BANK OF MAURITIUS

Guideline on Credit Impairment Measurement and Income Recognition

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Introduction

In 2014, the International Accounting Standards Board issued the IFRS 9 Financial Instruments which replaces the IAS 39 Financial Instruments: Recognition and Measurement. As stipulated in the Standard, entities are required to apply IFRS 9 for annual periods beginning on or after 1 January 2018.

This Guideline outlines the minimum prudential requirements with regard to asset classification, provisioning requirements and income recognition, which financial institutions are required to follow.

Purpose

This Guideline brings the prudential requirements in line with international standards and best practices. The Guideline also attempts to provide references, wherever relevant, with the provisions of the accounting standard IFRS 9.

Authority

This Guideline is issued under the authority of section 50 of the Bank of Mauritius Act 2004 and 100 of the Banking Act 2004.

Scope of application

This Guideline is issued to all deposit-taking financial institutions hereinafter referred to as financial institutions.

Effective date

The Guideline shall come into effect as from 1 January 2020. This Guideline supersedes the Guideline on Credit Impairment Measurement and Income Recognition issued in November 2004 and amended in June 2005 and April 2016.

Interpretation

"Concessions" are special contractual terms and conditions provided by a lender to a counterparty facing financial difficulty so that the counterparty can sufficiently service its debt. Concessions would normally involve modification of terms of the advances / securities, which would, inter-alia, include, alteration of repayment period / repayable amount / amount of instalments / rate of interest / roll over of credit facilities / sanction of additional credit facility / enhancement of existing credit limits / refinancing of existing facilities with a new contract / granting grace period / capitalising arrears / releasing collaterals or accepting lower levels of collateralisation / allowing conversion of debt to equity of counterparty / easing of any covenant

"Contractual payments" refers to principal, interest or any other payments due under a credit facility contract;

"Credit facility" refers, in this Guideline, to amounts due to a financial institution which it includes in its books.

"Financial difficulty" can be identified through the following non-exhaustive list of indicators:

- A counterparty is currently past due in any material credit facilities extended to it;

- A counterparty's outstanding securities have been de-listed, are in the process of being de-listed, or under threat of being de-listed from an exchange due to non-compliance with the listing requirements or for financial reasons;

- On the basis of actual performance, estimates and projections that encompasses the counterparty's current capabilities, it may be forecasted that all the committed/available cash flows will be insufficient to service all of its loan or debt obligations (both interest and principal) in accordance with the contractual terms of the existing agreements for the foreseeable future;

- A counterparty is in non-performing status or would be categorised as non-performing without the concession;

- The counterparty cannot obtain funds from sources other than existing financial institutions at an effective interest rate equal to the current market interest rate for similar loans or debt securities for a non-troubled counterparty;

- Excessive leverage and failure to pay statutory liabilities and operational creditors;

- Steep decline in production/sale/profit/margin figures;

"Independent appraiser" refers to an appraiser who:

- is a valuation surveyor recognised by a government, by a reputable institute or by an appropriate foreign authority for appraisal of a property;

- has no direct or indirect financial interest in the property being appraised, or in the transaction involving the financial institution in respect of that property; and

- has no credit granting or investment decision-making authority within the financial institution.

"Large credit" is a credit which amounts to more than 10 per cent of the financial institution's Tier 1 capital.

"Past due" refers to a contractual payment (interest, principal, fee or other amount) which has not been made as of its due date. In this respect, a credit facility would generally become 'past due' from the first day when, in the case of:

- An overdraft, the outstanding amount, including interest, breaches the approved limit;

- A revolving retail credit (e.g. credit card), the minimum periodic payment is not paid in full on the due date;

- A loan with periodic contractual payments, the amount due and payable (interest and/or instalment of principal and/or fees) is not paid in full by the due date; and

- Any other dues not paid on due date.

"Restructuring" refers, in this Guideline, to a distressed restructuring, that is, the process whereby a financial institution, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the financial institution would not otherwise consider.

"Retail credit" refers to a credit facility which satisfies the criteria for consideration as 'claim included in the regulatory retail portfolio' in the Guideline on Standardised Approach to Credit Risk.

1. Classification of credit facilities under prudential norms

1.1 Non-Performing Assets

1.1.1 A financial institution shall classify credit facilities as non-performing based on the number of days past due (DPD) and/or its assessment of the ability of the obligor to pay its credit obligations to the financial institution and/or to the group of the financial institution in full, without the financial institution having recourse to actions such as realising collateral or risk mitigants.

