Seychelles

Financial Institutions Act

Financial Institutions (Credit Classification and Provisioning) Regulations

Statutory Instrument 74 of 2010

Legislation as at 1 December 2014

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Statutory Instrument 74 of 2010

Commenced on 15 November 2010

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[S.I. 74 of 2010; S.I. 39 of 2011]

1. Citation

These Regulations may be cited as the Financial Institutions (Credit Classification and Provisioning) Regulations.

2. Interpretation

In these Regulations—

"**Board of Directors**" means the highest body of authority in a bank responsible for strategically guiding the bank, effectively monitoring management and properly accounting to shareholders;

"**Book Value**" means the value of an asset as stated on the books of account of a bank being the amount of the bank's investment in the asset less any specific and/or general provisions for loss;

"**Core Capital**" otherwise referred to as Tier 1 capital, means permanent capital for the purpose of computing risk weighted capital adequacy ratio;

"**Credit**" has the meaning given in section 2 of the Act;

"**Credit Concentration**" means an exposure to a customer, or group of closely-related customers that meets or exceeds 25 percent of Core Capital;

"**Eligible Collateral**" means the "net realizable" value of the following assets, provided that the bank's interest therein is fully enforceable—

(a) Balances with banks;

(b) Debt security, provided that the issuer is one of the following

  (i) The Government of Seychelles;

  (ii) A Government of a member country of the Organization of Economic Cooperation and Development (OECD); or

  (iii) A Government of a country with a current consensus country risk classification of 1 or 2, as published by the OECD;

(c) Guarantee, provided that the guarantee meets the following criteria—

  (i) The guarantee is issued by—

    (a) The Government of Seychelles;

    (b) A Government of a member country of the OECD;

(c) A Government of a country with a current consensus country risk classification of 1 or 2, as published by the OECD; or

(d) A bank with an independent credit assessment of AAA to AA - issued by an external credit assessment institution acceptable to the Central Bank;

(ii) The guarantee represents a direct claim on the guarantor;

(iii) The guarantee is denominated in the same currency as the credit;

(iv) The guarantee clearly and incontrovertibly defines the extent of the guarantee's cover of a specific credit;

(v) The guarantee is irrevocable and non-cancellable by the guarantor, except for non-repayment of the credit protection contract;

(vi) The guarantee has no clause in the credit protection contract that would allow the guarantor unilaterally to cancel the guarantee, increase the effective cost of the guarantee, or delay payment under the guarantee for any reason including the need to be funded in the budget;

(vii) The only condition required to be met for the guarantee to be called or enforced is the obligor's failure to meet his obligation to the bank; and

(viii) The guarantee is executed so that neither the guarantor nor any other person is in a position to challenge the legal rights of the bank in calling or enforcing the guarantee;

(d) the amount of 50 percent of the net realizable value of other tangible securities as approved by Central Bank.

"**Group of Closely-Related Customers**" has the meaning given in section 2 of the Act;

"**Large Exposure**" means an exposure to a customer, or group of closely-related customers, that meets or exceeds 10 percent of Core Capital but represents less than 25 percent of Core Capital;

"**Net Credit Balance**" means the outstanding principal balance of a credit less the "net realizable value" of any "eligible collateral;"

"**Net Realizable Value**" means the estimated selling price of an asset in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to sell the asset;

"**Non-Performing Credit**" means credit that is classified as Substandard, Doubtful, or Loss in accordance with these Regulations.

"**Renegotiated credit**" means a credit which has been refinanced, rescheduled, rolled over or otherwise modified because of weaknesses in the borrower's financial position or non repayment of the debt according to the original terms.

3. Application

(1) These Regulations shall apply to all banks that are licensed by the Central Bank pursuant to section 6 of the Act, to engage in banking business or offshore banking business and are applicable to each bank individually, and on a fully consolidated basis to each bank, its holding company and members of its group, if applicable.

(2) When a banking operation is conducted by way of a branch of a foreign bank, the role of the board of directors shall be assumed by the head office, which shall ensure that its branch is in compliance with applicable laws, regulations, guidelines and other prudential directives.

4. Requirements for a bank's credit classification process

(1) All of a bank's credits, including off-balance sheet credit equivalents, shall be reviewed for purposes of credit classification on at least a monthly basis.

(2) This credit review and classification function shall be performed in accordance with these Regulations and with the bank's written policy and guidelines by persons who are independent of the credit origination function.

(3) While small homogenous credits may be reviewed on a group-wide basis, the following credits must be reviewed on an individual basis—

(a) Large exposures;

(b) Credit concentrations;

(c) Non-performing credits;

(d) Credits that are deemed complex or otherwise of greater credit risk; and

(e) sampling of credits from each group within the portfolio.

(4) The remainder of the bank's credit portfolio may be divided into groups of credits with similar credit risk characteristics (such as type of credit) for review on a collective basis.

(5) In case a bank has more than one credit outstanding to a single customer or group of closely-related customers and one such credit is non-performing, then the bank shall review all other credits to that customer or group of closely-related customers for purposes of classification and shall document such review.

