BANK OF PAPUA NEW GUINEA

SUPERANNUATION PRUDENTIAL STANDARD 4/2006

PROVISIONING FOR BAD AND DOUBTFUL DEBTS

ARRANGEMENT OF SECTIONS

PART I—PRELIMINARY

1) ***Short Title***: This standard may be cited as Superannuation Prudential Standard No. 4/2006 (Provisioning for Bad and Doubtful Debts).

2) ***Authorisation***: The Bank of Papua New Guinea, acting under Section 43 of the ***Superannuation (General Provisions) Act* 2000** and all other powers enabling it, determines this Standard.

3) ***Application***: All Authorised Superannuation Funds ("hereafter call ASFs") and relevant licence holders.

4) ***Interpretations/Definitions***: In this Standard, unless the contrary intention appears—

a. "Act" means the ***Superannuation (General Provisions) Act* 2000**, and regulations, other prudential standards, licences, authorities and other instruments made under or for the purposes of that Act.

b. **"**loans and advances**"** – means any direct or indirect advance of funds (including indirect obligations) which are made to a person (including a corporate body or agency) on the basis of an obligation to repay the funds, or which is repayable by, or on behalf of, that person or another person (or corporate body or agency).

c. "net realizable value" – means that amount after discounting collateral held as security to current market conditions and also deducting the reasonable and estimable costs of recovery and sale including but not limited to: legal fees, valuation costs, estate agent fees, insurance cover to date of sale, costs of maintenance, security, and expenses necessary to put the collateral in a saleable condition.

d. "non-accrual" – means that accrual of interest has been suspended and an asset has been placed on a cash basis for financial reporting purposes. Interest is no longer accrued on the books of the ASF nor is it taken into income unless paid by the borrower in cash. Non-accrual assets include all assets which are non-performing unless an asset is both (i) well-secured and (ii) in the process of collection.

e. "non-performing" means that an asset is no longer generating income. For purposes of this prudential standard, the entire outstanding balance of an asset is considered "non-performing" when:
- any portion of principal or interest is due and unpaid for 90 days or more; or
- interest payments for 90 days or more have been capitalized, re-financed, or rolled-over into a new loan.

f. "process of collection" means that collection of an obligation is proceeding in due course in a timely manner either through:
a) legal action, including the enforcement of a judgment against the borrower; or
b) by collection efforts not involving legal action but which are reasonably expected to result in full repayment of the debt (including principal and all accrued interest) within 90 days, or in restoration of the debt to a current status through payment of all principal and interest which is due.

g. "well-secured" – means that a loan or advance is secured by:
   a) collateral that can repay the full debt (principal plus accrued interest) through timely sale under an involuntary liquidation program; also, (i) proper legal documentation must be held, (ii) the collateral must have a "net realizable value" which covers principal, accrued interest, and costs of collection, and (iii) there can be no prior liens which prevent obtaining clear title; or
   b) a guarantee from a financially responsible party where there has been performed proper financial analysis and determined that the guarantor is financially sound, well-capitalized, and able to honour the guarantee on demand; such guarantees must be (i) irrevocable and unconditional, (ii) payable on default of the borrower, and (iii) independently confirmed by the guarantor.

PART II—STATEMENT OF POLICY

5) ***Purpose***: This Standard principally prescribes requirements for methodology for provisioning for bad and doubtful debts to promote well-reasoned, effective work out plans for problem assets and effective internal controls to manage the level of such assets particularly to ensure that:
   (i) each ASF regularly evaluates loans and advances and their recoverability;
   (ii) timely and appropriate provisions are made to accurately reflect the true condition of a balance sheet of an ASF;
   (iii) there is consistent treatment of loans and advances among ASFs; and that
   (iv) there is adequate member reporting and public disclosure across the industry.

6) ***Scope***: This Standard applies to all ASFs and relevant licence holders.

7) ***Responsibilit****y*: It is the responsibility of the board of directors of the licensed Trustee (hereafter referred to as the Trustee board of directors) and other relevant licence holders to comply with this standard.

PART III—IMPLEMENTATION AND SPECIFIC REQUIREMENTS

8) ***Loan Review***
   (a) Frequency and reporting. The Trustee board of directors shall cause a review to be made of the quality of its loan book (loans and advances) on a regular basis, at least annually as part of the annual financial reporting process. Reports of such reviews shall be made on a timely basis directly to the Trustee board of directors and shall include enough information for the Trustee board to identify problems and to correct the problems in a timely manner.

   (b) Objectives. The loan review function shall ensure that:
      (i) the loan portfolio and lending function conform to a sound, written lending policy which has been adopted and approved by the Trustee board of directors;
      (ii) executive management and the Trustee board of directors are adequately informed of risk of each loan;
      (iii) problem credits are promptly identified, classified, and placed on non-accrual in accordance with this prudential standard;
      (iv) fully adequate provisions are made to the loan loss provisions account; and
      v) write-offs of identified losses are made in a timely manner.

9) ***Suspension of Interest***

(a) Transfer to Non-Accrual Status: A loan is to be placed on a non-accrual basis if it is reasonable to conclude that:

(i) there has been a deterioration in the financial condition of the entity to which the loan was issued.

(ii) payment in full of both principal and interest is not expected within a further 90 days;

(iii) it is non-performing unless it is well-secured through contractual arrangement and in the process of collection; and

(iv) for dealings with the Government of Papua New Guinea, contractual arrangements have relevant approvals including Section 60 & 61 of the Public Finances Management Act;

(b) All interest which is accrued but is uncollected 90 days beyond due date and still carried on the books shall be written off

(c) Interest which has been taken into income and capitalised by increasing the principal amount of the loan or overdraft shall be reversed and written off from the time the loan is or should have been placed in non-accrual status.

10) ***Classification of Principal Amounts in Arrears***

a) Any asset or loan which repayment is in past due 90 days or more but less than 180 days shall be classified as “Substandard” at a minimum.

b) Any asset or loan which repayment is in past due 180 days or more but less than 365 days shall be classified as “doubtful”.

c) Any asset or loan which is in repayment past due 360 days shall be classified as “Loss**”**

11) ***Provisioning Requirements***

The following minimum provisioning requirements are to be maintained:

i)	For loans graded “substandard”	25%
ii)	For Loans graded “doubtful”	50%
iii)	For loans graded “loss”	100%

12) ***Treatment of Multiple Loans to one Borrower***

If an ASF has multiple loans to a single borrower, and one loan meets the criteria for placing on non-accrual status, then the Trustee board of directors shall evaluate every other loan to that borrower and place other loans on non-accrual status if circumstances so require.

PART IV—CORRECTIVE MEASURES

13) ***Remedial Measures and Sanctions***

If a license holder fails to comply with this standard, the Bank may impose or vary conditions on the license to ensure compliance or, if necessary, suspend or revoke the license. Any license holder, which experiences difficulty in complying with the standard, should seek the assistance of advice the Bank forthwith.

PART V— EFFECTIVE DATE

14) ***Effective Date***: The effective date of this prudential standard shall be 30^{th} June 2006.

Questions and enquiries relating to this Prudential Standard should be addressed to The Manager, Financial System Supervision Department Bank of PNG, Tel: 322-7222.

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ACTING GOVERNOR