GOVERNMENT NOTICE NO. 53

FINANCIAL SERVICES ACT

(CAP.44:05)

FINANCIAL SERVICES (CREDIT RISK MANAGEMENT FOR DEVELOPMENT FINANCE INSTITUTIONS) DIRECTIVE, 2018

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IN EXERCISE of the powers conferred by section 34 of the Financial Services Act, I, DR. DALITSO KABAMBE, Registrar of Financial Institutions, make the following Directive—

PART 1—PRELIMINARY

Citation

1. This Directive may be cited as the Financial Services (Credit Risk Management for Development Finance Institutions) Directive, 2018.

Application

2. In this Directive, unless the context otherwise requires—

"book value" means the value of an asset as stated on the books of accounts of the institution or the amount at which an asset is recognized in the statement of financial position;

"classification categories" means classification categories of standard, sub-standard, doubtful and loss as outlined in this Directive;

"fair value" means the amount for which an asset could be exchanged between knowledgeable and willing parties in an arm's-length transaction and not in a forced sale;

"group of related borrowers" means a group of debtor companies or enterprises operating under common control of an individual or of a group of related individuals, or of a corporate body acting as a controlling party as defined in the Act;

"institution" means a development finance institution;

"large exposure" means a direct or an indirect exposure, of an institution to any person or group of related parties equal to or exceeding 10% of core capital of the institution;

"loan loss reserve" means a provision arising from differences in the amounts of specific provisions on identified losses from using prudential guidelines and International Financial Reporting Standards (IFRS);

"long term credit facility" means a credit facility with a repayment period of more than 60 months;

"medium term credit facility" means a credit facility with a repayment period of not less than 12 months but not more than 60 months;

"non-performing credit facility" means a credit facility which is

classified in one of the following asset categories: substandard, doubtful or loss;

"short term credit facility" means a credit facility with a repayment period of not more than 12 months; and

"specific provision" means the amount of reserves set aside to cover bad debts and computed as the difference between the book value of the credit facility and the estimated recoverable amount.

PART II—OBJECTIVES

Objectives

3. The objectives of this Directive are to ensure that an institution—

(*a*) enhances its credit risk management practices;

(*b*) complies with capital adequacy requirements particularly with regard to impairment of credit facilities and recognition of income and expenses;

(*c*) properly identifies and makes provisions on non-performing credit facilities; and

(*d*) presents statements of financial position and statements of comprehensive income that properly reflect the financial impact of non-performing credit facilities.

PART III— REQUIREMENTS

Board responsibility

4. The Board or a credit committee of the Board of an institution shall—

(*a*) approve all credit facilities;

(*b*) adopt and ensure implementation of a written policy covering, among other things, the following—

(i) approval of credit facilities and their timelines;

(ii) environmental impact assessments for applicable projects;

(iii) interest rate risk management;

(iv) syndication or co-financing;

(v) guarantee arrangements by the institution itself or by other financiers;

(vi) write-offs of loss credit facilities;

(vii) collection procedures, including on past due credit facilities;

(viii) sectors of lending the institution may be engaged in;

(ix) lending in foreign currency and foreign exchange risk management;

(x) restructuring of credit facilities;

(xi) pricing of credit facilities; and

(xii) practices relating to various kinds of collateral and valuation;

(*c*) determine primary economic impact measures and acceptable economic rate of return for the institution;

(*d*) determine, adopt and ensure implementation of sound risk management policies with respect to classification and provisioning on non-performing credit facilities; and

(*e*) review and approve the policies on an annual basis or as and when there are applicable regulatory changes.

Executive officer's responsibility

5.—(1) An executive officer shall—

(*a*) put in place an analytical framework for assessing credit quality;

(*b*) have written valuation methods for determining fair value of collateral and their impact on the capital and earnings of the institution;

(*c*) submit periodic reports to the Board about the institution's loan portfolio and projects under implementation;

(*d*) ensure that the institution has robust management information system; and

(*e*) ensure adherence to the requirements of this Directive.

(2) All documentation in subparagraph (1) shall be made available to the Registrar during on site examination or when requested.

Lending criteria

6. An institution shall grant a credit facility to an applicant where the application of the credit facility meets the following conditions—

(*a*) be commercially viable;

(*b*) ability to service the loan;

(*c*) creates employment;

(*d*) generates foreign currency; and

(*e*) generates tax revenue.;

(2) An institution shall obtain a credit report of the applicant from a licensed credit reference bureau prior to granting a credit facility.

Funding records

7. An institution shall maintain and update its records of committed and undisbursed lines of credit.

Loan portfolio audit

8. The internal audit function shall review the institution's loan portfolio at least on a yearly basis.

Independence of the risk function

9.—(1) The risk function shall be independent of the business and credit underwriting functions.