(6) Based on the credit review, each credit shall be assigned to classification categories on the basis of credit risk as per regulation 5.

(7) A bank may develop its own internal risk-grading system to indicate various levels of risk exposure in credits; however, such risk grades must be reconciled to the five categories contained in these Regulations for purposes of reporting to the Central Bank.

(8) Between each monthly credit review, if a bank gains knowledge of a material deterioration in the quality of an individual credit or group of credits within the credit portfolio, then the credit(s) must be promptly assigned to the classification category that accurately reflects its new status.

5. Credit classification categories

A bank's credits are classified on the basis of credit risk into the following five categories using the stated criteria—

(a) Credits which meet all of the following conditions shall be classified as "Pass"—

(i) The credit is performing, and is expected to continue to perform, in accordance with the credit contract.

(ii) Credit documentation is sufficient to support the outstanding credit, evidence the bank's perfected interest in collateral (if any), or permit the bank to properly supervise the credit or collateral (if any).

(iii) The financial condition of the obligor is sound and is expected to remain sound.

(iv) Secured credits are less than 30 days pastdue, payments on unsecured credits are upto-date, and overdrafts are operating within their approved limits and demonstrate good fluctuations, which at least service the interest applied/charged.

(b) Credits, including those that are currently performing and/or secured by unimpaired collateral, that meet one or more of the following criteria shall be classified as "Special Mention"—

(i) Credit documentation is insufficient to support the outstanding credit, evidence the bank's perfected interest in collateral (if any), or permit the bank to properly supervise the credit or collateral (if any).

(ii) Certain factors are known which could, in the future, impinge on the performance of the credit or impair the value of the collateral (if any) including deteriorating Credit Classification Categories general economic or sector conditions and adverse trends in the obligor's financial condition.

(iii) A credit is 30-89 days past-due or is not in compliance with any other term or condition of the credit contract.

(iv) An overdraft has surpassed the approved limits for 30 - 89 days without the bank's prior approval.

(c) Credits that have one or more of the following deficiencies shall be classified as “Substandard”—

(i) The primary source of repayment of the credit is insufficient to service the debt and the bank is relying on one or more secondary sources of repayment (such as liquidation of collateral, sale of fixed assets, or restructuring of the credit);

(ii) A credit is 90-179 days past-due or is not in compliance with any other term or condition of the credit contract;

(iii) An overdraft, continuously exceeds the approved limits for 90 179 days, without the bank's prior approval or has fluctuations that do not follow the business cycle;

(iv) Non-performing credits that are totally secured (including 100% of the principal balance and accumulated interest) by cash, Government securities, or Government guarantee meeting the requirements of “eligible collateral” shall be classified no more adversely than Substandard.

(d) Credits that have one or more of the following deficiencies shall be classified as “Doubtful”—

(i) Collection of the credit in full is highly questionable or unlikely;

(ii) There is a likelihood of loss on the credit; however, the situation could improve due to near-term important and reasonably specific pending factors such as a proposed merger, acquisition, liquidation, capital injection, perfection of liens, additional collateral, or other arrangements;

(iii) A credit is 180-364 days past-due;

(iv) An overdraft without the bank's prior approval continuously exceeds the approved limits for 180 364 days and has had minimum activity in the account.

(e) Credits that have one or more of the following deficiencies shall be classified as “Loss”—

(i) The credit is regarded as uncollectible or of such little value that its continuance on the however, the bank deems it to be neither sensible nor desirable to postpone removing the credit from its books of account while it pursues long-term recovery efforts;

[Note: There is no clause (ii).]

(iii) The credit is 365 days past-due or more;

(iv) An overdraft without the bank's prior approval continuously exceeds the approved limits for 365 days or more and has had minimum activity in the account.

6. Re-negotiated credits

(1) The classification of a credit which has been renegotiated to modify one or more of its terms shall not be improved unless repayment of principal and/or interest, in accordance with the credit contract, has been made for six (6) installment periods or a period of not less than six (6) months, whichever time period is greater.

(2) Subsequent to the expiration of the time period referenced in sub-regulation (1), a restructured credit may be Re-negotiated Credits classified no more favourably than “special mention” until

repayment of principal and interest has been made for six (6) additional installment periods or for an additional period of not less than six (6) months, whichever time period is greater.

(3) Subject to sub-regulation (1) and (2) restructured credit may be classified in line with regulation (5).

7. Minimum provisioning requirements

(1) At least monthly and based upon a bank's credit review and classification process, any impairment to the value of a credit or group of credits shall be recognized by reducing the book value of the credit and charging the income statement in the period in which the impairment occurred—

(a) Through the General Provisions for Bad and Doubtful Debts account for credits classified as Pass;

(b) Through the Specific Provisions for Bad and Doubtful Debts account for credits classified as Special Mention, Substandard, Doubtful, and Loss.

