STANDARD OF SOUND PRACTICE ON PROBLEM ASSET MANAGEMENT, PROVISIONING REQUIREMENTS AND ACCOUNTING FOR EXPECTED CREDIT LOSSES

UNDER THE BANKING SERVICES ACT, 2014

Standards of Sound Practices (SSP) are guiding principles issued by the Bank of Jamaica which set out minimum expectations of the Supervisory Authority in relation to its licensees; and against which licensees can evaluate their performance.

This Guidance will take effect on January 01, 2019.

Licensees will be allowed a 12 month transition period to become compliant with this regime. During this period of transition, the *draft Credit Classification, Provisioning, and Non-accrual Regulations (CCPNR)* remains applicable, with the exception of the list of assets acceptable as collateral, which has been superseded with the passage of *the Security Interests in Personal Property Act, 2013*. At the end of the transition period, the CCPNR will be discontinued.

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ABBREVIATIONS

ACLR	Accumulated Credit Loss Reserve
BSA	Banking Services Act
DTI	Deposit-taking Institution
ECL	Expected Credit Loss
FHC	Financial Holding Company
IFRS	International Financial Reporting Standards
LGD	Loss Given Default
NPE	Non-performing Exposures
PD	Probability of Default

GLOSSARY

Accumulated Credit Loss Reserve	Means the accumulated balance representing the licensee's best estimate of probable loan and other credit-related losses existing in the licensee's credit portfolio, which records additional accumulated provisions required by this Guidance. The ACLR consists of provisions for loan and other credit-related losses and may be directly charged against profits or be appropriated to a special reserve account.
Bank	Bank of Jamaica established by the *Bank of Jamaica Act.*
Counterparty	Means a natural or legal person to which a bank has exposure.
Deposit-taking Institution (DTI)	Means a bank, a merchant bank, or a building society.
Expected Credit Losses	Means the probability-weighted estimate of credit losses (i.e., the present value of all cash shortfalls) over the expected life of the financial instrument.
Fair Value	Means the price at which an asset is or may be exchanged on an arm's length basis between knowledgeable and willing parties. The determination of fair value is as prescribed by the existing accounting standards in Jamaica.
Financial Holding Company (FHC)	A company (a) licensed under the BSA as a FHC; and (b) under-which other companies within the financial group are held, including- a. any of that company's subsidiaries incorporated outside of Jamaica; and b. entities over which it has effective control.
Fully Secured	Means that the credit is satisfactorily secured by security of which the net market value, as defined, is sufficient to recover the debt outstanding and accrued interest and other charges, if any and the interest of the licensee (i.e. the lender) is perfected.
Licensee	A person or body that is licensed under the BSA.
Market Value	Refers to the appraised market value of a security as determined by an independent qualified appraiser or as otherwise determined by an exchange, industry group, pricing service or agency recognized by the Supervisor

Mitigant	To qualify as a mitigant for the purpose of provisioning, the collateral arrangement should be reflective of one: a. in which there is legal certainty of a licensee perfected security interest; b. for which a market price or value can be objectively ascertained, and c. for which a secondary market for disposal exists.
Net Market Value	Refers to the estimated market value adjusted for all costs to dispose of the security including legal and marketing costs, market liquidity, contingencies and any other costs that may impact the full cash collection of the market value.
Non-performing Exposure	Has the meaning assigned to it in ***Section 4.2.6***.
Provision	IFRS defines provision as a liability of uncertain timing or amount which can be measured only by using a substantial degree of estimation.
Supervisor	Means the Governor of the Bank acting in the capacity as the Supervisor of banks, financial holding companies, and other specified financial institutions under section 34B of the Bank of Jamaica Act.

EXECUTIVE SUMMARY

A good quality asset portfolio is fundamental to the financial soundness of a deposit taking institution (DTI) and by extension the stability of the banking system. A DTI's credit quality is usually a reflection of the quality of processes and procedures underpinning loans and investment decisions as well as the management and control of risks arising from those decisions, whether those exposures reside on the balance sheet of the financial entity or off its balance sheet.

Experience has shown that deficient credit underwriting and risk measurement practices usually result in impairment of the loan book, which traditionally is the most material asset category on a bank's balance sheet. Moreover, unanticipated deleterious business specific, environmental and economic events may occur which can result in, inter alia, borrowers being unable to service their agreements with the institution as agreed, thereby resulting in a deterioration in the income earning capacity of the asset. Subsequent to this deterioration, that asset becomes a problem asset that can adversely impact an institution's profitability, liquidity and capital position, leading ultimately to insolvency and failure, and if systemically important, could have a destabilizing effect on the financial system.

Consequently, a DTI should have established Board approved policies, procedures and practices for identifying, monitoring and managing problem assets, including non-performing exposures (NPEs). DTIs should likewise have sound Board approved expected credit loss (ECL) methodologies to address the deterioration of credit quality from the point of initial recognition, consistent with the International Financial Reporting Standards (IFRS) accounting framework.

In light of prudential concerns, international best practice, and Bank of Jamaica's responsibility for licensing, regulating and supervising DTIs and financial holding companies (FHCs), the time is opportune for the establishment of a Guideline which establishes uniform standards for licensees, that is, FHCs on a consolidated basis, and DTI's on a solo and consolidated basis (where applicable), to ensure that:

a. Assets and exposures are regularly evaluated using an objective grading system that is consistent with regulatory standards;
b. The prudential treatment for problem assets, including non-performing exposures, is consistent with regulatory and supervisory requirements;
c. Timely and adequate provisioning and non-accrual (**Schedule 1**) criteria are established to recognize, measure and monitor exposures and asset impairment; and
d. Write-offs are applied to accurately reflect the capital and earnings performance of the licensee.

This Guidance is intended to encourage the development of timely and effective work-out plans for problem assets and effective internal controls to manage such assets, and is consistent with *The Security Interests in Personal Property Act, 2013 (SIPPA).* This Supervisory Guidance applies to all assets carried on a licensee's balance sheet or reflected as off-balance sheet items, and is aimed at setting out the supervisory expectations related to sound problem asset management practices. This document presents minimum guidance, and should be enhanced where necessary based on, inter alia, the size, scope, interconnectedness, complexity and state of the institution's asset portfolio.

1.0 GUIDELINES FOR PROVISIONING

The term “provision” is commonly used in the context of items such as impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets. It is a requirement for any entity to assess at the end of each reporting period whether there is any objective evidence that any asset has been impaired. When such is the case, the amount is required to be recognized in the profit or loss account for the reporting period. This enables the presentation of a “true and fair” financial position of the entity for the period.

For regulatory purposes, an adequate Accumulated Credit Loss Reserve for anticipated loan and other credit related losses should be established. In this regard, a DTI should make a minimum provision for each credit classification category at least quarterly based on a review of the institution's loan portfolio. An increase in problem assets should logically result in an increase in provisions based on regulatory standards, as guided by the entity’s internal policies. Further, the licensee’s assessed individual and aggregate asset loss provisions must be adequate to absorb estimated credit losses.

It should be noted that this Guidance is intended to supplement, not replace any relevant accounting standards and should therefore serve as a prudential benchmark for the adequacy of provisions that a licensee should set aside for credit losses.

