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NATIONAL BANK OF ETHIOPIA

## LICENSING AND SUPERVISION OF BANKING BUSINESS LARGE EXPOSURES TO COUNTERPARTY OR GROUP OF CONNECTED COUNTERPARTIES DIRECTIVE NO. SBB/87/2024

**Whereas**, it's crucial to set prudential limit that keep the maximum loss that a bank could face in the event of an unprecedented counterparty failure to a level below which the bank's financial soundness is not jeopardized;

**Whereas**, it is important to ensure that banks have adequate policies and procedures in place to promptly detect, quantify, assess, track, report, and manage or reduce risk concentrations;

**Now, therefore**, in accordance with article 22 (1) and article 66 (2) of the Banking Business Proclamation No. 592/2008 (as Amended by Proclamation No.1159/2019), the National Bank of Ethiopia has issued this Directive.

### 1. Short Title

This Directive may be cited as “Large Exposures to Counterparty or Group of Connected Counterparties Directive No. SBB/87/2024”

### 2. Definition

For the purpose of this Directive, unless the context provides otherwise:

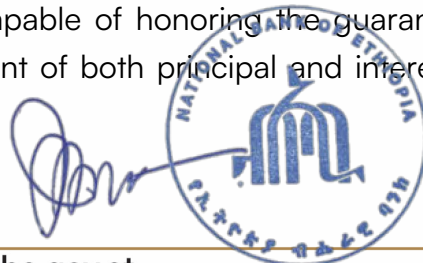
2.1 **“Bank”** means a private or state-owned entity, licensed by the National Bank to undertake banking business.

2.2 **“Cash Collateral”** means credit balances on accounts in the books of the lending bank over which customers have given the lending bank a formal letter of cession and which the bank, at its discretion, has transferred from the customer's account(s) to a specific or general cash collateral account(s) or blocked.

2.3 **“Cash-substitutes”** means:

2.3.1 a security issued by the Federal Government of Ethiopia;

2.3.2 an unconditional obligation or guarantee issued in writing by the Federal Government of Ethiopia or a domestic financial institution, where the beneficiary bank maintains a current written and well-documented evaluation evidencing the financial institution is financially sound and capable of honoring the guarantee on demand with respect to repayment of both principal and interest, or a specific





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amount, and the lending bank has not been advised of any determination by the guarantor to deny payment under the terms of the obligation or guarantee; and

- 2.3.3 an unconditional obligation or guarantee issued in writing by a foreign bank or foreign insurance company with an "A" or above rating by Standard and Poor's Corporation, Moody's Investor Services, or any other international rating company acceptable to the National Bank in their latest rating.
- 2.4 **"Counterparty"** means any natural or legal person to which a bank has exposure to.
- 2.5 **"Exposures"** means either on-balance sheet items, including loan and advance, and/or off-balance sheet items such as letters of guarantee, letter of credit, commitment by a bank to advance loans to customers.
- 2.6 **"Financial Institution"** means a bank, an insurance company, a reinsurer, a microfinance institution, a micro insurance company, payment instrument issuer, payment system operator, a capital goods finance company, a money transfer institution, a postal money transfer institution or such other similar institution as determined and licensed by the National Bank.
- 2.7 **"Group of Connected Counterparties"** means a group of counterparties with specific relationships of control or economic interdependencies, such that, if one of the counterparties were to fail, all of the counterparties would very likely fail.
- 2.8 **"Large Exposure"** means any financial assets of a bank to a counterparty or to a 'group of connected counterparties', that is equal to or above ten percent (10%) of the bank's total capital.
- 2.9 **"Loans" or "Advances"** means any financial assets of a bank arising from a direct or indirect advance such as unplanned overdrafts, participation in loan syndication or the purchase of loans from another lender, to a person that is obliged to repay the funds, either on a specified date or dates or on demand, usually with interest or through interest-free finance.
- 2.10 **"Majority-owned Subsidiary"** means a subsidiary controlled by a business entity holding over fifty percent (50%) of its capital.
- 2.11 **"Off-balance Sheet Item"** means commitment to advance loans, revocable or irrevocable documentary letters of credit, standby letters of credit, and guarantees or sureties issued on behalf of a borrower or counterparty.
- 2.12 **"National Bank"** means the National Bank of Ethiopia.
- 2.13 **"Senior Executive Officer"** means any officer of a bank who is managing two or more work units and is accountable to the chief executive officer or is directly

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reporting to the board of directors and includes positions at a level of deputy to chief executive Officer.

2.14 “**Total Capital**” shall include the paid-up capital, legal reserve and any other unencumbered reserve held by a bank and accepted by the National Bank.