(2) The bank shall determine the amount of the Provisions for Bad and Doubtful Debts using the Standard Percentages Method by applying the minimum percentages to the sum of the gross credit balance for general provisions and the sum of the net credit balance for specific provisions as follows—

(a) General Provisions apply 1% provision for credits classified as Pass; and nil provision for credits extended to the Government of Seychelles classified as Pass and

(b) Specific Provisions apply 5% provision for credits classified as Special Mention, 25% provision for credits classified as Substandard, 50% provision for credits classified as Doubtful and 100% provision for credits classified as Loss.

(3) The Central Bank may also direct a bank to increase its levels of provisions where reliable information indicates that losses are likely to be more than the minimum amounts.

8. Reconciliation with International Accounting Standard

The following requirement shall apply to banks reporting under International Financial Reporting Standard—

(a) They are required to calculate their provisions in accordance with the requirements of both International Accounting Standard (IAS) 39 and these Regulations;

(b) Should the provisions computed under IAS 39 be less than what is required under these Regulations; the bank shall assign the difference to a non-distributable equity reserve created through an appropriation of reserve;

(c) Where IAS 39 requires a higher provisioning than prescribed by these Regulations, the bank shall provide for the greater amount.

9. Write-off

(1) Credits which are uncollectible and of such little value that their continued reporting as bankable assets is no longer warranted, shall be written off.

(2) Credits (or portions thereof) shall be written off within twelve months of being classified as “loss”.

(3) Charge-offs shall be made against the specific credit loss reserve account and if the amount of the credit to be charged off exceeds the balance of the specific credit loss reserves account, additional reserves shall be established to cover the shortfall through charges to income or through transfers from the general credit loss reserves account.

(4) Recoveries on credits previously written off shall be recorded as income in the financial period during which such recovery occurs.

10. Income recognition requirements

(1) All categories of non-performing credit shall be placed on a non-accrual basis, that is interest due but uncollected should not be accrued as income, but instead should be shown as interest in suspense.

(2) Notwithstanding paragraph (1), interest on credits to the Government of Seychelles and credit guaranteed by the Government of Seychelles which have become non-performing, shall continue to accrue up to the limit of the guarantee.

(3) All interest on non-performing credit previously accrued into income but uncollected shall be reversed and credited into interest in suspense account until paid in cash by the borrower.

11. Acquisition of asset in lieu of repayment of credit

(1) If a bank acquires an asset in lieu of repayment of a credit, then the book value of the asset acquired shall be the unpaid balance of the credit or the net realizable value of the asset acquired, whichever is lower.

(2) If the net realizable value of the asset acquired is less than the book value of the credit, then the difference should be charged off through the provisions for bad and doubtful credits account when the asset is added to the books of account of the bank.

12. Restrictions

(1) A bank shall not re-negotiate, roll-over, refinance, renew, or modify the terms of a credit after becoming nonperforming in order to avoid an adverse classification or to cure a past-due status or other contract default.

(2) A bank shall not grant a credit or otherwise advance additional funds to an obligor for the purpose of enabling the obligor to meet existing payment obligations to the bank.

13. Management information system and reporting requirements

(1) When a credit is classified Doubtful or Loss, a bank shall obtain a current and reliable written indication of the net realizable value of the collateral and shall obtain regular updates thereafter.

(2) Each bank shall maintain a management information system adequate to identify and track—

(a) The features of individual credits, groups of credits, and the credit portfolio (including types of credits within the portfolio);

(b) The evolving condition of a credit such as—

(i) regularity of payments;

(ii) the financial condition of the obligor;

(iii) the status and value of collateral; and

(iv) all other attributes of the credit.

(c) The characteristics of obligors and groups of related customers; and

(d) Sectors in which the bank has credit exposures.

(3) Each bank shall maintain, and make available to authorized examiners of the Central Bank, adequate written records and reports in support of—

(a) Credit review and classification functions;

(b) Its evaluation and calculation of potential loss exposure in the credit portfolio;

(c) The entries made to the provisions for bad and doubtful credits accounts;

(d) Actions taken to ensure that the amount of the provisions for bad and doubtful credit accounts is adequate to cover the identified potential loss exposure in the credit portfolio.

(4) The board of directors shall require regular written reports showing—

(a) The lending activities of the bank are in compliance with the credit policies approved by the board of directors, with the Act, and these Regulations;

(b) The risks and potential loss exposure in the bank's credit portfolio have been identified;

(c) Problem or deteriorating credits have been identified, classified, placed on non-accrual status, and the action taken by management to reduce the risk of loss on such credits;

(d) The amount of accrued, but uncollected interest on the books of account of the bank is appropriate;

(e) Adequate provisions for potential credit losses have been made to the proper account; and

(f) Losses have been identified and written off.

(5) Within fifteen (15) days of each month end, each bank shall submit to the Central Bank reports, in the format prescribed by the Central Bank, showing an analysis and classification of its credits, provisions for bad and doubtful debt accounts, and interest in suspense accounts.