DTIs should continue to use collateral and other risk mitigants to allay the deleterious impact of credit risk and therefore the levels of provisions required to be held against expected losses should be guided by an assessment of the effectiveness of these mitigants[1]. In this regard, DTIs should continue to offset specific provisions, where applicable, against the value of the underlying collateral.

Lastly, these Guidelines should be read in conjunction with other Regulatory Guidance and Standards of Sound Practice regarding, inter alia, internal governance, credit risk management, capital adequacy and disclosures as may be supplemented by the relevant technical standards adopted by the Bank. The Guidance is structured around seven principles that are detailed in **Section 6.0** below.

2.0 RATIONALE AND OBJECTIVES

Supervisory authorities have recognized that their efficacy is dependent on the integrity of licensees’ balance sheets and income statements, which in turn are contingent on the proper identification, classification and accounting treatment of problem assets and expected credit losses. A financial institution’s asset quality reflects the management and control of risks in the entity’s loan and investments portfolio both on- and off-balance sheet.

Despite best efforts, deficient credit risk assessments and measurement practices have been known to impair financial institutions’ asset quality. Additionally, unforeseen business specific, environmental and economic factors may result in borrowers being unable to service their institutional agreements, thereby resulting in a deterioration in asset quality. In such an instance, that asset becomes a problem asset that can adversely impact the institution’s profitability and liquidity, which can in turn impair the financial

[1] With the planned implementation of Basel III, institutions will be able to mitigate credit risk using techniques other than traditional collateral. Under the existing credit management framework, institutions are required to have in place a collateral management system however, within the Basel III context this requirement will be enhanced. All institutions will be required to formally establish collateral management systems and operational procedures and processes that observe the principles of purpose, documentation, consistency, legal certainty and timeliness, risk identification, valuation, inspection, verification, operations, and reporting.

soundness of a DTI and possibly the financial system. In light of this, DTIs should have established Board approved policies, procedures and practices for identifying, monitoring and managing problem assets, including non-performing exposures. DTIs should likewise have sound Board approved expected credit loss methodologies to address the deterioration of credit quality from initial recognition, consistent with the IFRS accounting framework.

Financial institutions need to recognize problem assets using both quantitative and qualitative methodologies, and to appropriately treat the assets with regard to classification, accrual of interest, adequate provisioning and disposal. This Supervisory Guidance establishes uniform standards to be followed by licensees to ensure that:

a. assets and exposures are regularly evaluated using an objective grading system that is consistent with regulatory standards;
b. prudential treatment of problem assets, including non-performing exposures is consistent with regulatory requirements and recognized accounting practices;
c. timely and adequate provisioning and non-accrual **(Schedule 1)** criteria are contemplated to recognize, measure and monitor exposures and asset impairment; and
d. write-offs are applied to accurately reflect the capital and earnings performance of the licensee.

This Guidance is intended to encourage the development of timely and effective work-out plans for problem assets and effective internal controls to manage such assets, and is consistent with *The Security Interests in Personal Property Act, 2013 (SIPPA)*. This Supervisory Guidance applies to all loans, investments or other exposures carried on a licensee's balance sheet or reflected as off-balance sheet items, and is aimed at setting out the supervisory expectations for these licensees related to sound problem asset management practices. It presents minimum guidance, and should be enhanced where necessary based on the size, scope, interconnectedness, complexity and state of the institution's asset portfolio.

These Guidelines reflect the approach of IFRS, specifically the recently introduced IFRS 9 accounting standard for loan provisioning; as well as the recommendation of the Basel Committee on Banking Supervision (BCBS) contained in the Guidance on Credit Risk and Accounting for Expected Credit Losses, which was enacted to coordinate IFRS 9 with prudential policies. Notably, these provisions are intended to supplement, not replace any relevant accounting standards but are rather intended to serve as a prudential benchmark for the quantity of provisions that a licensee should set aside for credit losses. In sum, entities are expected to adopt the more conservative approach in its credit administration process.

These guidelines should be read in conjunction with the provisions of other Supervisory Guidance, and Standards of Sound Practices regarding internal governance, credit risk, capital adequacy, disclosures, supervisory review and evaluation process and requirements, and supervisory measures and powers, as supplemented by the relevant technical standards adopted by Bank of Jamaica.

3.0 STATUTORY AUTHORITY

Section 132(1)(c) of the Banking Services Act (BSA) provides that the Supervisory Committee may make Guidance for the operation of licensees, in relation to problem assets management and provisioning requirements. This statutory proviso gives the Supervisory Committee and the Bank the authority to administer varied measures against an institution for inter alia, any contravention of the Bank's Supervisory Guidance.

4.0 SCOPE OF APPLICATION[2]

This Guidance is generally applicable to all licensees as defined under the BSA, which are, commercial banks, merchant banks, building societies, financial holding companies, as well as entities providing necessary support services to the licensee or to the financial group, and which are held in accordance with section 73(2) of the Act.

5.0 SUPERVISORY PRINCIPLES FOR PROBLEM ASSETS & PROVISIONING

Licensees must establish, implement, and maintain strategies for problem asset management that are appropriate for the size, scope, complexity, and nature of their activities, to enhance the problem assets framework. These must include documented policies and procedures addressing:

Principle 1: roles of Board of Directors (Board) and Senior Management;
Principle 2: portfolio reviews and monitoring of credit quality;
Principle 3: credit risk classification and grouping;
Principle 4: problem asset identification and measurement;
Principle 5: collateralization and risk mitigation;
Principle 6: expected credit losses; and
Principle 7: mechanisms to ensure timely provisioning.

PRINCIPLE 1: ROLE OF BOARD OF DIRECTORS AND SENIOR MANAGEMENT

The Board of Directors and senior management of all licensed entities should oversee the nature and level of credit risk that is undertaken, and should fully understand their responsibilities in the oversight and management of the entity's problem assets and provisioning practices, including an effective system of internal control to consistently determine adequate allowances. The Board of Directors and senior management of all licensees should take steps to ensure that these responsibilities are successfully effected in accordance with the licensees' stated policies and procedures, and the applicable accounting framework.

1.1 Board of Directors

1.1.1 The Board should ensure that licensees have in place credit risk management policies, procedures and controls, as well as business processes which are commensurate with the size, scope and complexity of the institution's lending operations.

1.1.2 The Board should ensure that the institution has appropriate problem asset assessments and management processes, including effective internal controls and measurement models to consistently determine provisions in accordance with the licensees' stated policies and procedures, and the IFRS accounting framework.

[2] Cooperative societies that operate as credit unions will legally be required to adhere to these Standards when the legislation to bring them under the BOJ's regulatory ambit is passed and the regime takes effect. Until such time credit unions will be encouraged to work with these Standards.

1.1.3 The Board should be kept apprised with timely and appropriate information on the status of the problem assets portfolio, including classification of assets, levels of provisions, material problem assets and NPEs, including at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets and NPEs, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.