### 3. Scope of Application

This Directive shall be applicable to all commercial banks licensed by the National Bank.

### 4. Exposure Limits

- 4.1 The aggregate sum of all exposures directly or indirectly held by a bank to a counterparty or a group of connected counterparties, shall at no time exceed twenty five percent (25%) of the total capital of the bank.
- 4.2 Notwithstanding the provision stated under sub-article 4.1 of this Directive, a bank shall immediately communicate to the National Bank any breaches of the limit, and promptly rectify same.
- 4.3 The National Bank, on grounds it may think sufficient, may prohibit a bank from extending any loan or advance to any person.

### 5. Exclusions

- 5.1 A bank's exposures to Federal Government of Ethiopia and National Bank shall all be exempted from the large exposure limits. This exemption shall apply also to a bank's exposures to State/Federal Government- Owned Enterprises.
- 5.2 Any portion of an exposure guaranteed by, or secured by the Government shall be similarly excluded from the scope of this Directive provided the conditions for recognition of the credit risk mitigation are met, as determined by the National Bank.
- 5.3 Intraday interbank exposures.
- 5.4 In stressed circumstances, the National Bank may accept a breach of limit during an interbank lending, after the transaction, to help ensure stability in the interbank market.

### 6. Exposure Value

For the purpose of this Directive:

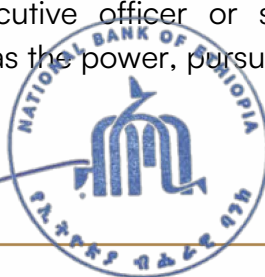


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- 6.1 a bank shall calculate the exposure value based on the book value of the exposure;
- 6.2 off-balance sheet items shall be converted into credit exposure by applying the credit conversion factors set out in the National Bank Capital Adequacy Directive; and
- 6.3 a bank, while computing the exposure value and determining compliance to the prudential limit required in this Directive, may consider and deduct cash collateral and cash substitutes.

## **7. A Group of Connected Counterparties**

- 7.1 A bank that has exposures to a group of counterparties with specific relationships or dependencies such that where one of the counterparties was to fail, all other counterparties would very likely fail, shall be treated as a single counterparty and shall be subject to the exposure limits stipulated in this Directive.
- 7.2 Two or more natural or legal persons shall be considered as a group of connected counterparties if at least one of the following criteria is satisfied:
  - 7.2.1 one of the counterparties, directly or indirectly, has control over the other(s); and
  - 7.2.2 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.
- 7.3 A bank shall assess the relationship amongst counterparties with reference to and shall establish the existence of a group of connected counterparties.
- 7.4 In assessing whether there is a control relationship between counterparties, a bank shall automatically consider that criterion is satisfied if one counterparty owns more than fifty percent (50 %) of the voting rights of the other entity.
- 7.5 A bank shall assess connectedness between counterparties based on control using the following criteria:
  - 7.5.1 voting agreements (including control of a majority of voting rights pursuant to an agreement with other shareholders);
  - 7.5.2 significant influence on the appointment or dismissal of an entity's administrative, management or supervisory body, such as the board of directors, including the right to appoint or remove a majority of those members, or the fact that a majority of members have been appointed solely as a result of the exercise of an individual entity's voting rights; and
  - 7.5.3 significant influence on chief executive officer or senior executive officers, including, when the entity has the power, pursuant to a contract





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or otherwise, to exercise a controlling influence over the management or policies of another entity including through consent rights over key decisions.

- 7.6 A bank shall refer to the criteria specified in appropriate internationally recognized accounting standards for further qualitative guidance when determining control.
- 7.7 A bank may satisfactorily demonstrate that the counterparties in question do not, because of the control, form a group of connected counterparties, even in cases where control has been created in accordance with any of these principles and secure approval from the National Bank.
- 7.8 A bank shall exercise caution while conducting transactions that attract connectivity based on economic interdependence. It shall consider, at the very least, the following qualitative factors:
- 7.8.1 where fifty percent (50%) or more of one counterparty's gross receipts or gross expenditures (on an annual basis) is derived from transactions with the other counterparty including, the owner of a residential or commercial property and the tenant who pays a significant part of the rent;
- 7.8.2 where one counterparty has fully or partly guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is so significant that the guarantor is likely to default if a claim occurs;
- 7.8.3 where a significant part of one counterparty's production or output is sold to another counterparty, which cannot easily be replaced by other customers;
- 7.8.4 when the expected source of funds to repay the loans of both counterparties is the same and neither counterparty has another independent source of income from which the loan may be serviced and fully repaid;
- 7.8.5 where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities;
- 7.8.6 where the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other(s); and
- 7.8.7 when two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found — in this case, the funding problems of one counterparty are likely to spread to another due to a one-way or two-way dependence on the same main funding source.
- 7.9 If a bank satisfactorily demonstrates to the National Bank that some of these criteria do not automatically imply an economic dependence i.e., when a

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counterparty, which is economically closely related to another counterparty may overcome financial difficulties, or even the second counterparty's default, by finding alternative business partners or funding sources within an appropriate time period, can become financially sound, the bank, after securing approval from the National Bank, may not need to combine these counterparties to form a group of connected counterparties.

