EASTERN CARIBBEAN CURRENCY UNION

PRUDENTIAL STANDARD FOR THE TREATMENT OF IMPAIRED ASSETS FOR INSTITUTIONS LICENSED UNDER THE BANKING ACT

January 2021

EASTERN CARIBBEAN CENTRAL BANK

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This Prudential Standard is issued by the Eastern Caribbean Central Bank, in the exercise of the powers conferred on it by section 184 of the Banking Act, 2015.

1. Commencement

This Prudential Standard shall come into effect on the **1st January 2022.**

2. Definitions

"Adequately-secured" means the collateral securing the facility has the following characteristics:

a) the fair value of the collateral is sufficient to ensure that the licensed financial institution will recover the outstanding principal and other previously unpaid amounts, and any estimated shortfalls in all remaining cash flow due over the life of the asset (this includes any amounts arising over the period until collateral is obtained and settled); and
b) there is reasonable assurance that collection efforts will result in payment of amounts due in a timely manner (including full compensation for overdue payments).

"Capital Base" means the total of paid-up share capital, statutory reserve fund, share premium account, retained earnings and any other capital account approved by the Central Bank, in the case of local licensed financial institutions, or such other capital account or similar measure as approved by the Central Bank in the case of a licensed branch of a foreign financial institution, less any amount by which that total has been impaired in either case.

"**Credit facility**" means loans, advances, lines of credit, commitment letters, standby facilities, letters of credit, overdrafts, and any other arrangement or facility whether on or off-balance sheet, inclusive of accrued interest.

"Fair Market Value" means the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion. Where fair value refers to the value of collateral or other forms of security held covering an asset, the fair value must have regard to the projected costs of obtaining and selling the security.

"**Hardcore balance**" means an outstanding debit balance in an overdraft account that shows no fluctuations over a 90 day period.

"Impaired assets" means any asset (on- or off-balance sheet) where there is evidence of weakness in the licensed financial institution's ability to collect the full amount of cash flows contracted to be received, based upon evidence of deterioration in the borrower's ability or willingness to settle the amounts due as prescribed by the original contracted terms and conditions.

"**Large exposures**" means exposures to a person or a borrower group, which amounts to ten per cent or more of the capital base of a licensed financial institution.

"**Level 1**" means the licensed financial institution on a stand-alone basis.

"**Level 2**" means the licensed financial institution's legal entity, its immediate parent entity, and all its legal subsidiaries, unless the Central Bank otherwise determines in writing, a different composition for a group of companies of which the licensed financial institution is a member.

"**Licensed Financial Institution**" means any person or incorporated entity licensed to conduct banking business under the Banking Act, 2015.

"Non-performing or impaired credit facilities" are exposures for which the ultimate collectability of principal and interest is compromised and there is no longer reasonable assurance that an institution will collect all amounts due, according to the contractual terms of the agreement. These would include loans that are past due 90 days and above, and overdrafts whose performance is defined in paragraph 10.4 (Substandard).

"Past Due Facility" means a facility where the contractual payments were not made on the contractual dates and remain unpaid.

"**Related Party**" would be treated as defined by the Banking Act, 2015. A licensed financial institution must treat entities as related for the purposes of this Prudential Standard, where there are:

a) a linkage by cross-guarantees;
b) common ownership or management;
c) ability to control or exert significant influence;
d) financial interdependency;
e) other connections which in the licensed financial institution's assessment, would lead it to regard facilities it has provided to the various entities as representing a common risk; or
f) where the Central Bank determines the entities are related.

Licensed financial institutions are not required to treat facilities provided to family members as related for the purposes of this Prudential Standard, provided independent income sources to support the repayment exist amongst the family members concerned.

"Restructured Facility" means a facility where the original contractual terms have been modified to provide for concessions of interest or principal or other payments due, or for an extension in maturity for reasons related to the financial difficulties of a borrower.

"Security" includes any arrangement that protects the licensed financial institution from losing, partially or fully, the principal, interest or other amounts due on a facility. This will include secured interests in assets, cash collateral and guarantees.

"**Uncollected interest**" means interest that is accrued on a credit facility, and is held in a suspense account.