1.1.4 **The Board** of a licensee must, inter alia:

a. ensure that effective problem asset management policies and processes are developed, documented, approved, implemented and maintained. These policies and processes should be easily accessible to the employees who are responsible for implementing and/or utilizing it, and systematic and consistently applied to determine appropriate provisions;
b. at least annually, review and approve all material changes to the problem asset management strategies, policies and procedures, and related controls and systems, providing recommendations where necessary;
c. ensure that the licensee's processes and systems for identifying, classifying, monitoring and addressing problem assets and NPEs are consistent and commensurate with the size, scope and complexity of the of the institution's lending and investment operations, and operate in accordance with stated risk appetite of the Board;
d. be satisfied that the licensee's internal control and credit review function provides adequate assurance of internal compliance with the licensee's policies and procedures on classification and provisioning of problem assets;
e. understand and determine the nature and level of risk being taken by the licensee and how these risks relate to the levels of provisions;
f. review all material credit facilities with an adverse classification beginning at the level of 'underperforming financial asset' quarterly, or more frequently where necessary;
g. ensure assets and exposures determined to be uncollectible have been recognized in a timely and appropriate manner through provisions or write-offs, following approved policies;
h. ensure processes and systems for determining forbearance is approved, sufficiently robust, and commensurate with the stated risk appetite of the Board;
i. ensure that the internal audit function is adequately staffed and conducts periodic reviews of the problem asset management function to determine compliance with established policies and procedures;
j. ensure the selection and appointment of qualified and competent management to administer the credit risk function;
k. ensure senior management develops and maintains robust and consistently applied processes to determine appropriate provisions;
l. require senior management to report periodically the results of credit risk assessments and measurement processes, including estimates of ECL provisions;
m. review all reports presented by senior management; and
n. when material deteriorations in credit quality are anticipated, communicate frequently with the Supervisor on the condition of assets, the classification of assets, the forward-looking level of provisions, and the effectiveness of strategy to improve the institution's asset quality.

1.2 Senior Management

1.2.1 Senior management should ensure the adoption and adherence to robust methodologies that address policies, procedures and controls for assessing and measuring credit risk on all lending exposures, to inform the measurement of provisions and appropriate and timely recognition of ECLs in accordance with the applicable accounting framework.

1.2.2 Senior management should establish policies and procedures which set out the accountability and reporting structure of the ECL model validation process, internal standards for assessing and approving changes to the models, and reporting of the outcome of the model validation;

1.2.3 Senior management should ensure the institution's policies and business processes, as well as, the Board's strategy is properly implemented and consistently applied, in line with the stated risk appetite of the Board.

1.2.4 Senior management is also responsible for the development and effective implementation of the problem assets and provisions framework and policies on asset write-offs approved by the Board.

1.2.5 The **Senior Management** of a licensee must, inter alia:

a. establish, implement, and as necessary, update suitable policies and procedures to communicate the credit risk assessment and measurement processes internally to all relevant personnel;
b. provide appropriate disclosure, and prepare a report for the Board on the condition of the credit portfolio, at least quarterly, but more frequently, should senior management adjudge that the circumstances are warranted. At a minimum, the report should provide a status update on new and ongoing significant problem assets, including NPEs, as well as the levels of provisions, the status of collateral or other risk mitigants held against those exposures, and the attendant impact or implications on the institution's capital;
c. ensure the procedures used by the licensee to establish impairment provisions on problem assets are prudent, appropriate in relation to total credit risk exposure, and based on cash flow projections that take into account economic conditions;
d. consider relevant facts and circumstances, including forward-looking information, that are likely to cause ECLs to differ from historical experience, and that may affect credit risk and the full collectability of the institutions' cash flows;
e. ensure that loans are appropriately valued using forward-looking approaches, uncollectable credits written-off, and expected or probable losses adequately provided for;
f. ensure licensees utilize a database (whether internally or externally developed) on the market values of accepted collateral, including movable assets, that is updated at least annually, or more frequently depending on evident market conditions or other extenuating circumstances;
g. maintain effective systems, business processes and controls for identifying, measuring, monitoring, and addressing loan quality problems in a timely manner;
h. ensure portfolio reviews are conducted at least annually;
i. ensure a report on all credit facilities categorized as 'underperforming' are placed on a watch-list which is to be monitored by the asset committee on an ongoing basis; and
j. be able to demonstrate that it understands and is appropriately considering inherent risks when pricing lending exposures.

1.2.6 An example of an appropriate database (Section 1.2.5(f)) is one that, inter alia:

a. is updated at least annually, or more frequently depending on evident market conditions or other extenuating circumstances;
b. defines the acceptability and eligibility of collateral or other risk mitigants; and
c. provides prudent and accurate valuations of collateral or other applicable risk mitigants;

1.3 Asset Committee

1.3.1 An **Asset Committee** should have oversight of the deteriorating assets and problem assets. This committee should be charged with:

a. reviewing of problem assets and assets with weaknesses based on identified factors that could possibly undermine repayment;
b. developing strategies to improve the institution's asset quality;
c. establishing timelines for reporting to senior management on asset quality and attendant trend deteriorations, classification of assets, status of collateral and levels of provisions;
d. evaluating the effectiveness of implemented strategies on specific intervals and taking corrective actions where necessary;
e. evaluating collateral securing the loans, which should take into consideration the market and forced sale values, location of the collateral and the marketability and liquidity of same; and
f. oversight, amendment and reporting on watch-listed credits. Watch-listed credits should be provided to senior management and the Board periodically.

PRINCIPLE 2: PORTFOLIO REVIEWS AND MONITORING OF CREDIT QUALITY

All licensees should have robust and sound methodologies for assessing credit risk, which should include adequate processes, resources and systems in place for ongoing oversight and regular review of the overall composition and quality of the credit portfolio, asset classifications, and the condition of impaired assets, which include NPEs. Licensees should have a system of independent, ongoing assessments of its credit risk management processes, impaired assets status and adequacy of provisioning levels, the results of which should be communicated directly to the Board of Directors and senior management.

2.1 Internal Reviews

2.1.1 Licensees should ensure that credit risk management policies, procedures, information systems and controls provide for the systematic and regular monitoring of the credit risk to which it is exposed. Licensees should include a robust process that is designed to equip the DTI with the ability to know the level, nature and drivers of credit risk upon initial recognition of the lending exposure, to ensure that subsequent changes in credit risk can be identified and quantified.

2.1.2 The level and the intensity of portfolio reviews and monitoring should reflect the impact of potential credit exposures, both individually and aggregate of facilities, on the earnings and capital of the licensed entity.

2.1.3 Licensees should conduct frequent internal reviews of their credit portfolios and measurement models of problem assets and ECLs, for asset classifications and provisioning; and submit recommendations to the Board to address any weaknesses. These reviews should be subject to independent oversight by the internal audit function.

2.1.4 Policies, procedures, internal business processes and systems, as well as controls governing portfolio reviews and the monitoring of credit quality should at all times be commensurate with the scope, size and complexity of exposures undertaken by the licensee.

2.1.5 Licensees should conduct consistent regular reviews of their problem assets both on- and off-balance sheet (at an individual or transaction level, or at a portfolio level for exposures with homogenous characteristics) and asset classification, provisioning and write-offs.

2.1.6 Reviews should be conducted on a transaction (individual item) basis, except for homogeneous exposures below a certain materiality threshold (e.g. retail loans, credit card receivables). These homogeneous facilities may be pooled together with all other facilities that have not been considered or provided for on an individual basis.

2.1.7 For the purposes of this Guidance, at a minimum, all of the following categories within the credit portfolio should be reviewed quarterly, or more frequently where significant/material problems in credit quality are determined:

a. large, complex and higher risk asset items;
b. large off-balance sheet credit commitments;
c. past due and non-performing credit facilities; and
d. loans on the watch-list.

