BANKING COMMISSION

P.O. Box 1408
Majuro, Marshall Islands 96960

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INSTRUCTIONS AND REPORTING FORMS 1

STATEMENT OF ASSETS AND LIABILITIES

PURPOSE

The Balance sheet is the principal regulatory return which directly or indirectly governs the content of all other financial reports used for off-site by the Banking Commission.

The form has been amended to incorporate risk weights to assist in the calculation of risk weighted capital adequacy to determined compliance with the conditions of license of locally incorporated banks.

STATUTORY REFERENCE

Under Section 37 (1), the Commissioner is obligated to notify banks in writing of regulatory reporting requirements intended to strengthen supervision of the RMI banks.

Instructions 1 represent the official reference source applicable for the Monthly Balance Sheet return, for use by bank personnel with responsibility for regulatory reporting.

Banks that fail to submit timely and accurate Monthly Balance Sheet returns may be subject to fines under Section 37 (3).

FREQUENCY/SUBMISSION DATE

All licensed banks are required to submit the Monthly Balance Sheet within 30 days after the last business day of each month.

RECEIPIENT

Banking Commission, Capital Building, Floor 2 Room 268, Majuro.

Phone: (692) 625-6310; Fax (692) 625-6309: E-mail: bankcom@ntamar.net

SIGNING AUTHORITY

The Senior RMI Officer of the institution concerned, or in his absence a designated officer must sign the completed return, to certify the accuracy of the information submitted.

INSTRUCTIONS 1
STATEMENT OF ASSETS AND LIABILITIES

GENERAL DEFINATIONS

Instructions 1 represents a reference source applicable to the Monthly Balance Sheet report. Branches of foreign banks are only required to complete Column 1.

Three significant dividing lines are readily evident in the balance sheet: Between (i) “resident” and “non resident”, which for regulatory reporting purposes defines a RMI bank’s “domestic” and “foreign” business and (ii) the government from private sector, which is useful for assessing market penetration and counter party risk and (iii) the risk weight factors of 0, 20, 50 and 100% reflecting broad judgments about the relative likelihood of counter parties being unable to meet their obligations to a bank. The higher the risk, the greater the capital required.

Resident: Residents are organizations (governments, corporations, partnerships, etc.) or individuals that have a center of economic interest in the Republic of the Marshall Islands (RMI), and that in general reside in the RMI over a period of one year or more.

Resident status accordingly applies to the central government and its agencies, publicly owned or controlled domestic enterprises, and private sector business organizations and individuals that are normally resident in RMI and/or conducting business from RMI. This would include subsidiaries/branches/partnerships etc created under the laws of a foreign country but operating in RMI.

Non Resident: Includes all economic units not covered by the definition of resident. In terms of banking transactions, this will mainly involve foreign domiciled businesses and individuals.

Government Sector: The “Government” sector subdivides into four parts, as explained in the ensuing notes which use RMI references to clarify:

(i) Central Government – Refers to all governmental elements that are agencies or instruments of the central authority of the Republic whether covered by or financed through RMI’s budget or controlled funds.

(ii) Local Government – Refers to regional governmental units exercising an independent competence in its jurisdiction for example Majuro Atoll Local Government.

(iii) Marshall Islands Development Bank (MIDB) – This is a government owned and controlled “development bank” as distinct from a commercial bank or other supervised “deposit taking” institutions.

(iv) Non-financial Pubic Enterprises – Refers to other nonfinancial enterprises owned or controlled enterprises by the central government. Good examples would be Air Marshall Islands (AMI), Marshalls Energy Company (MEC), Majuro Water and Sewage Company (MWSC), and Marshall Islands Visitors Authority. Likewise, National Telecommunications Authority (NTA) would come under this category so long as the government has ownership control and appoints the directors.

Any uncertainty as to which sector and category a particular company should be reported on should be directed to the Banking Commission for clarification. In turn, the Commissioner is responsible for notifying banks, if/as/when any such enterprise is to be reclassified.

Private Sector: The domestic private sector components also come in four categories:

(1) Banks, as defined in the Banking Act to include Savings and Loan companies.

(2) Businesses, which are subdivided between (a) Non-Bank Financial Companies, which would include insurance companies and Credit Unions and (b) Commercial Businesses.

(3) Nonprofit Institutions like churches, and

(4) Individuals

Instructions 1 for the Monthly Balance Sheet are intended to achieve conformity in the reporting of balance sheet accounts. The instructions are in three parts, namely "Assets" then "liabilities" and finally "Capital and Reserves".

Please note that all foreign currency denominated assets or liabilities are to be translated into US$'s at closing foreign currency rates applicable for the reporting date.