3. Objectives

Credit risk usually represents the single largest risk facing a licensed financial institution. The presence of a well-functioning credit risk management framework is therefore fundamental to the safety and soundness of a licensed financial institution. It is the responsibility of the Board and senior management of a licensed financial institution to oversee the nature and level of credit risk which a licensed financial institution undertakes.

This Prudential Standard provides a framework for the monitoring, recognition, measurement, classification, provisioning, accounting and reporting of impaired facilities of licensed financial institutions. The Prudential Standard supplements and does not replace, any requirements under relevant legislative provisions or international financial reporting standards necessary to show a true and fair view of the financial state of affairs of a licensed financial institution.

The Prudential Standard seeks to ensure that licensed financial institutions have in place adequate frameworks for ensuring the carrying amounts of credit portfolios represent recoverable values; determining adequate allowances for credit losses; and ensuring that there is timely recognition of identified losses.

4. Application

(1) This Prudential Standard applies to all licensed financial institutions.

(2) This Prudential Standard applies to all on- and off-balance sheet assets of licensed financial institutions that give rise to counterparty credit risk.

(3) All licensed financial institutions shall comply with this Prudential Standard in its entirety on a Level 1 basis.

(4) All licensed financial institutions shall comply with the reporting components of this Prudential Standard on a Level 2 basis.

(5) Throughout this document, all submission timeframes will be measured in calendar days.

(6) This Prudential Standard should be read in conjunction with all other standards issued by the Eastern Caribbean Central Bank.

5. Overview

Adequate loan review and classification policies and practices are essential to an effective credit risk management framework. Licensed financial institutions are required to continuously assess their credit portfolios with a view to recognising any deterioration in credit quality and making adequate provisions for anticipated losses. Such reviews should systematically and realistically classify banks' credit exposures based on the perceived risk of default, and identify and assess the adequacy of provisions. This Prudential Standard provides guidance on the minimum criteria for the classification and application of provisions on impaired assets.

A licensed financial institution's credit risk management framework must include documented policies and procedures addressing the:

a) monitoring of credit quality;
b) recognition and appropriate measurement of impaired assets (both on- and off- balance sheet) in a timely manner;
c) consideration of collateral (including the sound and prudent valuation of collateral[1]);
d) classification of assets;
e) adequacy of provisions;
f) write-down or write-off of uncollectible assets; and
g) production of data and other information required for adequately assessing the credit risk exposure of the licensed financial institution and reporting to the Central Bank.

[1] In accordance with the Prudential Valuation Standards issued December 2017

Licensed financial institutions must have in place, adequate systems to ensure that facilities are appropriately classified and provisioned for regulatory purposes, in accordance with the requirements of this Prudential Standard.

Licensed financial institutions are required to observe the requirements of the International Financial Reporting Standards (IFRS) relating to impaired facilities, for their Audited Financial Statements.

6. Role of Board of Directors and Senior Management

The board of directors and senior management must ensure that their institutions have an appropriate credit risk assessment framework and internal controls in place, to consistently determine provisions for loan losses, in accordance with the institution's risk profile, its stated policies and procedures, the applicable international accounting standards and the specified treatment outlined in this Prudential Standard.

The board of directors must instruct senior management to develop and maintain an appropriate, systematic and consistently applied framework to determine provisions for loan losses. The framework must be flexible to ensure the inclusion of new or additional relevant information about the collectability of financial assets, and consistently allow for the capturing of such information in determining loan loss provisions.

The board of directors must undertake at least on an annual basis, a review of the credit risk assessment framework and approve material changes to credit risk management policies and procedures, and the related controls and systems. It is the responsibility of the board of directors and senior management of each licensed financial institution to maintain loan loss provisions at an appropriate level and to oversee and monitor the credit risk assessment and provisioning processes.

7. Enforcement

Licensed financial institutions found in violation of this Prudential Standard are subject to remedial actions specified in Section 75[2] of the Banking Act 2015.

8. Regulatory Reporting Requirements

(1) Each licensed financial institution shall submit a copy of its credit risk management policies and procedures to the Central Bank within 30 days of approval by the Board. The revised policies and procedures shall be submitted to the Central Bank, as they are approved.