2.1.8 When assessing the credit portfolio, where applicable the following information should be evaluated or considered:

a. The original amount of the credit facility or advance, the terms, interest rate, current balance, status, and purpose;
b. The track record of the borrower or issuer including the service of previous borrowings;
c. Contractual payment delinquencies and underperforming facilities;
d. The credit rating or score of the borrower;
e. The manner in which the project was financed;
f. The collateral secured including, up to date appraisals, legal assignments and insurances;
g. Reasonably possible one-off events;
h. The performance of credit facilities or advances to members within the group in which the borrower or issuer belongs; and
i. For a company, balance sheet, debt/service ratio, cash flow and other financial data on the business and of any guarantors of the issuer or borrower.

2.2 External Reviews

2.2.1 An independent external body should review annually, or within such other period as may be agreed in writing by the Supervisor, the licensee's credit quality to identify and assess the institution's asset quality. The organization consulted to conduct the review should be sufficiently independent and experienced to conduct the review.

2.2.2 This external review body should conduct at least annually, or within such other period as may be agreed in writing by the Supervisor, reviews of the problem asset management process to ensure its effectiveness. The independent review should at a minimum cover:

a. Credit risk of lending exposures;
b. Changes in credit risk and related ECL provisions;
c. Problem assets updates;
d. Recovery processes;
e. Provisioning adequacy;
f. The management and disposal of collateral or other risk mitigants;
g. Reporting processes; and
h. The effectiveness of business relationships with external agencies and consultants where applicable.

2.2.3 Loan approval limits should be revised periodically by independent assessment to include actual valuations of the performance of authorized personnel and the performance of credit facilities over the life of the loan.

PRINCIPLE 3: CREDIT RISK CLASSIFICATION AND GROUPING

All licensed entities should have an established credit risk classification system, including policies and processes and documented thresholds, to: classify the credit risk inherent in all on- and off-balance sheet activities, provide insight into the licensee's credit quality and Board approved risk appetite, improve portfolio management and act as early warning system for asset impairment.

3.1 Credit Risk Classification Systems, Policies & Processes

3.1.1 Licensees should have policies and processes for grading or classifying assets, and establishing appropriate and robust provisioning levels.

3.1.2 The credit risk classification system should be robust and capture all lending exposures to allow for an appropriate differentiation of credit risk and grouping of lending exposures within the credit risk rating system, reflect the risk of individual exposures and, when aggregated across all exposures, the level of credit risk in the portfolio as a whole.

3.1.3 A licensee's credit risk classification system should encompass every financial asset, including performing loans and off-balance sheet exposures. Homogenous risk classification facilities which have the same risk characteristics on a portfolio basis is acceptable.

3.1.4 Licensees should conduct regular and systematic independent reviews of all credit facilities to provide assurances about the reliability of the classification systems and processes.

3.1.5 A licensee's credit risk classification system should include arrangements for the periodic validation of the classification model to ensure the continual delivery of reliable information and the adequate collation of exposures of varying credit quality.

3.1.6 Licensees should designate the personnel responsible for the design, implementation, operation and performance of the system as well as those responsible for periodic testing and validation.

3.2 Credit Risk Classification Grading

3.2.1 Consistent with the applicable IFRS accounting framework, licensees should ensure that credit risk classification systems include at least the following three (3) categories, in which all facilities should be included:

a. Performing financial assets – where credit risk has not increased significantly since initial recognition. Recognize 12 months ECL, and recognize interest on a gross basis;
b. Underperforming financial assets – where credit risk has increased significantly since initial recognition. In this instance, recognize lifetime ECL, and recognize interest on a gross basis; and
c. Non-performing financial assets – where the financial asset is credit impaired. Recognize lifetime ECL, and present interest on a net basis, that is, on the gross carrying amount less credit provisions.

3.2.2 The credit risk grade a licensee assigns upon initial recognition of a lending exposure may be based on the following non-exhaustive criteria:

a. Product type;
b. Credit standards;
c. Place of issue;
d. Terms and conditions;
e. Type of issuer/debtor/guarantor;
f. Insurance
g. Place of establishment of the issuer/ debtor/guarantor;
h. Liquid primary or secondary markets;
i. Currency;
j. Cross-border use and movability;
k. Collateral type and amount;

3.2.3 Assigned credit risk grades should be regularly reassessed, and may subsequently change on either a portfolio or an individual basis, due to additional relevant factors such as, but not limited to, changes in industry outlook, business growth rates, consumer sentiment and changes in economic forecasts (such as interest rates, unemployment rates and commodity prices) as well as weaknesses in underwriting identified after initial recognition, or departure from the listed primary source of repayment.

3.2.4 ECL estimates should be updated on a timely basis to reflect changes in credit risk classifications for either groups of exposures or individual exposures.

3.2.5 Should an on- or off-site examination result in the Supervisor assigning a lower grade to an asset than that assigned by the licensee, the licensee should (i) re-classify the asset to the lower grade assigned by the Supervisor; and (ii) make provisions as required. Any subsequent upgrades, or additional downgrades, should be made if circumstances are demonstrated to the satisfaction of the Supervisor.

3.2.6 Rarely, assigned provisioning levels may include a nil allowance; for example, in the case of fully collateralized loans, provided that licensees:

a. have adopted sound policies to monitor collateral and estimate its value throughout the life of the loan; and
b. maintain compliance with the principles contained within in these guidelines.

3.2.7 The licensee should provide the Supervisor with full access to information concerning the classification of assets in sufficient detail and, within such period as may be agreed by the Supervisor.

3.3 Credit Risk Classification Grouping

3.3.1 Lending exposures should be grouped according to shared credit risk characteristics so that changes in the level of credit risk respond to the impact of changing conditions on a common range of credit risk drivers.

3.3.2 A licensee's methodology for grouping exposures to assess credit risk (such as by instrument type, product terms and conditions, industry/market segment, geographical location or tenure of instrument) should be documented and subject to appropriate review and internal approval.

3.3.3 Categories should be sufficiently granular to allow licensees to group exposures into portfolios with shared credit risk characteristics, so that licensees can reasonably assess changes in credit risk and thus the impact on the estimate of ECL.

3.3.4 Licensees should periodically review the basis of grouping, to ensure that exposures within the group remain homogeneous in terms of their response to credit risk drivers, as grouping implemented upon initial recognition will not necessarily be appropriate in subsequent periods given the potential for change in the relevant characteristics and attendant impact on the level of credit risk for the group.

3.3.5 Exposures should not be grouped in such a way that an increase in the credit risk of particular exposures is masked by the performance of the group as a whole.

3.3.6 Licensees should disclose to the Supervisor the methods used by management to satisfy itself that lending exposures are appropriately grouped, such that these groups continue to share credit risk characteristics.

PRINCIPLE 4: IDENTIFICATION, MEASUREMENT AND MANAGEMENT OF PROBLEM ASSETS

All licensed entities should adopt, document and adhere to sound methodologies, established policies and processes, including documented thresholds, as well as information systems and other organizational resources, to measure and manage the credit risk inherent in all on- and off-balance sheet activities, to enable the early identification of impaired assets and exposures, and reflect realistic repayment and recovery expectations.