1.1.2 Accordingly, a non-performing asset (NPA) is a credit facility where:

- The obligor is past due by more than 90 days on any credit obligation to financial institution and/or to the group of the financial institution. This, inter alia, includes more than 90 days past due status of an overdraft account, a term loan, overdue bills, amount of liquidity facility or receivables representing positive mark to market value of a derivative contract.

- Where there is assessment that the obligor is unlikely to pay its credit obligations to the banking group in full based on the contractual terms.

1.1.3 The indicators for unlikeliness to pay will include:

- The financial institution puts the credit obligation on non-accrual status.

- The financial institution makes account-specific provision resulting from a significant perceived decline in credit quality subsequent to the financial institution granting the credit facility.

- The financial institution sells other credit obligations from the same counterparty at a material credit-related economic loss.

- The financial institution consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or, where relevant, fees.

- The financial institution has filed for the debtor's bankruptcy or a similar order in respect of the obligor's credit obligation to the financial institution and/or to the group of the financial institution.

- The debtor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of the credit obligation to the banking group.

1.2 Standard Assets

1.2.1 All other credit facilities which are not classified as NPAs, should be classified as standard.

1.3 Special Mention Accounts

1.3.1 Financial institutions should, however, identify the stress in standard assets, immediately after past due status of 30 days, by classifying stressed but standard assets as Special Mention Accounts (SMAs). This will facilitate early identification of stress and timely resolution as per the board approved policy of each financial institution. The SMAs may be categorised as under:

SMA Sub-Category	Basis for Classification - Past due status
SMA-1	31-60 days
SMA-2	61-90 days

1.4 Sub-categorisation of NPAs

1.4.1 Financial institutions are required to classify NPAs further into following three categories based on the period for which the asset has remained non-performing and the realisability of dues.

Category	Criteria and description
Sub-standard	A NPA classified as sub-standard shall exhibit well-defined credit weaknesses in respect of the business, cash flow or financial position of the obligor which may lead to the financial institution sustaining losses thereon, if the deficiencies are not corrected. A NPA which is past due by more than 90 days but has been classified as NPA for no more than 1 year should, as a minimum, be classified as sub-standard.
Doubtful	A NPA classified as doubtful shall exhibit all the weaknesses inherent in a sub-standard credit facility as well as supplementary weaknesses that make the prospect of full recovery of the credit facility questionable without having recourse to the collateral and loss thereon highly likely. A NPA which has remained as NPA for more than 1 year but no more than 5 years should, as a minimum, be classified as doubtful.
Loss	A NPA should be classified as loss if the credit facility is considered uncollectible and of such little value that maintaining it as a bankable asset is not warranted although there may be some salvage or recovery value from the security available (i.e. recoverable value of security is less than 10 per cent of total outstanding credit). A NPA should, as a minimum, be classified as loss when: (i) The asset remained as NPA for more than 5 years; or (ii) The loss has been identified by the financial institution's internal auditor or external auditor or on site examination of Bank of Mauritius.

1.5 Availability of Security, Net Worth of Borrower/Guarantor

1.5.1 The availability of security or net worth of borrower/guarantor should not be taken into account for the purpose of treating the credit facility as NPA or otherwise.

1.5.2 Notwithstanding section 1.5.1 above, the treatment of government guaranteed credit facilities shall subject to section 1.9.

1.6 Restructured Credit Facilities

1.6.1 The restructuring of a standard credit facility will immediately lead to re-classification of the facility as non-performing as per the asset classification norms. The non-performing assets, upon restructuring, would at least continue to have same asset classification as prior to restructuring and would slip into a lower asset classification as necessary as per the asset classification norms.

1.6.2 The above classification of restructured accounts as NPAs is in line with the extant accounting standard IFRS 9, where restructured accounts are required to be placed under Stage 3.

1.6.3 Banks should maintain proper documentation for all other restructuring which are not considered distressed restructuring, along with detailed rationale for that.

1.7 Asset Classification - Timely Classification and Annual Review

1.7.1 Financial institutions should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of non-performing credit facilities, especially in respect of high value accounts. Appropriateness of classification exercise should be reviewed in line with the board approved policy, at least annually by the financial institution. The financial institution may fix a minimum cutoff point to decide what would constitute a high value account depending upon their respective business levels, as per their own board approved policy. The cutoff point should be valid for the entire financial year.

