under the doubtful and loss category that</li> </ol>

c. NPL under the substandard category that have become performing through repayment made by the borrower shall be subject to 3-month observation period.

Other requirement;

- i. No new bank guarantees, letter of credit and other OBS item shall be granted to the NPL borrower that are placed under observation period, however, existing bank guarantees or letter of credit that have already been issued may be renewed for the completion of the ongoing project
- ii. Renewal of overdraft/working capital may be granted by FIs but credit facilities should be renewed within 90 days (including the past overdue before expiry of the loan) from the date of expiry of the facilities.
- iii. During the observation period, no borrower shall be allowed to **withdraw the undrawn amount** of the overdraft/working capital from sanctioned amount
- iv. Classification of NPLs placed under **observation** shall be as per its respective loan classification buckets
- v. Financial institutions must have in place process for monitoring and reporting of loan classification under **6 months observation period**
- vi. Independent reviews/audit shall be conducted monthly by the control functions of the financial institution to ensure compliance to said directive, quarterly data shall be submitted to **RMA** as per prescribe format

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Other requirement;

- vii. No new bank guarantees, letter of credit and other OBS item shall be granted to the NPL borrower that are placed under observation period, however, existing bank guarantees or letter of credit that have already been issued may be renewed for the completion of the ongoing project
- viii. Renewal of overdraft/working capital may be granted by FIs but credit facilities should be renewed within 90 days (including the past overdue before expiry of the loan) from the date of expiry of the facilities.
- ix. During the **curing** period, no borrower shall be allowed to **withdraw the undrawn amount** of the overdraft/working capital from sanctioned amount
- x. Classification of NPLs placed under **curing** shall be as per its respective loan classification buckets
- xi. Financial institutions must have in place process for monitoring and reporting of loan classification under **curing period** period



	<p>xii. Independent reviews/audit shall be conducted monthly by the control functions of the financial institution to ensure compliance to said directive, quarterly data shall be submitted to Authority as per prescribe format</p>
<p>Section 7; Regulation on borrowers information, credit files shall also include;</p> <ul style="list-style-type: none"> <li>A) loan application and all authorized approvals;</li> <li>(b) appraisal of project as well as collateral, memoranda and correspondences;</li> <li>(c) loan agreements;</li> <li>(d) certificates of insurance;</li> <li>(e) collateral-inspection documents;</li> <li>(f) credit reports &amp; annual credit analyses;</li> <li>(g) restructuring, rescheduling and renewal documentation;</li> <li>(h) past loan applications;</li> <li>(i) all updated financial statements;</li> <li>(j) rental information for income-producing real estate credits;</li> <li>(k) in the case of term loans, i.e., loans maturing after one year, cash flow projections updated annually during and for the life of the loan;</li> <li>(l) valid identity card copy and passport-size photo;</li> <li>(m) valid license/registration certificates;</li> <li>(n) ownership certificate of land, vehicle or other collateral, and;</li> <li>(o) hypothecation of mortgage deed, signed by borrower and financial institution.</li> </ul>	<p>The department proposed to include either of the options as detail below;</p> <p>Credit File shall include:</p> <ul style="list-style-type: none"> <li>a. Application Documents</li> <li>b. Appraisal and Approval Documents</li> <li>c. Consummation Documents</li> <li>d. Perfection Documents</li> <li>e. Formation Documents</li> <li>f. Insurance Documents</li> <li>g. Customer Financial Documents</li> <li>h. Collateral Documents</li> <li>i. Credit Information</li> </ul>

**Or**

**Retail loan**

- A) loan application
- B) Valid CID
- C) CIB report of borrower
- D) Construction approval for housing
- E) Civil drawing and estimates for housing
- F) Department undertaking for GE, EIS
- G) Ownership certificate- Security (where applicable)
- H) Proof of Income- Pay slip/ rental
- I) Vehicle quotation from authorized dealer for vehicle loan
- J) NoC from members for family / joint ownership
- K) Loan sanctioned note/Approved note sheet
- L) Loan agreement
- M) Security agreement (where applicable)
- N) Copy of LMS/CRST charges (where applicable)
- O) Copy of insurance (where applicable)
- P) Any other documents to mitigate the credit risk

**Corporate/business loan**

- A) KYC
- B) loan application
- C) Valid trade license
- D) CIB report of borrower
- E) CIB reports of guarantor

- F) Article of Incorporation for limited company
- G) Board's resolution for limited company
- H) Project proposal for project financing
- I) Project approval from Department of Industry for project financing
- J) Ownership certificate- Security
- K) Valuation of security
- L) BIT/audited financials for past 3 years-existing business/company
- M) Financial projection for new business/company
- N) Tax clearance for existing business/company
- O) Quotation of capital assets for term loan for set up
- P) Quotation of stocks / operational expense for working capital
- Q) Work order/Supply order for CRCS
- R) Bill routing/SI for CRCS loan
- S) NoC from members for family/joint ownership
- T) Loan sanctioned note/Approved note sheet
- U) Loan agreement
- V) Security agreement
- W) Copy of LMS/CRST charges
- X) Creation of Charges with RoC for Limited company
- Y) Copy of insurance
- Z) Any other documents to mitigate the credit risk