(2) The risk function shall perform quarterly review of the institution's loan portfolio.

Classification of non-performing credits

10. An institution shall classify credit facilities in the following categories—

(*a*) Standard – A credit facility shall be classified as standard if—

(i) it is current;

(ii) repayment installments are not more than 30 days overdue for short term credit facility; and

(iii) repayment installments are 31 to 90 days overdue for medium and long term credit facility;

(*b*) Special Mention – A credit facility shall be classified as special mention if—

(i) repayment installments are 31 to 90 days overdue for short term credit facilities; and

(ii) repayment installments are 91 to 180 days overdue for medium and long term credit facilities;

(*c*) Substandard – A credit facility shall be classified as sub-standard if—

(i) repayment installments are 91 to 180 days overdue for short term credit facilities; and

(ii) repayment installments are 181 to 365 days overdue for medium and long term credit facilities;

(*d*) Doubtful – A credit facility shall be classified as doubtful if—

(i) repayment installments are 181 to 365 days overdue for short term credit facilities; and

(ii) repayment installments are 366 to 746 days overdue for medium and long term credit facilities; and

(*e*) Loss – A credit facility shall be classified loss if—

(i) repayment installments are more than 365 days overdue for short term credit facilities; and

(ii) repayment installments are more than 746 days for medium and long term credit facilities.

Review of credit facilities

11.—(1) An institution shall review all credit facilities on a quarterly basis for purposes of credit classification and for determining whether the credit facility has suffered a decline in, or impairment to, value.

(2) Where between formal quarterly reviews, the institution establishes a significant deterioration in the quality of an individual credit or in a material part of the credit portfolio, the institution shall—

(*a*) promptly assign the credit facility to a new classification category that accurately reflects the status of the credit facility; and

(*b*) make applicable provisions to the income statement.

(3) An institution shall review each large exposure on an individual item basis.

Write-offs

12. An institution shall write off all credit facilities that were classified as loss, from its books in the subsequent quarter preceding the one in which the loss classification was made.

Income recognition

13.—(1) An institution shall place all non-performing and value-impaired credit facilities on non-accrual status and the institution shall immediately—

(*a*) cease reflecting in its income statement the accrual of interest;

(*b*) reverse uncollected interest which has previously been accrued; and

(*c*) not classify interest as income except when received in cash.

(2) An institution shall place a non-performing credit facility on non-accrual status regardless of any collateral held against it.

(3) An institution shall restore a credit facility which had been placed on non-accrual status to accrual status only when the borrower has made all payments of past-due principal and interest.

Loan loss provisions

14. An institution shall determine the amount of the provision for loan loss impairment in the manner set out in the Schedule hereto.

Accounting treatment for provisioning of losses

15.—(1) Where provisions required under this Directive are higher than impairment charges computed under International Financial Reporting Standard (IFRS) the excess in provisions shall be treated as an appropriation of retained earnings to loan loss reserve.

(2) The loan loss reserve in subparagraph (1) shall not be treated as capital where it is no longer available to meet unidentified losses which may subsequently arise elsewhere in the credit portfolio.

(3) An institution shall report loan loss reserves separately on the call report as prescribed by the Registrar.

(4) An institution may only credit the loan reserve in subparagraph (1) back to retained earnings after recoveries have been made on non-performing credit facilities or with prior approval of the Registrar.

Restrictions

16.—(1) An institution shall not restructure, renegotiate, roll-over or modify the terms of a credit facility unless approved by the Board.

(2) Credit facilities to a single borrower or group of related borrowers shall not exceed 25% of the institution's core capital without prior approval by the Registrar.

(3) An institution shall not extend any overdraft credit facilities.

PART IV—ENFORCEMENT

Monetary penalties

17. The Registrar may impose the following monetary penalties for violation of the provisions of this Directive—

(*a*) for the institution, up to K50,000,000; and

(*b*) for natural persons who are members of the Board of directors, or senior management up to K10,000,000.

(2) An institution that fails to comply with the provisions of this Directive shall have its financial statements qualified by its external auditor.

Administrative Penalties

18 In addition to the monetary penalties imposed in paragraph (17), the Registrar may impose directions, administrative penalties and enforcement action as provided for under the Act.

SCHEDULE (para. 14)

Classification Category	Repayment Status	Provision Requirement
Standard	Short term 0-30 days overdue Medium and long term: 31-90 days	0%
Standard	Short term: 91 days overdue Medium and long term: 91-180 days	5%
Standard	Short term: 91 days overdue Medium and long term: 181-365 days	20%
Doubtful	Short term: 91 days overdue Medium and long term: 366-746 days Short term: 91 days overdue	50%
Loss	Medium and long term: over 746 days	100%

Made this 29th day of June 2018.

D. KABAMBE, PhD
Registrar of Financial Institutions

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