1.7.2 Responsibility and validation levels for ensuring proper asset classification should be fixed by the financial institutions.

1.7.3 As a minimum, financial institutions should have information systems that cater for automatic asset classification based on the number of days past due.

1.8 Asset Classification - Level of Application

1.8.1 In cases where a financial institution has more than one credit facility (other than retail) extended to a counterparty, the financial institution must consider all facilities to that counterparty as NPAs when any one of the facilities is classified as NPA. In other words, non-performing status should be applied at the level of the counterparty.

1.8.2 For credit facilities extended to retail counterparties, the definition of NPA can be applied at the level of a particular facility, rather than at the level of the borrower. As such, for retail credit facilities, classification of one credit facility as NPA does not

mandatorily require a financial institution to treat all other credit facilities to the same borrower as NPA. However, it needs to be emphasised that financial institutions need to exercise abundant precaution in this regard to ensure that the increase in credit risk / impairment is not masked in such cases.

1.8.3 When a counterparty belongs to a group, designating credit facilities to the counterparty as NPA, however, does not mandatorily lead to designating credit facilities to the other entities from the same group as NPAs. However, designating credit facilities to one of the entities in the group as NPA should be one of the inputs, along with the respective financial situation of other entities in the group, which should also be taken into account while assessing the creditworthiness and determining the performing or non-performing status of credit facilities to the other entities in the group.

1.9 Asset Classification - Exemption from Classification as NPA

1.9.1 Credit facilities extended directly to the Government of Mauritius or extended to entities backed by Government of Mauritius guarantees or Bank of Mauritius guarantees, though overdue, may be treated as NPA only when the Government of Mauritius or Bank of Mauritius repudiates the guarantee when invoked. The same principle may be applied in case of credit facilities in the domestic currency of other investment grade sovereigns which are extended directly to or which are guaranteed by those sovereigns and central banks.

1.9.2 Credit facilities fully secured by cash are exempted from treatment as NPA.

1.9.3 The exemptions in this section are also applicable for the purpose of both General Provision and Specific Provision under section 2.

1.10 Asset Classification - Non-binding Requirements on Stages of Asset Classification

1.10.1 An important caveat is that a non-performing credit facility need not go through the various stages of grading in cases of serious credit impairment and such facilities should be straightaway graded as doubtful or loss as appropriate.

1.11 Asset Classification - Upgradation of Non-performing Credit Facilities as Performing

1.11.1 In principle, an asset classified as NPA shall be upgraded when the irregularity/deficiency in the account which led to the account being classified as NPA is fully rectified on a sustainable basis. A transient rectification of the irregularity/deficiency near the balance sheet date may not result in upgradation of the account unless there are satisfactory evidence to support that the rectification of the irregularity/deficiency is sustainable and the inherent credit weakness has mitigated substantially.

1.11.2 Therefore, if arrears of interest and principal are paid by borrowers in full and reduction in credit risk is considered sustainable, the NPA may be upgraded to standard asset.

1.11.3 However, as regards the upgradation of non-performing restructured accounts to standard account, the same should be upgraded only when all the outstanding

loans/facilities perform satisfactorily for a period of 6 months (i.e. interest and principal on all facilities in the account are services as per the restructured terms of payment) from the commencement of the first payment of interest or principal, whichever is later, on the credit facilities with the longest period of moratorium under the terms of restructuring.

1.12 **Asset Classification - Treatment under IFRS 9**

1.12.1 Under the extant accounting standard IFRS 9, all NPAs will be categorised as credit facilities in Stage 3 and vice versa.

2. Provisioning

2.1 **Regulatory Floor**

2.1.1 In view of implementation of Expected Credit Loss (ECL) provisioning requirements under the Accounting Standard IFRS 9 and to ensure consistency and address the concerns on modelling risk, it has been decided to introduce regulatory floors for provisioning in the regulatory capital calculation (i.e. minimum CET1 reduction requirement).

2.1.2 The regulatory floors shall require financial institutions to calculate accounting ECL provisions as per IFRS 9 and the prudential floors (independently for General Provisions and Specific Provisions) provided by Bank of Mauritius. When a financial institution makes lower accounting provisions than the regulatory floors, the shortfall shall be accounted for through either:

(i) additional provisions by the financial institution; or
(ii) a charge to the equity of the financial institution.

2.2 **General Provisions**

2.2.1 General Provisions consist of:

(i) Provision on standard credit; and
(ii) Macroprudential provision.