Amounts not risk weighted: Show in this column amounts in each asset items that are not risk weighted because they:

(1) are secured by cash. To be eligible for inclusion in this column:

- there must be a written agreement between the bank and the party lodging the cash collateral establishing the banks direct and unconditional recourse to the cash collateral;

- cash collateral lodged by a third party must be accompanied by an indemnity or guarantee of the borrower's obligation to the bank;

- an amount equivalent to the borrower's obligation is blocked in the bank's system until the obligation is extinguished; and

- where an exposure is collateralized by a time certificate of Deposit the bank must retain physical possession of the instrument until the obligation is repaid.

(2) Are guaranteed by the RMI Central government or a Central government within the OECD. Guarantee arrangements must provide for direct, explicit, revocable and unequivocal recourse to the guarantor. Indirect guarantees (such as guarantees of guarantees) and letters of comfort are not recognized for the purpose of allocating risk-weightings; or

(3) Carry a specific provision.

Currency: In the Marshall Islands the US dollar is used for local transactions, so "currency" consists of US notes and coins and the US dollar equivalent of other currencies held.

Balances with Banks: Three categories of interbank placements are shown, split between demand (non-interest) and time deposits: (i) deposits with Head Office/Branches, (ii) Deposits with Foreign Banks, and (iii) Deposits with Domestic Banks.

Federal funds sold: Include amounts held in the US Federal Reserve System that are owed to the banks.

Foreign Investment Securities: Include amount invested in US Government securities and other foreign securities. Other foreign securities should be itemized as the risk weight depends on the issuer.

Loans and advances: **Loans and Advances** are to be reported gross, including "Overdrafts", according to the following major categories explained in the prior "General Definition" section:

i. Central Government

ii. Local Government

iii. MIDB

iv. Nonfinancial Public Enterprises

v. Banks

vi. Private Sector, Business to distinguish between (a) Non-Bank Financial Companies, and (b) Commercial Businesses

vii. Private Sector Nonprofit Institutions, and

viii. Private Sector, Individuals splitting between installment loans (mainly "allotments"), overdrafts, mortgages and any "other" loans.

Overdrafts: The reporting form does not require a sector breakdown of overdrafts; reports all extension of credit via the overdrawing of deposit accounts. Overdrawn deposit accounts are effectively a loan to the customer and should be reported on the asset side of the balance sheet in the appropriate loan category.

The Allowance for Credit Losses is then deducted from the aggregate of Loans and Advances, so that "**Loans Net of the Allowance for Credit Losses"** is disclosed on the Balance Sheet. In column 2, the specific provision components of the Allowance for Credit Losses should be shown against the relevant categories of loans and advances with the remaining general component shown against the Allowance for Credit losses.

Allowance for Credit Losses: The amount in the Allowance For Credit Losses is derived as follows:

a) Opening Balance at the prior reporting date PLUS

b) The provision for loan losses charged against income in the current period LESS

c) Net Write-offs/charge-offs taken in the current periods. (Net write-offs refers to write-offs after deducting recoveries; net write-offs refers to the situation where recoveries in the current reporting period (from write-offs recorded in previous periods) exceed write-offs currently being registered.

Note: WRITE-OFFS are usually recorded when standard collection processes (liquidating collateral, instituting legal proceedings etc) that can reasonably be expected to result in repayment of the debt have so far failed, such that management has concluded it is no longer prudent to defer write-off. Recoveries on assets written off in previous accounting periods offset write-offs in the current accounting period, as and when the recovery amounts are realized.

Fixed Assets: Report all owned fixed assets at historic cost, including where applicable any bank premises, leasehold improvements, furniture and equipment to be reported in the Balance Sheet LESS depreciation. The current balance in the reserve is to be reported in parentheses.

NOTE: ACCUMULATED DEPRECIATION includes depreciation on fixed assets charged against income for the year-to- date plus the reserve for depreciation at the beginning of the year, adjusted for any fixed asset disposals or write-offs.

Other Assets: Include accrued interest receivable, prepaid expenses not charged to operating expenses and sundry other assets (eg supplies) not addressed in the proceeding asset categories.

NOTE: In the case of a start-up bank, other assets may include pre-opening expenses subject to amortization in the initial year(s) of operations. Unamortized pre-opening expenses may be shown in Column 2 as not zero weighted, as they are required to be deducted on the Capital return.

Foreign Assets: Foreign assets are obligations of non-residents entities.

Domestic Assets: Derived by deducting FOREIGN ASSETS from TOTAL ASSETS.

Deposits by Banks: Deposits by banks come from three sources, Head Office & Branches Abroad, Other Banks Abroad or Domestic Banks. The reporting bank is asked to report non-interest bearing categories as Demand Deposits and interest bearing categories as Time Deposits, which is consistent with the reporting of DEPOSITS WITH BANKS on the asset-side.

