

Treatment of Off-Balance Sheet Exposures

This Statement is intended to capture off-balance sheet as well as on-balance sheet exposures. The principal off-balance sheet credit transactions are likely to be direct credit substitutes and commitments. Guarantees and standby letters of credit are usually converted into on-balance sheet exposures if the counterparty they are supporting fails but there may be circumstances when the bank is reasonably certain that such instruments will be called upon at a future date because of uncertainty about the client. Loan commitments, which are irrevocable, should also be classified as impaired assets if the creditworthiness of the client has deteriorated to an extent that makes repayment of any loan drawdown (or associated interest payments) doubtful. Any foreign exchange transactions, which expose a bank to credit risk, are also captured by this statement. If doubt arises as to whether the bank will receive cash flow entitlements from foreign exchange transactions, banks should treat such an exposure as an impaired asset. Banks should take into account current exposures and potential exposures, which could arise from movements in exchange rates.

Provisions for off-balance sheet exposures do not generally appear in the totals of either specific or general provisions disclosed in a bank's financial statements but are often included in "other liabilities" and are disclosed as part of the notes to the accounts. For the purposes of the Impaired Assets Return these should be reported under the heading of specific provisions.