4.1 Policies and Processes

4.1.1 A licensee should formulate and document policies and processes for the timely identification, management and assessment of problem assets including, NPEs. These should also contain sound ECL methodologies to address deterioration of credit quality from the point of initial recognition, until it is performing.

4.1.2 Licensees' credit risk identification processes should ensure the proper identification of factors that could impact changes in credit risk exposures and estimates and measurement of ECL, including consideration of credit risk inherent in new products and activities.

4.1.3 Institutions should have policies and procedures that identify and guide the management of problem assets. These policies should be approved by the Board and should include, but not be limited to the following:

a. The authority and responsibility of officers and specific bodies (e.g. committees);
b. The level and frequency of reporting and monitoring;
c. The strategies to be utilized to manage problem assets, and any specific order of strategy application;
d. Collateral management and disposal;
e. Debt collection mechanisms; and
f. The ability (and rules associated with, where applicable), to use external agents (example, licensed credit bureaus and reputable audit firms) and professionals to provide advice on problem assets management.

4.1.4 Licensees should establish internal limits or thresholds, in accordance with board approved policies and stated risk appetite, for the purpose of identifying significant credit risk exposures, and to regularly review the level of the threshold.

4.1.5 Licensees should have clearly-established processes in place for forbearance procedures[3] **(see Schedule 2 for further details),** limitations on credit facility renegotiations **(Schedule 3),** and the disposal of problem assets, in line with well-established policies and procedures.

4.2 Identification of Problem Assets

4.2.1 An asset must be identified as a problem asset when there is reason to believe that the timely collection of all amounts due, including principal and interest, will not be forthcoming in accordance with the contractual terms; or additionally, if the licensee is without recourse to realize security (if held).

4.2.2 For the purposes of paragraph 4.2.1, the existence of the following factors will, at a minimum, constitute "reason to believe" that an asset (on- or off-balance sheet) is a problem asset and should be so treated:

a. A breach of contract, such as a default or delinquency in interest or principal;
b. A licensee to which facilities have been provided is subject to administration or resolution proceedings, unless the facilities are otherwise well secured;
c. A write-off has been taken on an asset even if it is not in breach of contractual requirements. This does not apply in the case of some restructured facilities and assets acquired through enforcement of security;
d. concessions in terms of a facility (e.g. interest or principal payments) granted to a party to a facility relating to such a party's financial difficulties;

[3] Forbearance occurs when the contractual terms of an exposure have been modified to reflect concessions granted by the licensee that it would not otherwise consider, due to deterioration in the borrower's financial condition.

e. With respect to off-balance sheet facilities, the licensee is unlikely to receive timely payment of the full amounts which it has exchanged or is contracted to advance;
f. The credit exposure is determined to be a ***non-performing exposure*** (See Section 4.2.6); or
g. Any other matter which might reasonably suggest to a DTI that a party to a facility may be unlikely to meet its contractual obligation.

4.2.3 Where an exposure has been identified as a problem asset (on a transaction or collective/portfolio basis), a licensee should raise provisioning levels to cover any shortfall in cash flows contractually due to be received.

4.2.4 Licensees should have organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations.

4.2.5 At a minimum a licensee should conduct quarterly impairment assessments of its credit portfolio for the purposes of annual and interim financial reporting, or more frequently where there is evidence to suggest impairment of the credit portfolio. These assessments should be documented and available to the Supervisor for review on request.

4.2.6 Identification of Non-Performing Exposures

4.2.6.1 The following exposures are considered as non-performing:

a. all exposures that are "defaulted", that is, a default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place:

   i. The bank considers that the obligor is unlikely to pay its credit obligations in full, without recourse by the bank to actions such as realizing security (if held).
   ii. The obligor is past due more than 90 days on any material credit obligation to the bank[4].
   iii. Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current outstandings.

b. all exposures that are credit-impaired (in the meaning of exposures having experienced a downward adjustment to their valuation due to deterioration of their creditworthiness) according to the IFRS accounting framework[5] should also be classified as non-performing.

c. all other exposures that are not defaulted or impaired but nevertheless:

   i. are material exposures that are more than 90 days past due; or
   ii. where there is evidence that full repayment based on the contractual terms, original or, when applicable, modified (e.g. repayment of principal and interest) is unlikely with the contractual terms; or additionally, without the bank's realization of collateral, whether or not the exposure is current and regardless of the number of days the exposure is past due.

[4] In the case of retail and public sector entities obligations, for the 90-day figure, a supervisor may substitute a figure of up to 180 days for different products, as it considers appropriate to local conditions. In one member country, local conditions make it appropriate to use a figure of up to 180 days also for lending by its banks to corporates; this applies for a transitional period of five years.

[5] In particular, when the accounting framework is IFRS 9, "impaired exposures" are those that are considered "credit-impaired" in the meaning of IFRS 9 Appendix A. When the accounting framework is US GAAP, "impaired exposures" are those exposures for which credit losses are measured under ASC Topic 326 and for which the bank has recorded a partial write-off.

4.2.6.2 Non-performing exposures should always be categorized for the whole exposure, including when non-performance relates to only a part of the exposure.

4.2.6.3 In the case of exposures to a non-retail counterparty where the DTI has more than one exposure to that counterparty, the DTI must consider all exposures to that counterparty as non-performing when any one of the material exposures is non-performing. Thus, the non-performing status should be applied at the level of the counterparty.

4.2.6.4 In the case of exposures to a retail counterparty, the non-performing status can be applied at the transaction level. In the case of a retail counterparty with more than one exposure from a DTI, the DTI should consider the non-performing or performing status of the other exposures when deciding about the status of a given exposure.

4.2.6.5 In the case of exposures to a group, non-performing status can be applied at the counterparty level. At the same time, the DTI should consider the non-performing or performing status of the other group entities when deciding about the status of any of the group entities.

4.3 Measurement of Problem Assets

4.3.1 In determining measures of impairment, licensees must have a realistic and comprehensive view of all of its business activities (including both on- and off-balance sheet exposures), taking into account all available information on a timely basis.

4.3.2 Each licensee's Board should ensure that the measures of problem assets, and the levels of provisions reported to the Supervisor are prudent and reasonable.

4.3.3 Policies and procedures covering the measurement of impairment of facilities, and the provisioning levels flowing from this impairment, should be well documented with clear details of supporting analysis and rationale, and should include the level and type of data and other information required to enable a licensee to adequately measure its impaired assets.

4.3.4 Problem asset measurement policies and procedures of licensees should include the role and responsibilities of the senior management and the Board in determining and monitoring the adequacy of measures to manage impaired facilities and inform provisioning levels.

4.3.5 All licensees should indicate the basis to be used for determining whether assets are managed on a transaction or portfolio (group) basis, and whether measures of impairment and provisions are to be assessed on an individual or portfolio basis. This should incorporate the processes to be followed when deciding to make a change in the assessment of provisions from a portfolio basis to an individual facility basis.

4.3.6 The problem asset assessments and measurement processes should be forward-looking and provide the relevant information for senior management to make informed judgements about the credit risk of lending exposures, and the related classifications and provisions for ECLs.

4.4 Management of Problem Assets

4.4.1 When engaging in problem asset management, all licensees are required to subscribe to the general standards of sound practices in relation to credit risk management.