7.10 There are cases where a thorough investigation of economic interdependencies will not be proportionate to the size of the exposures. In such circumstances, a bank is expected to identify possible connected counterparties on the basis of economic interdependence in all cases where the sum of all exposures to one individual counterparty exceeds five percent (5%) of total capital.

## **8. Reporting Requirement**

A bank shall submit to Banking Supervision Directorate of the National Bank reports showing month-end exposures of every single counterparty that exceeds ten percent (10%) of total capital of a bank, within twenty (20) days after the end of the period for which the data are reported. The report shall be submitted in accordance with Annex 1 attached herewith, which shall be part of this Directive.

## **9. Policies and Procedures for Monitoring Large Exposures**

9.1 The board of directors shall ensure that the bank has a board-approved policy and management has also put in place procedures governing large exposures and risk concentrations. The board shall ensure the policy is reviewed regularly and it remains adequate and appropriate. The policy shall, at a minimum, incorporate:

9.1.1 exposure limits;

9.1.2 the process for identifying, measuring, evaluating, monitoring, controlling and reporting large exposures and risk concentrations of the bank.

9.1.3 stress testing and scenario analysis of the bank's large exposures and risk concentrations to assess the impact of changes in market conditions and key risk factors including economic cycles, interest rates, liquidity conditions or other market movements on its risk profile, capital, and earnings; and

9.1.4 conduct of regular independent reviews to verify on-going compliance with the prudential limit and standards set by the National Bank.





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9.2 A bank shall ensure it has adequate processes and controls in place to monitor exposures that are exclusions as per Article 5 of this Directive. A bank shall consider how the risks arising from these types of exposures are incorporated into its risk management framework.

9.3 A bank shall have appropriate limits in place aimed at constraining its exposures to large single or connected counterparties. In setting such limits, specific considerations shall be given to the:

9.3.1 prevailing statutory and prudential limits on exposure to a single counterparty;

9.3.2 quality of the bank's processes for its management of credit concentration risk; and

9.3.3 bank's risk-taking capacity including its capital and liquidity position.

9.4 A bank shall implement processes for clearly communicating and articulating the nature and frequency of reporting to the board and senior management.

9.5 A bank shall establish and maintain adequate systems that can identify, measure, monitor and aggregate exposures to single counterparties in a timely manner.

## **10. Transition Period**

A bank which, due to the revisions made thereof, is not in compliance with the requirements of this Directive shall submit an action plan within ninety (90) days after this directive enters into force, to bring down its excess exposures according to this Directive within a maximum of three (3) years from the effective date of this Directive.

## **11. Repeal**

Credit Exposures to Single and Related Counterparties Directives No. SBB/53/2012 is hereby repealed and replaced by this Directive.

## **12. Effective Date**

This Directive shall enter into force as of 12<sup>th</sup> day of June 2024.

  
**Mamo Esmelealem Mihretu**  
Governor





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**ANNEX 1**

**Monthly Return on Large Exposures  
List of Counterparties that Exceed Ten Percent of the Bank's Total Capital  
(in millions of Birr)**

**Name of Bank:** \_\_\_\_\_  
**Reporting Month:** \_\_\_\_\_  
**Total Capital** \_\_\_\_\_

Name of Counterparty*	Type of Exposure	Sector of Exposure	Approved Limit/Facility	Exposure Amount/ Outstanding Balance (on-balance sheet) A	Off-balance Sheet Exposure Amount (e.g. guarantee) B	Maturity Date	Exposure Amount (A+B) as Percent of Total Capital	Status (classification)	Collateral	
									Type	Estimated /Face value

Note: \*Exposure to group of connected counterparties (if any) shall be listed here and same shall be treated as single counterparty for determining total exposure as percent of total capital.

\*\*Classification shall be reported in line with relevant Asset Classification and Provisioning Directive of the National Bank.

Prepared by: \_\_\_\_\_

Approved by: \_\_\_\_\_

(Name and Signature)

(Name and Signature)

Telephone: \_\_\_\_\_

Telephone: \_\_\_\_\_