2.2.2 *Provision on Standard Credit*

2.2.2.1 A financial institution shall maintain a minimum level of provisioning on standard credit equivalent to:

(i) 1 per cent of standard credit facilities consisting of bullet repayment with maturity of more than 2 years, whereby the repayment of the entire principal is at maturity; or

(ii) 1 per cent of standard credit facilities for commercial real estates; or

(iii)0.5 per cent of all other standard credit facilities.

2.2.3 *Macroprudential Provisions*

2.2.3.1 In addition to General Provisions, financial institutions are also required to make provisioning for certain sectors, as decided from time to time, as a macroprudential measure. At present, financial institutions shall make Macroprudential Provisions for credit facilities extended to the Resident segment of the following sectors of the economy:

Type of Facility	**Macroprudential Provision**
Household - Housing	0.5%
Household - other than Housing	0.75%
Accommodation	1.0%
Construction (including commercial real estates)	1.0%

2.2.4 Stage 1 and Stage 2 provisioning under the extant accounting standard IFRS 9 will qualify as General Provisions.

2.3 **Specific Provisions**

2.3.1 Specific Provisions consist of:

(i) Provision on NPA;
(ii) Provision on interest accrued; and
(iii)Provision for diminution in fair value.

2.3.2 *Provision on NPA*

2.3.2.1 A financial institution shall maintain a minimum level of provisioning on NPA with regard to classification and assessment of credit impairment as follows:

<table>
<tr><th>Classified credit facilities</th><th>Regulatory Floor for Specific Provisioning</th></tr>
<tr><td>Sub-standard</td><td>15 per cent of outstanding amount of credit (without taking into account any securities)</td></tr>
<tr><td>Doubtful</td><td>100 per cent of unsecured portion of outstanding credit

and

between 30 and 50 per cent of secured portion of outstanding credit depending upon the period of time for which the asset has remained as NPA.

<table>
<tr><th>Time as NPA</th><th>Percentage (%)</th></tr>
<tr><td>Less than 2 years</td><td>30</td></tr>
<tr><td>Between 2 and 4 years</td><td>40</td></tr>
<tr><td>Between 4 and 5 years</td><td>50</td></tr>
</table>
</td></tr>
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<table>
<tr><td>Loss</td><td><u>If loss has been identified in terms of the negligible recoverable value of security as per the definition of loss in section 1.4.1:</u>

100 per cent of outstanding amount of credit (without taking into account any securities)

<u>Else:</u>

100 per cent of unsecured portion of outstanding credit

and

between 80 and 100 per cent of secured portion of outstanding credit depending upon the period of time for which the asset has remained as NPA.

<table><tr><th>Time as NPA</th><th>Percentage (%)</th></tr><tr><td>Between 5 and 7 years</td><td>80</td></tr><tr><td>More than 7 years</td><td>100</td></tr></table></td></tr>
</table>

2.3.2.2 Secured portion refers to security to which the financial institution has a valid recourse and of which the realisable value is estimated on a realistic basis which, as a minimum, complies with the provisions of section 2.5.

2.3.3 *Provision on Interest Accrued*

2.3.3.1 Financial institutions shall maintain a prudential provision of 100 per cent on any amount of interest on credit facilities which have been categorised as non-performing and accrued to the income statement.

2.3.4 *Provision for Diminution in Fair Value*

2.3.4.1 Financial institutions shall maintain a provision for any diminution in fair value caused by the restructuring of a credit facility.

2.3.5 Stage 3 provisioning under the extant accounting standard IFRS 9 will qualify as Specific Provisions.

2.4 Capital Treatment of Provisions

2.4.1 In line with the Guideline on Scope of Application of Basel III and Eligible Capital, General Provisions will qualify for inclusion within Tier 2 capital, subject to a maximum of 1.25 percentage points of credit risk-weighted risk assets calculated under the standardised approach.

2.5 Available Security

2.5.1 Eligible Security

2.5.1.1 Financial and physical (primary and collateral) securities which are considered as eligible collateral under the Basel III capital standards are eligible for determining the secured portion of outstanding credit facilities for provisioning purposes. Eligible securities are detailed in Annex 1.

2.5.2 Realisable Value of Security

2.5.2.1 The following conditions shall be met in determining the value of security:

(i) The value of a security should be appraised on a regular basis and should be based on a conservative view of current market prices, suitably discounted for price volatility and the lack of ready market for assets. All realisation costs, including legal costs, must be taken into account.