4.4.2 Licensees should develop the approaches to be followed in the management of arrears and the write-down or write-off of impaired assets.

4.4.3 To mitigate common causative factors[6] resulting in asset impairment, licensees should pay special attention to their investments or treasury operations. Areas for enhancement should include:

a. The credit underwriting and administration processes.
b. The quality/rating of investments acquired. Risk assessments should not be limited to rating agencies' rating but should also include the entity's own risk assessment and analysis. Policies should stipulate the type of securities that the financial institution can invest in.
c. More frequent valuation of the investment portfolio.
d. The diversification policies in line with the entity's risk appetite and tolerance. Investments diversification should encapsulate:
   - Issuers (single or related).
   - Geographic distribution.
   - Characteristics of securities (e.g. corporate, government securities, bonds etc.)
   - Credit ratings (specifically low ratings)
e. The analysis process for identifying, evaluating, selecting and investing in securities.
f. Ongoing monitoring of the issuer(s) (and related parties/groups where applicable) and the security portfolio and individual securities.

4.4.4 Licensees should have established policies and procedures in place, authorized by the required internal body and/or senior management where applicable, to guide the proficiency of the relevant internal debt collections department or, where necessary, external debt collection agencies. In employing the services of an external debt collection agency, licensees should ensure that customer confidentiality is maintained to the extent required by law. The business relationship between licensees and the debt collection agency should be based on a legal agreement/contract which identifies the roles and responsibilities, fees and covenants.

PRINCIPLES 5: COLLATERALIZATION AND OTHER RISK MITIGANTS

Licensees should have appropriate mechanisms, policies and procedures in place to establish, record, effectively assess, monitor and control the eligibility and recognition of risk mitigants held against credit exposures, including guarantees and other collateral. Further, all licensees should on at least an annual basis, establish for individual and homogenous exposures, the market value of risk mitigants associated with credit exposures (on- and off-balance sheet) for senior management and Board review.

5.1 Policies and Processes

5.1.1 Licensees should ensure that the policies and procedures guiding the risk mitigation process are linked to the licensee's credit quality assessment, approval and management process and provide for a consistent application across the entity.

[6] Weak documentation, lack of perfected collateral, issuing of loans without proper collateral and credit underwriting, and poor financial analysis of borrowers and issuers of securities/investments

5.1.2 Licensees should have Board approved risk mitigating policies and procedures determined by best practices, to establish, record, effectively assess and monitor the value of collateral or other risk mitigants. These policies and procedures should include at a minimum:

a. The definition of marketable and non-marketable assets;
b. The acceptability and eligibility of various forms of collateral or other risk mitigants, and the circumstances in which they may be used;
c. The prudent and accurate valuation of collateral or other applicable risk mitigants prior to entering into any contract, and over the life of the contract, having regard to the time, costs and difficulties involved in generating payments through access to risk mitigants;
d. The procedures for ensuring that the applicable risk mitigants are, and continue to be, certain, enforceable and realizable; and
e. A documented process for collection of payments in distressed situations.

5.1.3 Licensees should have appropriate mechanisms in place for regularly assessing the market value of risk mitigants, including guarantees and other collateral.

5.1.4 The legal mechanism by which collateral or other risk mitigants are given must be robust and ensure that the lender has clear rights over the proceeds from the collateral or other risk mitigant, including a framework that allows the potential lender to have a perfected first priority claim over the risk mitigant.

5.1.5 Where the Supervisor assesses that practices being applied by a licensee to the recognition and valuation of risk mitigants may result in its inappropriate recognition, and consequently a misstatement of provisioning levels and regulatory capital, or which otherwise may reflect adversely on the licensee's safety and soundness, the Supervisor may, direct the licensee to:

a. Adjust its policies, procedures and valuation methodologies or practices;
b. Increase levels of provisioning; or
c. Hold higher levels of capital.

5.1.6 Licensees should have well documented, Board approved policies outlining the extent to which the value of collateral and other risk mitigants affect ECL.

5.1.7 Institutions should have approved policies and procedures for the management and disposal of collateral or other applicable risk mitigants.

5.2 Eligibility of Risk Mitigants

5.2.1 Licensees should hold at all times adequate collateral or other risk mitigants with values which are not dependent on the performance of the borrower, to protect the entity against the risk of default by the borrower.

5.2.2 Licensees should conduct sufficient legal review to ensure legal certainty of collateral taken. That is, potential claims on collateral or other risk mitigants are binding on all parties and legally enforceable in all relevant jurisdictions. Any claim on collateral or other risk mitigant should be properly filed on a timely basis, clearly documented, meet all relevant legal requirements, and be realizable within a practical timeframe.

5.2.3 Collateral or other risk mitigants accepted by licensees must be valued at or less than the current fair value[7] under which the property could be sold under private contract between a knowledgeable and willing seller and an arm's-length buyer on the date of valuation.

5.2.4 All licensees should annually, or within such other period as may be agreed in writing by the Supervisor, monitor the values of, and the specific exposures (either immediate or contingent) attributable to the item being utilized as collateral or other risk mitigant. Frequency of monitoring should be increased where the market is subject to significant changes in conditions. An external body should annually review the values of the collateral.

5.2.5 Licensees should periodically assess whether the types and volume of collateral or other risk mitigants used, pose a concentration risk and whether it is within the tolerance levels set by the Board and defined in the Board approved policies and processes.

5.2.6 Licensees should demonstrate to the satisfaction of the Supervisor, that there are liquid secondary markets for disposal of all collateral or other risk mitigants in an expeditious and economically efficient manner. A reassessment of this condition must be effected both periodically and when information indicates material changes in the market.

5.2.7 Market prices for risk mitigants should be well established, independently verifiable and attainable by licensees, with realized values of these risk mitigants not deviating significantly from established market prices.

5.2.8 Licensees should ensure that reliance on collateral or other risk mitigants is not a substitute for an appropriate assessment of credit risk of the borrower, in particular, the borrower's ability to meet contractual obligations.

PRINCIPLE 6: EXPECTED CREDIT LOSSES

Licensees should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring credit risk on all lending exposures, and validating models used to assess and measure expected credit losses. The measurement of allowances should build upon those robust methodologies and result in the appropriate and timely recognition of expected credit losses in accordance with the applicable accounting framework.

6.1 Policies and Processes

6.1.1 Licensees should have appropriate policies and processes to validate models used to assess and measure expected credit losses. These policies and procedures should set out the accountability and reporting structure of the model validation process, internal standards for assessing and approving changes to the models, and reporting of the outcome of the model validation.

6.2 ECL Assessment and Measurement

6.2.1 Licensees should ensure the use of robust methodologies in the estimation of ECL that consider varying potential scenarios. This includes the development and documentation of the process to

[7] The determination of fair value is as prescribed by the existing accounting standards in Jamaica.

generate relevant scenarios to be utilized. The scenarios should not be subjective, biased or overly optimistic.

6.2.2 The ECL estimate should always incorporate the expected impact of all reasonable and supportable forward-looking information, including macroeconomic factors, that affects credit risk and collectability. Further, it should reflect an unbiased and probability-weighted amount that is determined by evaluating the range of possible outcomes as well as incorporating the impact of the time value of money.