<p>Timeline for loan disbursement is within 3 months from the loan is sanctioned/approved as per the directive of RMA/DFRS/34/2022-2023/2934, FSPs about the requirement on the disbursement of loan in order to institute common practice in the financial system and to have consistency across all FSPs (the directive was drawn from section 51 of Rules and Regulation of loan origination and monitoring 2022</p>	<p>The department proposed not to include this directive in the revised PR, since the directive was drawn from Rules and Regulation of loan origination and monitoring 2022;</p> <p>FIs is required to conduct their due diligence</p>
<p><b>10.6 THIRD PARTY GUARANTEES</b>  While a financial institution accepts a guarantee issued by a third party for a loan, they shall ensure that the guarantor does not have any record of loan defaults with any other financial institution, and that the guarantee is fully backed by the guarantor’s unencumbered assets.</p>	<p><b>1. Guarantor</b></p> <p>The department proposed to amend the provision as per RMA’s board’s direction as detailed below;</p> <p>A guarantee is a contract to perform or discharge the liability of a third person or entity in case such person or entity defaults on the loan. The individual or entity that gives the guarantee shall be referred to as the “guarantor”.</p> <ul style="list-style-type: none"> <li>i. There are two types of guarantees, personal and corporate guarantee: <ul style="list-style-type: none"> <li>a. <b>Personal guarantee</b> is a loan guaranteed by an individual and the guarantor shall be called a personal guarantor.</li> <li>b. <b>Corporate guarantee</b> is a loan guaranteed by a corporate entity and</li> </ul> </li> </ul>

the guarantor shall be called a corporate guarantor.

- ii. The Guarantee may be provided or accepted based on the cash flow against fixed income such as salary, personal or business income, business assets, etc. of a person or an entity.
- iii. A personal guarantor is equally liable in case of default by the principal debtor. In other words, the liability of a personal guarantor shall be co-extensive with the liability of the principal debtor.
- iv. In case of default by the principal debtor, if the corporate guarantor is a:
  - a. Company, only the entity shall be equally liable and no new credit facility shall be extended by any financial institution to the entity.
  - b. Sole proprietorship or partnership, the entity and its owner/ owners shall be equally liable and no new credit facility shall be extended by any financial institution to the entity.

## **2. Mortgagor**

- i. Mortgage means any charge on any immovable/movable properties for securing money or money's worth. A registered or rightful owner of the property (whether person or entity) that provides his/its interest or right in an immovable/movable property as a security to avail a loan for oneself or for

	<p>another person or entity by entering into a security agreement is called the “mortgagor”.</p> <p>ii. The mortgagor is liable to the creditor/lender in the event the primary borrower/debtor fails to make repayment of the loan to the extent of the value of the mortgage or security.</p> <p>The mortgagor will be eligible for loans even if the primary borrower’s loan is in default and the mortgagor will not be subject to the observation period as the value of the mortgaged properties is adequate to cover the outstanding loans.</p>
<p><b>FINANCING LIMIT</b>  A financial institution shall not finance <b>more than three fourths</b> of the cost of the project, and the borrower shall be required to meet the remaining <b>one fourth</b> of the project cost from primary sources. Subject to the maximum financing limit of three fourths of project cost, a financial institution may prescribe different financing limits for different types of loans and advances depending on the appraisal of the project, and the borrower’s creditworthiness.</p>	<p>The department proposed to edit the provision as follows;</p> <p>A financial institution shall not finance <b>70%</b> of the cost of the project, and the borrower shall be required to meet the remaining <b>30% of the project</b> cost from primary sources. Subject to the maximum financing limit of <b>70%</b> of project cost, a financial institution may prescribe different financing limits for different types of loans and advances depending on the appraisal of the project, and the borrower’s creditworthiness.</p>
<p>Section 12; Regulation on establishment of branches, agencies, and other such offices financial institutions</p> <p><b>LAUNCHING OF NEW PRODUCTS</b>  A financial institution shall seek written approval from the RMA prior to the introduction of new products to the public. Further, a financial institution is required to fulfill the</p>	<p>Proposed to include provision on closure of branch, extension new products need to inform Authority  The regulated entities are required to inform about the closure of branch, extensions and new products if any to the Authority.</p>

prerequisite conditions listed below for the launching of the new products and furnish the details to RMA accordingly:

### Section 16; Reporting Requirement

#### REPORTING FORMAT AND PERIODICITY

For the purpose of off-site surveillance, the RMA requires a financial institution to submit the following reports in the formats prescribed by the RMA and as per the period indicated:

<u>Function/Purpose</u>	<u>Frequency</u>
i. Statement of Condition, Assets	Monthly
ii. Statement of Condition, Liabilities	Monthly
iii. Statement of Condition, Fixed Assets	Monthly
iv. Statement of Condition, Other Assets	Monthly
v. Statement of Condition, Other Liabilities	Monthly
vi. Income & Expenditure Statement	Monthly
vii. Foreign Currency Balances	Monthly
viii. Liquidity Return	Monthly
ix. Statement of Sectoral	
Monthly Prudential	

The department proposed to edit the provision as follow;

- ✓ the Authority requires a financial institution to submit the reports in the formats prescribed by the Authority and as per the period indicated,
- ✓ to delete the provision from ( i- xxii)
- ✓ New provision; Fraud Reporting; the financial institution is required to report within 24 hours after detecting the fraud activities in addition to the normal monthly reporting (in line with the issued directive of 27<sup>th</sup> December 2023)

Ratios	Monthly	
xi.	Monthly Data History	
	Monthly	
xii.	Classification of Loans & Advances by Sector & Repayment Status	
		Monthly
xiii.	Statement of Ten Largest Exposures & Exposures Exceeding 10% of Capital Funds	
		Monthly
xiv.	Statement of Large Loans & Advances by Sector	
		Monthly
xv.	Statement of New Loans Sanctioned During the Month	Monthly
	Loans/Overdrafts/Working Capital Advances Enhanced/Renewed During the	
	Month	
		Monthly
xvi.	Statement of Off-Balance Sheet Items	
		Monthly
xvii.	Capital Adequacy	
		Monthly
xviii.	Related/Connected Lending	



xix.	Monthly Statement of 30 Largest Non-Performing Loan Monthly Statement of 30 Largest Depositors Monthly(for banks only) xxi. Audited Annual Accounts Annually	