Nonresident Nonbank Deposit: These deposits belong to nonresident companies or individuals who have a bank facility in the RMI. The balance sheet format calls for a separation of these nonresident deposits as between Demand, Time or Savings categories, which are defined below.

Central Government Deposits: Recording of Government Deposits has been kept separate, as before, with the only change being that the deposit is to be indicated. For this purpose, non-interest bearing deposits are to be recorded as Demand Deposits and interest bearing deposits as Time Deposits, as for "Deposits by Banks".

Demand Deposits: Demand Deposits are broadly defined as deposits with checkbook privileges and fund are fully transferable to third parties and are exchangeable on demand for cash. Except for so-called "Checkable Savings Accounts" (see below), demand deposits are usually non-interest bearing.

Checkable Savings: These accounts also provide for checkbook transfer of funds but, in contrast with a standard Demand Deposit account, they generally earn a nominal rate of interest. Checkable Savings are accordingly reported as a distinct component of Demand Deposits, subdivided between the Government sector (other than Central Government deposits reported separately), Business, Individuals and Other. The Reporting Form requires the combination of the above "Checking Accounts" and "Checkable Savings", which represent the total of Demand Deposits excluding Bank and Central Government owned Demand Deposits.

Less: Items in Process of Collection: This is a third component, often referred to as "FLOAT", netted against Demand Deposits. Items in process of collection refers to checks in transit which can soon be expected to clear. The amount of the "float" can be volatile as between reporting periods, for instance where there are large intergroup transfers, interbank or certified checks and money orders to be cleared.

Time Deposits: RMI banks have historically offered fixed date time deposits registered in the depositor's name, which, when offered, normally pay a higher interest rate than savings or alternative short to medium term investment. However, they can be subject to an early withdrawal penalty. NOTE: Section 46 (2) of the Banking Act prohibits the issue of "bearer" time deposits in the RMI.

Borrowings: This account is to include any form of borrowings, differentiating short-term, defined to be any borrowings with an original term to maturity of one year or less. SHORT TERM BORROWINGS could accordingly include Bankers Acceptances

Issued, group borrowings from Head Office or branches abroad and, if Section 46 (2) no longer existed, “bearer certificates of deposit. LONG TERM BORROWINGS would accordingly apply for any form of debt assumed by the bank with an original term in excess of one year.

Other liabilities: Among those that remained are (i) INTER OFFICE LIABILITIES other than amounts reported separately elsewhere in the balance sheet and (ii) INTEREST NOT PAID or accrued interest payable. As a result, residual OTHER LIABILITIES, where applicable, would include Restructed Deposits on Import Letters of Credit, Pension Fund Provisions, estimated taxes payable, dividends, disclosed and payable and other miscellaneous liabilities not reported elsewhere.

The Banking Act Section 20 requires that domestically incorporated banks must have a minimum Paid Up Capital of $1 million.

Section 21 (1) requires that a domestic bank must also accumulate a "Reserve Fund", until the balance is equal to Paid Up Capital; this is to be accomplished by transferring not less than 25% of profits each year, until the Reserve to Paid Up Capital ratio reaches 1:1.

The Act does not require branches of banks headquarters outside RMI to assign capital in support of their operations in the Republic. Instead, reliance is placed on the parent organization capital, and hence in its willingness and ability to honor all branch obligations in the Republic.

The ensuing reporting requirements accordingly facilitate periodic supervisory measuring of the reserve/paid-up position of the bank. There are three major components of capital:

i. **Paid-up Capital:** Include ISSUED AND FULLY PAID SHARES, which in the case of shares having a stated par value, plus any PAID-IN PREMIUM after deduct holdings of Treasury stock.

ii. **Legal Reserve:** The balance to be reported as LEGAL RESERVE is derived by adding the transfer from net income for the reporting period to the balance carried forward, minus any transfers approved by the Commissioner under Section 21 (2) to Paid-up Capital.

iii. **Undistributed Profits:** The balance in this amount at the reporting date is derived by adding (a) Profits (deducting Losses) for the current reporting period to (b) Undistributed Profits carried forward from the prior period, and (c) deducting any cash dividends paid or stock dividends issued and transfer to Legal Reserve. Foreign owned branches have historically transferred profits for the year to Head Office at year-end. Nevertheless, their interim profits and final profits retained are to be reported as Undistributed Profits.

Foreign Liabilities: The "Deposits By Head Office and Branches" have historically represented the main component in Foreign Liabilities. The aggregate amount of FOREIGN LIABILITIES is derived by deducting Deposits By Domestic Banks from the total of DEPOSITS BY BANKS plus NONRESIDENT NONBANK DEPOSITS.

Domestic Liabilities: The balance of residual liabilities are DOMESTIC.

Capital and Reserves: The total of these accounts is defined as DOMESTIC, even if lodged in a branch of a bank with a foreign head office.

Banking Commission (May 2004)