6.2.3 Licensees should ensure procedures used to measure ECL are robust and take into account criteria such as updated valuations of credit risk mitigants (and, in particular collateral), cash flow estimates based on assessments of borrower-specific factors and current and future macroeconomic conditions, together with other relevant forward-looking information that could impact the expected collectability of the asset;

6.2.4 Licensees should be able to demonstrate that the forward-looking information factored into the ECL estimation process has a link to the credit risk drivers for particular exposures or portfolios.

6.2.5 Licensees should identify and document the ECL assessment and measurement methods (such as a loss rate method, probability of default (PD) or loss-given-default (LGD) method, or another appropriate and established method) to be applied to each exposure or portfolio. The ECL estimation technique used should be the most appropriate in the particular circumstances, and typically should be aligned with how the licensee manages the credit risk exposure.

6.2.6 Licensees should include a process for evaluating the appropriateness of significant inputs and assumptions in the ECL assessment and measurement method chosen. Licensees should also document the reasons why the selected method is appropriate, given the application of different ECL measurement methods to different portfolios and types of individual exposures.

6.2.7 Licensees should exercise care when determining the level of ECL provisions to be recognized for accounting purposes to ensure that the resulting estimates are appropriate (i.e. consistent with neutrality and neither understated nor overstated).

6.2.8 Licensees should implement sound and robust credit risk methodologies with the objective that the overall balance of the provision for ECL is developed in accordance with the applicable accounting framework and adequately reflects ECL within that framework.

6.3 ECL Model Validation

6.3.1 Licensees should have robust policies and procedures in place to validate the accuracy and consistency of its model-based rating systems and processes and the estimation of all relevant risk components, at the outset of model usage and on an ongoing basis.

6.3.2 Licensees should ensure that model validation is conducted when the ECL models are initially developed, and when significant changes are made to the models. The ECL models should be independently reviewed at least annually, or within such period as may be agreed by the Supervisor. There should be comprehensive documentation of the model validation framework and process.

6.3.3 Model validation should be performed independently of the model development process and by employees with the necessary experience and expertise, and all significant findings and outcomes of model validation should be reported in a prompt and timely manner to senior management.

6.3.4 An independent review of the model validation process should be conducted to evaluate its overall effectiveness and independence of the model validation process from the model development process. The findings of the review should be reported in a prompt and timely manner to senior management.

6.3.5 Licensees should implement an effective model validation process to ensure that the credit risk assessment and measurement models are able to generate accurate, consistent and unbiased predictive estimates on an ongoing basis.

6.3.6 Licensees should ensure existing processes and systems are evaluated and, where necessary, modified to collect and analyze relevant information affecting the assessment and measurement of ECL, including the maintenance of appropriate reports, details of reviews performed, and identification and descriptions of the roles and responsibilities of the personnel involved.

PRINCIPLE 7: MECHANISMS TO ENSURE TIMELY PROVISIONING

Licensees should formulate and implement adequate policies, procedures and information systems for the establishment of appropriate and robust provisioning levels, taking into account off-balance sheet exposures, and ensuring provisions are timely and reflect the impact of realistic economic conditions.

7.1 Policies and Processes

7.1.1 Licensees should ensure that the framework and methodology for establishing provisions, whether determined on a portfolio basis or individually (on a transaction basis), are robust.

7.1.2 Licensees should maintain adequate records to support their determination of loan loss potential and provisions, and make such records available to the Supervisor for inspection on request. If a review by the Supervisor concludes that additional provisions are required for individual loans or for the loan portfolio in aggregate, the licensee will be required to make the necessary adjusting entries.

7.1.3 Licensees should have policies and procedures to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions and past loss experience.

7.2 Provisioning Methodology

7.2.1 In order to establish an adequate Accumulated Credit Loss Reserve (ACLR) for anticipated loan and other credit related losses, a minimum provision should be made for each credit classification category at least quarterly following management's review of the institution's portfolio.

7.2.2 An increase in problem assets should result in an increase in provisions in line with regulatory requirements, as well as the entity’s internal policies.

7.2.3 A licensee's aggregate amount of individual and portfolio assessed asset loss provisions should be adequate to absorb estimated credit losses.

7.2.4 A licensee should provide the Supervisor with full access to information concerning the amount of provisions held against the various categories in relevant detail, within such period as may be agreed by the Supervisor.

7.2.5 For the purposes of these Guidelines, the Supervisor may, by notice in writing, direct the licensee to vary the level of provisions to a level which is more consistent with that licensee's risk profile, should the Supervisor determine that a licensee is insufficiently prudent in its approach to its own provisioning policies, or is significantly at variance with best practice provisioning policies.

7.2.6 When determining provisioning levels, facilities with the following characteristics are exempt:

a. Fully guaranteed by the Government of Jamaica, that is explicit, unconditional, legally enforceable and irrevocable over the life of the credit exposure in question;
b. Fully guaranteed by a sovereign state, other than the Government of Jamaica, with an investment grade rating from a credit rating agency approved by the Regulator for Jamaica, which said guarantee is explicit, unconditional, legally enforceable and irrevocable over the life of the credit exposure in question;
c. Extended directly to the Central Government of Jamaica;
d. Fully secured at all times by cash in Jamaican Dollars or other currencies readily convertible to Jamaican Dollars, delivered to the licensee and placed with it in a pledged special account;
e. Held for a period of less than one month and fully secured by investments that are investment grade, as rated by a credit rating agency approved by the Bank of Jamaica, so, however, that the licensee shall give the Bank of Jamaica prior notice of such exposure being incurred;
f. An interbank exposure of less than one month; or
g. An exposure arising from the underwriting of securities that are held for less than 90 days.

7.3 Fully Secured Credits

7.3.1 Where a non-accrual credit or portion thereof is fully secured, but collateral remains unrealized for a period of twelve months (i.e. nine months after non-accrual), except as otherwise stated below, a provision of 50% should be established against the credit balance due. Where collateral remains unrealized for a further six months (i.e. fifteen months after non-accrual), except as otherwise stated below, this provision should be increased to 100%.

7.3.2 Where collateral consists of both tangible and intangible movable assets, such as highly specialized plant or equipment, inventory, accounts receivable, cash flows, livestock, crops and others, the Supervisor may, after giving due consideration to the conditions attendant, extend the period over which full provision is achieved, up to but not exceeding twenty-four months (i.e. twenty-one months after non-accrual).

7.3.3 Where collateral consists of real estate, the Supervisor may, after giving due consideration to the conditions attendant, extend the period over which full provision is achieved, up to but not exceeding twenty-seven months (i.e. twenty-four months after non-accrual).

SCHEDULE 1

NON-ACCRUAL CREDITS

Non-Accrual Criteria

1. A credit should be classified as non-accrual where a payment is contractually 90 days or more in arrears.

Income Recognition Criteria

2. When a credit is classified as non-accrual, all previously accrued but uncollected interest is to be reversed against income in the accounting period in which the credit is classified as non-accrual. The amount reversed should include all recorded but uncollected interest in the year-to-date and prior periods.

3. Where a credit has been classified as non-accrual, subsequent interest payments should be dealt with as follows:-

   a. where a write-off has been made, credit (increase) Accumulated Loan Loss Reserve Account - Recoveries up to the amount of the Write-off. Where a provision has been established, credit (decrease) the loan principal and reverse the provision (debit the Accumulated Loan Loss Reserve account and credit the Provisions for Loan and Other Credit Losses account).

   b. when write-offs and provisions have been fully extinguished, credit interest income on a cash basis until the credit meets the criteria for returning to accrual status.