(2) Licensed financial institutions shall submit to the Central Bank on a an annual basis via electronic prudential return form, Prudential Return 08 - Annual Classification of Assets, within three (3) months after the end of the financial year to which it relates.

(3) A report on differences between International Financial Reporting Standards and Regulatory provisioning shall be submitted to the Central Bank at least annually. The report must include a reconciliation of the two approaches, detailing the differences in recognition of impairment and provisioning levels.

(4) Within three months of its financial year end, a licensed financial institution shall provide the Central Bank with a declaration from its Chief Executive Officer or Managing Director, endorsed by the Board, that they have:

a) identified the credit risk inherent in the licensed financial institution at Level 1 and Level 2;
b) appropriately recognised impairment in the assets of the licensed financial institution; and
c) applied provisions appropriate for the potential losses in financial assets due to credit risk.

[2] Section 74 in the Anguilla Banking Act 2015

(5) A licensed financial institution must submit to the Central Bank, an explanation endorsed by the Board, of any qualifications made to the Chief Executive Officer or Managing Director's declaration, including plans for corrective actions to address any deficiencies identified in the risk management systems.

9. Repeal

The Prudential Credit Guidelines which came into effect in June 1997 are hereby repealed.

10. Standards

10.1 Credit Risk Assessment

(1) Licensed financial institutions must continuously assess the credit risk inherent in their business.

(2) The level and intensity of credit risk assessments should reflect the impact of potential credit exposures, both individually and on an aggregate basis, on the earnings and capital of the licensed financial institution.

(3) All large exposures, restructured loans and advances, special mention, substandard, doubtful and loss facilities; all unsecured credit facilities; all loans to related parties, significant shareholders[3] and their affiliates; loans to Directors, staff, external auditors; and all credit facilities granted as an exception to policy, must be reviewed at least annually.

(4) At least 80.0 per cent of the value of the credit portfolio (including off-balance sheet items), must be reviewed annually.

(5) To ensure continuous assessment, there should be a review of at least 20.0 per cent of the credit portfolio each quarter. Credit facilities that were reviewed in the preceding quarter, do not qualify for inclusion in the current quarter's 20.0 per cent threshold.

(6) The information assessed as part of the loan reviews should include at a minimum:

a) the terms, the interest rate, the current balance, status, and the purpose of the facility;

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[3] As defined by the Banking Act 2015

b) for commercial loans, the business of the borrower, balance sheets, cash flows and other financial data both on the business and the guarantors;
c) an evaluation of the current status of the project being financed;
d) the security, including up-to-date valuations of collateral[4], legal assignments and insurances;
e) the perfection of security;
f) the history of the borrower including the servicing of previous borrowings;
g) other borrowings, including borrowings with other banks; and
h) if part of a group, the performance of facilities to other members of the group.

(7) A licensed financial institution's credit risk assessment framework must include measures to:
a) enable the licensed financial institution to understand the current financial condition of an entity which is a party to a credit facility provided by the institution;
b) monitor compliance with existing covenants attached to credit facilities provided by the institution;
c) assess, where applicable, the value of collateral held;
d) identify contractual payment delinquencies and classify potential problem credit facilities on a timely basis; and
e) ensure prompt application of appropriate remedial management actions.

(8) A licensed financial institution’s credit risk assessment must produce, at a minimum, timely and accurate information on:
a) impaired facilities;
b) past due facilities;
c) the fair market value of the security held against impaired and past due facilities;
d) the status of other sources of cash flows upon which a licensed financial institution might be reliant in determining incurred or estimated future credit losses on facilities;
e) estimated future credit losses reflecting the inherent credit risk in its business; and
f) the value of specific and general provisions.

[4] See Valuation Standards

(9) A licensed financial institution must have policies and procedures to ensure timely responses to identified material changes in its credit risk profile. Policies, procedures and controls governing credit risk assessments must be commensurate with the scope, scale and complexity of the business undertaken by the institution.

(10) As part of its credit risk assessment framework, a licensed financial institution must establish criteria for identifying and reporting to senior management and the Board, those credit exposures deemed to be a source of concern.