(ii) The realisable value of any security should be appraised at least every 2 years, either internally in case the financial institution has developed in-house expertise or by an independent appraiser. The realisable value of any security not appraised for more than two years (either internal or external) will be taken as zero.

(iii) In the case of a large non-retail credit facility, the appraised value of security should be supported by a written opinion of an independent appraiser. Appraisals of such security by independent appraisers should be carried out at least every three years, without which it would attract a realisable value of zero. The appraisal of such security should be done more frequently by an in-house appraiser.

(iv) In the case of all other non-retail credits, it is also preferred that a written opinion of an independent appraiser is obtained on the appraised value of security at periodic interval as per the board approved policy, say at least once every 5 years. The appraisal of such security should be done more frequently by an in-house appraiser.

(v) Management of the financial institution must ensure that the appraisal is reasonably comprehensive, up-to-date and based on assumptions acceptable to it. If the Bank deems it necessary, it may require the financial institution to have the appraisal carried out, at its expense, by another independent appraiser.

(vi) In case of pari-passu or subordinated charges over the security, the extent of availability of security to a financial institution, should be well documented and assessed periodically, at least once in two years.

2.5.2.2 Notwithstanding the above conditions in determining the value of security, with regard to syndicated loans, financial institutions may not revalue the security on such loans if such valuation is not feasible under the given arrangement for the loan.

3. Income Recognition

3.1 In congruence with IFRS 9, FIs should calculate interest revenue on a performing credit facility by applying the effective interest rate to the gross carrying amount of the credit facility.

3.2 In the case of non-performing credit facilities, financial institutions should also stand guided by the IFRS 9 and should calculate interest by applying the effective interest rate to the amortised cost of the non-performing credit facilities.

3.3 Any interest revenue which is accrued on credit facilities classified as NPA will form part of Specific Provisions as detailed in section 2.3.1. In case the financial institution makes lower provision under Stage 3 under the accounting standard IFRS 9 than Specific Provisions under prudential norms, the shortfall should be accounted for as outlined in section 2.1.2.

3.4 Financial institutions should stand guided by IFRS 9 with regard to the computation of the effective interest rate. FIs should however document the methodology by which the effective interest rate is calculated and keep records of the components which were considered as an integral part of the effective interest rate.

4. Reporting Requirements

4.1 On a quarterly basis, not later than 20 working days after the last day of each quarter, financial institutions are required to provide information to the Bank on classification of assets and provisioning, in such form and manner prescribed by the Bank.

5. Transitional Arrangements

5.1 Additional burden, if any, due to the prudential requirements within this Guideline will be allowed to phase-in for 1 year from the date of implementation of this Guideline, at the discretion of financial institutions.

Bank of Mauritius
6 June 2019

Annex 1 – Eligible Securities

An indicative list of the eligible securities is provided below:

A. Financial collaterals:
  (i) Cash (as well as certificates of deposit or comparable instruments issued by lending bank) on deposit with the bank that is incurring the counterparty exposure.
  (ii) Gold
  (iii) Debt securities rated by a recognised External Credit Assessment Institution (ECAI) with external rating grade of 3 or above as per the Guideline on Standardised Approach to Credit Risk.
  (iv) Debt securities not rated by a recognised ECAI where these are:
    - issued by a bank;
    - listed on a recognised exchange;
    - classified as senior debt;
    - all rated issues of the same seniority by the issuing bank have external rating grade of 3 or above as per the Guideline on Standardised Approach to Credit Risk; and
    - the bank holding the securities as collateral has no information to suggest that the issue justifies an external rating grade below 3 (as applicable).
  (v) Equity securities that are included in a main index or which are listed on a recognised security exchange;
  (vi) Investments in collective investment schemes (CIS) and mutual funds where
    - the price for a unit is publicly quoted daily; and
    - the CIS or mutual fund is limited to investing in the instruments listed in the financial collaterals listed above.

B. Financial receivables with original maturity of less than or equal to one year where repayment will occur through commercial or financial flows related to the underlying assets of the borrower. Those does not include receivables associated with securitisations, sub-participations or credit derivatives.

C. Commercial real estate and Residential real estate

D. Other physical collaterals for which there are:
  (i) liquid markets whereby they can be disposed of in an expeditious and economically efficient manner; and
  (ii) well established, publicly available market prices.