Changes in Classification

4. Non-accrual credits may revert to accrual status when all the criteria of Schedule 3, Part A, are simultaneously met.

SCHEDULE 2

FORBEARANCE

A. Identification of Forbearance

1. Forbearance occurs when the contractual terms of an exposure have been modified to reflect concessions granted by the licensee that it would not otherwise consider, due to deterioration in the borrower's financial condition. Such modifications should be agreed to in writing by the licensee and the borrower, and may include any one or more of, but not limited to, the following concessionary terms:

    a. A reduction in the originally agreed principal amount and/or interest rate;

    b. A write-off of a portion of the principal and/or interest outstanding;

    c. A deferral or extension of interest and/or principal repayments;

    d. Capitalization of interest or arrears;

    e. Extension of the tenor of the credit facility;

    f. Changing an amortizing loan to an interest payment only;

    g. Releasing collateral or accepting lower levels of collateralization;

    h. Allowing the conversion of debt to equity of the counterparty;

    i. Deferring recovery or collection actions for extended periods of time;

    j. The substitution of a new guarantor for the original guarantor and/or the addition of a new debtor.

2. Where the licensed entity considers the addition of a new debtor to an existing exposure pursuant to a forbearance exercise, the new debtor should be subject to the licensee's full credit risk assessments that would have been or are applicable to the original debtor and such an exposure would qualify as a performing exposure based on a positive credit risk assessment.

3. Concessions may only be granted when:

    a. The existing financial position of the borrower(s) clearly demonstrates the capacity to service the debt under the new terms of the contract;

    b. There is little or no doubt as to the ultimate collection of all principal and interest; and

    c. An initial cash payment is made or an improvement in security is taken.

4. Where the modified terms include capitalization of interest, the licensee should ensure that the security value is adequate to cover the total balance outstanding under the forborne exposure and the interest capitalized should be treated as deferred income and transferred to the profit and loss account only when it has been realized.

5. All forborne exposures should be approved by the licensee's Board of Directors or the appropriate delegated committee of the Board. The entity's records should clearly indicate the reasons for forbearance and the new concessionary terms and conditions granted.

6. Forborne exposures should be reported to the Supervisor. DTIs should pay particular attention to the appropriate credit risk classification of exposures on which forbearance has been granted more than once.

B. Refinanced Exposures

7. Where concessionary terms are granted for reasons other than the financial difficulties of the borrower and the concessionary terms are equivalent to new debt with similar credit risk characteristics, then the debt shall not be considered a forborne exposure but a refinanced exposure.

8. Exposures shall only be refinanced when the existing financial position of the borrower demonstrates a capacity to service the debt under the new terms of the contract.

C. Criteria for Exit from the Forborne Exposures Category

9. A forborne exposure will be identified as such until it meets both of the following exit criteria:

   a. When all payments, as per the revised contractual terms, have been made in a timely manner over a continuous repayment period of not less than one year (probation period for reporting). The starting date of the probation period should be the scheduled start of payments under the revised terms, regardless of the performing or non-performing status of the exposure at the time that forbearance was granted; and

   b. The counterparty has resolved its financial difficulty.

D. Forbearance and Performing Status

10. Where subsequent to the forbearance, reasonable doubt arises regarding the collectability of all amounts due under the contractual terms of the agreement, the exposure should be considered as further impaired and should be measured accordingly.

11. Forbearance may be granted on performing exposures. Any forborne exposure which subsequently becomes overdue for the payment of principal or interest, in full or in part, for 90 days or more according to the terms of the concession agreement should be placed in non-performing status and should remain in non-performing status until the borrower pays from his own funds all overdue principal and interest.

12. When forbearance is applied to a non-performing exposure, the exposure should remain non-performing until they meet both criteria for exit from the forborne exposures category. When the original exposure would have been categorized as non-performing had the forbearance not been granted, the new exposure should be categorized as non-performing.

SCHEDULE 3

RETURNING A CEDIT FACILITY OR NON-PERFORMING EXPOSURE TO PERFORMING STATUS AND LIMITATIONS ON CREDIT FACILITY RENEGOTIATIONS

A. Re-categorizing Credit Facilities or Non-performing Exposures as Performing

An exposure or a credit facility ceases to be non-performing and can be re-categorized as performing when all the following criteria are simultaneously met:

a. the counterparty does not have any material exposure more than 90 days past due;
b. repayments have been made when due over a continuous repayment period as specified by the supervisor of at least three months[8]. A longer repayment period can be required for non-performing forborne exposures;
c. the counterparty's situation has improved so that the full repayment of the exposure is likely, according to the original or, when applicable, modified conditions; and
d. the exposure is not "defaulted" according to the Basel II standard or "impaired" according to the IFRS accounting framework.

The following situations will not lead to the re-categorization of a non-performing exposure as performing:

a. a partial write-off of an existing non-performing exposure (that is, when a bank writes off part of a non-performing exposure that it deems to be uncollectible);
b. repossession of collateral on a non-performing exposure, until the collateral is actually disposed of and the bank realizes the proceeds (when the exposure is kept on balance sheet, it is deemed non-performing); or
c. extension or granting of forbearance measures to an exposure that is already identified as nonperforming subject to the relevant exit criteria for non-performing exposures.

B. Limitations on Credit Facility Renegotiations

The renegotiation (refinancing, rescheduling, renewal or other modifications) of credit agreements arising from weaknesses in the borrower's financial position and/or inability to repay would be allowable under the following conditions:

a. The borrower can demonstrate the capacity to service the credit facility under the new conditions of the contract;

b. Credit facilities classified as doubtful or loss would not be eligible for renegotiation unless such facilities have either an improvement in the facility collateral or an up-front cash payment;

c. In no case should the interest on the renegotiated facility be below the institution's average cost of funds;

[8] In exceptional circumstances and subject to prior agreement from supervisors, a shortened period may be used when aa bank puts in place specific remedial measures to restructure the borrower's business, that include a direct participation in the borrower, that are immediately applicable and make the full repayment of the exposure likely.

d. Commercial credit facilities can be renegotiated only twice over the life of the original facility and mortgage facilities and not more than twice in a five year period;

e. Where a credit facility has been renegotiated, it should not be immediately given a more favorable classification unless a continuous repayment period and collection in accordance with the contractual terms have been demonstrated for a minimum period of one year;

f. Any loan rescheduling involving capitalization of interest (whereby uncollected interest is added to unpaid principal at the payment date or maturity of a credit facility or advance) would require an increase in the value of the collateral to cover the capitalized interest, where applicable; and

g. The new credit facility resulting from the interest capitalization will be offered only if the borrower can demonstrate the capacity to service the facility under the new conditions of the contract.

The forbearance of an exposure may facilitate its return to ‘unimpaired’ or performing status. However, financial institutions should guard against unjustified or premature facility upgrades by utilizing, among other things, a probation period for reporting. The limitations on credit facility renegotiations in the recommendations above are intended to place parameters on the treatment of facility upgrades and upward reclassification, in order to ensure that the credit portfolio is accurately and fairly represented.