(11) The criteria must be approved by the Board of the licensed financial institution and be used as a trigger to consider whether to change the pattern and frequency of monitoring of such credit exposures, to undertake corrective actions or to make the applicable changes to provisioning and capital held against potential losses.

(12) The criteria should be consistent with the classification criteria and classification categories specified in paragraph 10.4.

(13) Where a licensed financial institution uses different classification categories, these must be mapped to the classification categories specified in this Prudential Standard, for reporting to the Central Bank.

10.2 Recognition of Impaired Credit Facilities

(1) A licensed financial institution must have policies and procedures to ensure the timely and reliable recognition of impaired credit facilities. Such policies and procedures must provide a documented analytical framework approved by the Board of the licensed financial institution for assessing impairment. Further, the credit risk management policy must be supported by appropriate accounting procedures, and information systems, to ensure its integrity.

(2) The existence of any of the following factors will, at a minimum, constitute evidence of weakness and require a credit facility (on- or off-balance sheet) to be regarded as impaired:

a) an asset is more than 30 days past due and not adequately secured;

b) an asset is 90 days or more past due, regardless of security;

c) an entity to which facilities have been provided is subject to administration or bankruptcy proceedings;

d) with respect to off-balance sheet facilities, the licensed financial institution is unlikely to receive timely payment of the full amounts which it is contracted to advance; and
e) the asset has been restructured.

(3) A Restructured Facility must be classified as *Substandard* at a minimum, as per paragraph 10.4.

(4) A Restructured Facility must remain with its current classification until the asset has operated in accordance with the restructured terms and conditions, for a period of at least twelve months or three payment cycles, whichever is longer.

(5) Facilities that have resulted from the conversion of hardcore elements of overdrafts into term loans, must be treated as a Restructured Facility.

(6) When restructuring a credit facility that is secured by collateral, a new valuation of the collateral should be undertaken to ensure appropriate coverage of the exposure, where the valuation is older than three years.

(7) Non-performing assets for the purposes of this Prudential Standard include any asset (on- or off-balance sheet) where the principal or interest payments are past due by 90 days or more.

(8) Overdrafts and facilities which do not have pre-established repayment terms are considered non-performing when any one or more of the following conditions exist:
a. the facility exceeds the approval limit for 90 consecutive days or more;
b. the facility has expired;
c. interest is due and unpaid for 90 days or more;
d. the account has been inactive for 90 days; or
e. Payments have been insufficient to cover principal, interest and bank charges over a 90-day period.

(9) Credit cards are considered non-performing when payments made on the cards are below the minimum payment for a 90 day period.

(10) Where a credit facility has been identified as impaired, a licensed financial institution must classify the asset in accordance with paragraph 10.4 and raise regulatory provisions in accordance with the provisioning schedule prescribed by this Prudential Standard.

10.3 Measuring Impairment

(1) A licensed financial institution must have policies and procedures, approved by the Board, which provide for prudent and realistic measures of the impairment of facilities incorporating, as appropriate, the exercise of experienced credit judgements and valuation of collateral. Such measures must incorporate estimates of future cash flows[5].

(2) As part of its measurement of impairment, a licensed financial institution must have policies and procedures to ensure the reliability, consistency and prudence of estimates of future cash flows used in determining the level of impairment of facilities.

(3) A licensed financial institution must have policies and procedures for establishing, recording and reviewing the value of collateral held against facilities provided to entities. These policies and procedures must include at a minimum:

   a) the acceptability of various forms of collateral and the circumstances in which it may be used;
   b) the valuation of collateral prior to granting a facility and periodic updates over the life of the facility; and
   c) procedures for ensuring that the collateral is, and continues to be, enforceable and realisable.

(4) The timing and intensity of review of collateral values must have regard to the reliance placed on collateral values in estimating future cash flows. It is the responsibility of the Board and senior management of a licensed financial institution to ensure that where the value of collateral materially underpins estimates of future cash flows, the values of collateral used are timely, reliable and the licensed financial institution's physical access to collateral is assured.

