



**GUIDELINES TO ISLAMIC BANKS
GUIDELINES NO. BU/G-2/2018/10**

GUIDELINES ON CREDIT RISK MANAGEMENT

1 INTRODUCTION

- 1.1 Credit risk is most simply defined as the potential financial losses that a bank may incur if a bank borrower or counterparty fails to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximise a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organisation.
- 1.2 It is the policy of Autoriti Monetari Brunei Darussalam ("the Authority") to ensure that banks under its supervision have adequate and effective credit risk management systems commensurate to their credit risk-taking activities. Towards this end, these Guidelines on Credit Risk Management ("these Guidelines") set forth the expectations of the Authority with respect to the comprehensive management of credit risk.
- 1.3 These Guidelines further articulate sound principles and practices that should be embedded in the credit risk management framework of banks and cover the following areas:
- a) establishing an appropriate credit risk environment;
 - b) operating under a sound credit granting process; and
 - c) maintaining appropriate credit administration, measurement, monitoring and control processes over credit risk.

While banks may employ different approaches in the management of their credit risk, the Authority expects that all these areas are effectively addressed.

- 1.4 These Guidelines as elaborated upon further in **ANNEX 1** are issued pursuant to section 127 of the Islamic Banking Order, 2008 and applies to all Islamic banks in Brunei Darussalam (hereinafter referred to as "bank(s)").
- 1.5 The broad principles and standards under these Guidelines are aligned with the September 2000 Basel Committee paper '*Principles for the management of credit risk*' and the December 2015 Basel Committee paper on '*Guidance on credit risk and accounting for expected credit losses*'.
- 1.6 These Guidelines shall take immediate effect.
- 1.7 The Authority expects banks to embrace the spirit of these Guidelines and adhere to these Guidelines on a "comply or explain" basis.



2 EVALUATION OF CREDIT RISK MANAGEMENT

- 2.1 The Authority will evaluate the bank's credit risk management system not only at the level of individual legal entities but also across the subsidiaries within the consolidated banking organization. The Authority will not restrict the scope of the credit risk-taking activities of a bank, so long as the bank is authorized to engage in such activities and:
- 2.1.1 Understands, measures, monitors and controls the risk assumed;
 - 2.1.2 Adopts risk management practices whose sophistication and effectiveness are commensurate to the risk being taken; and
 - 2.1.3 Maintains capital commensurate with the risk exposure assumed.
- 2.2 If the Authority determines that a bank's risk exposures are excessive relative to the bank's capital, or that the risk assumed is not well-managed, the Authority may direct the bank to reduce its exposure to an appropriate level and/or to strengthen its risk management systems. In evaluating the above parameters, the Authority expects banks to have sufficient knowledge, skills and appropriate system and technology necessary to understand and effectively manage their credit risk exposures.
- 2.3 The principles set forth in these Guidelines are to be used in determining the adequacy and effectiveness of a bank's credit risk management process and adequacy of capital relative to exposure. The Authority will consider the following factors:
- 2.3.1 The bank's business strategies, operating environment, and the competencies of its officers and personnel; and
 - 2.3.2 The major sources of credit risk exposure and the complexity and level of risk posed by the assets, liabilities, and off-balance sheet activities.
- 2.4 In addition to the observance of the credit risk management principles set forth in these Guidelines, the Authority also expects banks to implement policies and procedures to prevent undue hardship and over-indebtedness of individual borrowers and to ensure that loans to individuals comply with the Notice on Total Debt Service Ratio (TDSR).

**MANAGING DIRECTOR
AUTORITI MONETARI BRUNEI DARUSSALAM**

Date: 15 Rabiulakhir 1439 / 2 January 2018