(5) For the purposes of this Prudential Standard, all assets taken as collateral by a licensed financial institution must be valued in accordance with the Valuation Standard for Financial Institutions licensed under the Banking Act, 2015.

(6) Reliance on security must not:

   a) be a substitute for an appropriate assessment of a party to a facility, in particular, the party's ability to meet its contractual obligations; or
   b) compensate for insufficient information about a counterparty.

[5] Includes principal and interest payments

10.4 Classification of facilities

Licensed financial institutions should assess credit exposures based on the degree of risk presented and the likelihood of contractual payments by the borrower. Credit facilities that are performing and unimpaired are categorised as *Pass* or *Special Mention*.

For loans that are partially secured by cash, a split classification may be applied, whereby the cash-secured portion is classified as *Pass*, and the remaining balance which is unsecured is classified based on the appropriate classification criteria.

(1) All credit facilities (on- and off-balance sheet) must be classified using the following classification criteria:

<u>*PASS*</u>

All of the following conditions apply:

i. Adequate financial information available to appropriately assess the ability of the counterparty to service the facility.
ii. No evidence of any adverse financial information on the counterparty.
iii. The facility is not more than 29 days past due, its contractual repayment period.

For overdraft facilities:

iv. Overdrafts operating within the approved limit, with payments adequate to cover bank charges and allow for fluctuations in the overdraft balance, in accordance with the overdraft agreement, in the last three (3) months.

<u>*SPECIAL MENTION*</u>

Special mention facilities are facilities that are performing. However, due to particular weaknesses, these facilities require increased attention to prevent further deterioration.

Any one of the following conditions applies:

i. The facility is not more than 29 days past due its contractual repayment period, but certain factors may affect the borrower's ability to service the facility in full or the market value of the collateral is in doubt.

These factors include:

a. The borrower may be experiencing adverse operating trends (such as declining revenues or margins) or an ill-proportioned balance sheet (such as decreasing inventory without an increase in sales, high leverage, tight liquidity);
b. Non-financial reasons such as management problems or pending litigation;
c. Facilities which could deteriorate because of adverse economic or market conditions, such as changes in interest rates or entry of new competitors; and/or
d. Asset secured by Government Securities where issuing Government is in default of obligations.

ii. The facility is 30–89 days past due, its contractual repayment period and adequately-secured.
iii. Inadequate financial information is available to appropriately assess the ability of the counterparty to service the facility.
iv. Overdrafts operating within the approved limits, with the facility not being repaid to at least 50 per cent of limit at least once in the last three (3) months or in accordance with the terms of the agreement, whichever is shorter.

SUBSTANDARD

Substandard facilities display characteristics that jeopardise the full liquidation of the debt. Substandard facilities have an increased probability of default if the deficiencies are not corrected. These facilities require more intensive supervision by bank management. A credit that is currently performing but has weaknesses that cast doubt on the customer's ability to comply with the terms and conditions of the credit, may be classified as sub-standard.

Any one of the following conditions applies:

i. Facilities 30-89 days past due its contractual repayment period and not adequately secured.

ii. Facility 90-179 days past due, its contractual repayment period and adequately secured.
iii. Facilities 180-364 days past due, their contractual repayment period and adequately secured.
iv. Overdrafts continuously operating in excess of the approved limit for a period of 30 days or more.
v. Overdrafts on which the contracted interest payment and or principal have not been paid for 90 days or more and this is not as a result of any special client arrangement. There must be documentary evidence of the special client arrangement. Licensed financial institutions should have in place, documented policies with respect to discretionary excesses.
vi. Overdrafts with inadequate fluctuations, and principal not being fully repaid at least once in the last 12 months.
vii. The facility has been restructured and is adequately secured.
viii. Other adverse factors, which give rise to some doubt as to the ability of the customer to comply with the agreed repayment terms.

DOUBTFUL

Doubtful facilities have well-defined credit weaknesses that make collection or liquidation in full, highly questionable and improbable. A doubtful asset has a high probability of total or substantial loss, but because of specific pending events that may strengthen repayment ability, has not been classified as *Loss*. These facilities should be managed by a skilled and experienced team of credit risk experts.

Any one of the following conditions applies:

i. The credit exhibits the weaknesses inherent in those classified as *Substandard*.
ii. The outstanding balance has been called but has not been liquidated within a period of 30 days.
iii. Well defined credit weaknesses, such as borrower's cash flow being assessed as insufficient to service the debt as arranged.
iv. The primary source of repayment has become insufficient to service debt and the institution has to look at secondary sources, such as collateral or guarantees.

v. Facilities 90-179 days past due, their contractual repayment period and not adequately secured.
vi. Facilities 180-364 days past due, their contractual repayment period and not adequately secured.
vii. Overdrafts with inadequate fluctuations, and not being fully repaid at least once in the last 24 months.
viii. The facility has been restructured and inadequately secured.

<u>*LOSS*</u>

Facilities classified as *Loss* are uncollectible and must be written off within 90 days after being classified as *Loss*.

Any one of the following conditions applies:

i. The credit exhibits the weaknesses inherent in those classified as *Doubtful*.
ii. Facilities considered uncollectible.
iii. Facilities at least 365 days past due, their contractual repayment period, regardless of security.
iv. Facilities which may have some recovery value but it is neither practical nor desirable to defer write-off.
v. Unsecured facilities 180 days past due, their contractual repayment period.

(2) Licensed financial institutions at their discretion, may apply more stringent classification and provisioning criteria.

(3) A licensed financial institution must demonstrate to the Central Bank if requested, that any value ascribed to collateral is reliable in a recovery situation.

(4) Cash collateral must be held by the licensed financial institution as a deposit, with appropriate controls on withdrawal.

(5) Asset classification should be carried out based on an assessment of the borrower's ability to repay the asset in full.

(6) Where a licensed financial institution has multiple facilities to a group of related entities, the licensed financial institution must have policies and procedures to ensure that if one asset is assessed as impaired, consideration is given to whether it would be prudent to

classify the remainder of the group's facilities as impaired. Extension of the impairment classification is not required if:

a) the various facilities are not cross-collateralised, and there are no cross guarantee arrangements between the related entities; or
b) there are cross-collateral and guarantee arrangements but, in aggregate, there is sufficient security among the group of related entities to ensure ultimate collectability of all principal and interest on both the impaired and performing exposures.

(7) All facilities identified as impaired must be classified as *Substandard*, *Doubtful* or *Loss*.

10.5 Provisioning for Impaired Credit Facilities

For regulatory reporting purposes, licensed financial institutions must report specific provisions on the outstanding principal balance, in accordance with the following:

Classification	Level of Provision
Pass	0%
Special Mention	5%
Substandard	25%
Doubtful	60%
Loss	100%

(1) Provisions should be made for all adversely classified credit facilities (on- and off-balance sheet).

(2) A general provision of 2.0 per cent of the total of unreviewed facilities must also be reported.

(3) **For the purpose of calculating loan loss provisions as per the International Financial Reporting Standards,** licensed financial institutions must utilise a realistic time to collect (TTC) in determining the fair market value of real estate collateral of impaired credit facilities. Licensed financial institutions shall have a Board approved policy to caluculate the TTC. The TTC must represent a general average of the time to dispose of each type of collateral, utilising at a minimum, the following assumptions:

a. The performance of the real estate market in the respective member country;
b. The enacted foreclosure legislation;

c. The collateral type, whether residential, commercial or bare land;
d. The historical sales experience for similar real estate collateral;
e. The number of years the credit facility is in non-accrual status;
f. The length of time the licensed financial institution have actively begun procedures to dispose of the collateral.

In cases where a licensed financial institution uses a TTC less than the historical average, the licensed financial institution must support this decision with a definitive agreement to sell the property within the specified timeframe. **The TTC shall never be less than the time the credit facility has been classified as non-accrual**. In cases where the average TTC is less than the time the credit facility has been in non-accrual, the licensed financial institution shall use the number of years in non-accrual as the TTC in their calculations as per the International Financial Reporting Standards.

(4) Where the provisions based on the Central Bank's classification methodology is higher than that determined under the International Financial Reporting Standards, licensed financial institutions are required to compute the difference. The difference shall be a deduction from the licensed financial institution's Tier 1 capital.

(5) The working papers and reports for both methodologies must be available to the Central Bank for inspection/review upon request.

10.6 Transitional Arrangement

Effective from the date of commencement, for regulatory purposes, all licensed financial institutions will calculate total loan loss provisions based on paragraph 10.5 of this Standard, and be guided by paragraph 10.5 (3) and (4). The reporting and application requirements for facilities classified as *"Loss"* will be phased in over a three-year period.

- During the first year after commencement, licensed financial institutions will be required to report and apply a minimum of 50.0 per cent of the total loan loss provisions.
- During the second year after the date of commencement, licensed financial institutions will be required to report and apply a minimum of 75.0 per cent of the total loan loss provisions.

- From the third year of commencement, licensed financial institutions will be required to report and apply 100 per cent of the total loan loss provisions.

There shall be no transitional period with regard to the implementation of paragraph 10.5(3) and (4).

10.7 Collateral

(1) The underlying security, its market value and its recoverable value are important factors to consider in the process of underwriting any secured credit facility. The type of security to be obtained will depend on the type and purpose of the credit facility. Factors that impact the decision to accept a particular type of security should include marketability and valuation.

(2) Licensed financial institutions must have standardised valuation techniques, which should be applied consistently. These techniques should be consistent with the Valuation Prudential Standard for Licensed Financial Institutions under the Banking Act, 2015 (Valuation Standard).

(3) The value of security can change considerably in the life of any credit exposure. As such, it is important that licensed financial institutions have up-to-date valuations, where there is reliance on security for full payment of amounts due on a facility. The frequency of collateral valuations shall be in line with the Valuation Standard.

(4) Licensed financial institutions must obtain new valuations of collateral for facilities classified as Doubtful if the current valuation is older than 24 months.

(5) Pursuant to the Valuation Standard, licensed financial institutions must establish policies and procedures on real estate appraisals to include acceptable valuation methods, the format of appraisal reports and clearly documented criteria concerning the conduct of appraisals.

(6) Licensed financial institutions must maintain and revise periodically an approved list of certified or licensed quantity surveyors and valuation surveyors or independent appraisers of real estate.

(7) Licensed financial institutions should regularly assess the value of floating assets due to the continuous changes in the volume or value of these assets. Floating assets include, but

are not limited to, cash, accounts receivable, inventory and outstanding shares, which may be used as collateral to secure credit. An assessment of pledged assets, other than cash, should be conducted at least annually and supported by relevant third party information. Pledged cash balances should also be reviewed on a quarterly basis to ensure that the balance pledged supports the outstanding credit facility.

(8) Managers' valuations are acceptable for collateral pledged on credit facilities with outstanding balances up to $270,000. However, a valuation from an independent appraiser is required for collateral pledged on credit facilities with outstanding balances over $270,000. Managers' appraisals should be considered for internal use only, by the licensed financial institution and should not be utilised in lieu of an expert appraisal for reporting to the Central Bank.

10.8 Accounting for Impaired Facilities

(1) In accounting for impaired facilities, the following should be adhered to:

a) All categories of non-performing credit facilities should automatically be placed in non-accrual status, that is, interest due thereon should not be recognised as income unless such loans are adequately secured and the full collection is assured within three months. Neither should interest be accrued on overdrafts when the approved limit has been reached and/or when credits to the account are insufficient to cover interest accruals for at least a three-month period, whichever is sooner.

b) All interest previously accrued and uncollected but taken into revenue should be reversed and credited to a memorandum account specifically created for this purpose, unless paid in cash by the borrower. Future interest charges should also be credited into the same account until such facilities begin to perform.

c) When payments are received for impaired facilities, payments shall first be applied to the outstanding principal before allotments are made to interest charges accrued in accordance with section (b) above.

d) A non-accrual loan may be restored to accrual status when the licensed financial institution documents and provides to the credit committee or board of directors evidence that:

i. all arrears of principal and interest have been paid in full and the facility is performing;
ii. the asset has performed in accordance with contractual terms for twelve months or three payment cycles, whichever is longer;
iii. it is reasonably expected that the customer is capable of fully servicing all future obligations under the facility; and
iv. In the case of overdrafts, when the account is operating within the established limit and all interest arrears have been paid in cash.

(2) Loans and advances must be written off within 90 days after being classified as loss. This does not, however, extinguish the bank's right to full recovery of the outstanding debt.

10.9 Restructured Facilities

Licensed financial institutions must not modify facilities in order to postpone or avoid debt classification or provisioning requirements, or the avoidance of ceasing interest accruals. The following are specific requirements relating to the modifying of facilities:

a) The customer's existing financial position should allow for the servicing of debt under the revised terms and conditions.
b) Commercial loans should not be restructured more than twice over the life of the original loan. Commercial loans that have been restructured more than twice over the original life of the loan must be classified as *Doubtful*.
c) Personal mortgages and loans should not be restructured more than twice in a five year period. Personal mortgages and loans that have been restructured more than twice in a five year period must be classified as *Doubtful*.
d) The uncollected interest should be capitalised and included in the restructured asset and reported separately to the Central Bank.
e) The collateral for restructured facilities should cover the full amount of the principal and capitalised interest.
f) Restructured facilities should not be reclassified upward for at least twelve months or three payment cycles (whichever is longer) following the commencement of the new arrangements.

10.10 Provisioning for Impaired Investments

(1) At the end of each reporting period, an entity is required to assess whether there is any indication that an investment may be impaired (that is, its carrying value may be higher than its recoverable value).

(2) The International Accounting Standards include a list of external and internal indicators of impairment. If there is an indication that an investment may be impaired, then the investment's recoverable amount must be calculated.

(3) Impaired investment securities must be provisioned for. Some of the factors to be taken into consideration in determining impairment include:

   a) Adverse conditions specifically related to the issuer, the security or to specific conditions in an industry or in a geographic area.
   b) Downgrading of the security, issuing authority or guarantor by a rating agency.
   c) Deterioration in the financial condition of the issuer.
   d) Significant and prolonged decline in the fair value of available for sale investments.

10.11 Treatment of Other Impaired Assets

(1) Licensed financial institutions must assess all other assets at the end of the reporting period, for any indication of impairment. If an asset is found to be impaired, the licensed financial institution must reduce the existing carrying value of the asset to its recoverable value, and the impairment loss shall be recognised immediately in the profit and loss account or in accordance with the relevant International Accounting Standards. The new carrying value of the asset would also affect its depreciation or amortisation charge, as the new carrying value must be depreciated or amortised over the remaining useful life of the asset.

(2) Impairment losses on revalued assets shall be recognised in other comprehensive income, representing a decrease in the revaluation reserve.

(3) Any reversal of impairment losses shall be recognised via the same method that the initial loss was recognised. Impairment losses which were previously recognised through the profit and loss account should be reversed in the same manner. Impairment losses which

reduced the revaluation surplus of revalued assets shall be reversed through other comprehensive income, and thus be treated as a revaluation increase.

(4) All reversals of impairment losses shall be treated in accordance with the relevant International Financial Reporting Standard.

10.12 Treatment of Off-Balance Sheet Exposures

(1) The recognition, measurement, provisioning and reporting of impairment of off-balance sheet facilities are to be undertaken in the same manner as on-balance sheet facilities.

(2) Appraisal of off-balance sheet facilities should be undertaken quarterly with a view to determining the extent of loss the licensed financial institution may likely sustain.

(3) The principal off-balance sheet exposures to be captured by this Prudential Standard are likely to be direct credit substitutes, commitments, and pending and protracted litigations, or any other exposure so classified.

(4) Direct credit substitutes (such as guarantees and standby letters of credit) are usually converted into on-balance sheet items when called. However, there may be circumstances when the licensed financial institution is reasonably certain that such an instrument will be called upon at a future date, because of uncertainty about the counterparty. In such cases, the off-balance sheet exposure should be regarded as impaired and a provision made.

(5) Loan commitments that are irrevocable should be classified as impaired, if the creditworthiness of the client has deteriorated to an extent that makes full repayment of any loan drawdown (or associated interest payments) doubtful