DIRECTIVE

NO.DO1-93/AQ

PRUDENTIAL GUIDELINES ON ASSET QUALITY FOR BANKS

Arrangement of Sections

DIRECTIVE NO.DO1-93/AQ
PRUDENTIAL GUIDELINES ON ASSET QUALITY FOR BANKS
PART I: SHORT TITLE, AUTHORIZATION, APPLICATION AND INTERPRETATION

Sec. 1: Short Title - Prudential Guidelines

Sec. 2: Authorization - Section 16 of the Banking Act of 1989

Sec. 3: Application - Banks in Malawi

Sec. 4: Interpretation - In this Directive unless the context otherwise requires

1) "bank" is as defined in Section 2 of the Banking Act of 1989;

2) "banking business" is as defined in Section 2 of the Banking Act of 1989;

3) "classification" means the category of a non-performing credit facility, using either subjective or objective criteria to determine its ultimate collectibility;

4) "credit facility" means any asset or off-balance-sheet item which contains credit risk, to include: loans, overdrafts, advances, leases, acceptances, bills discounted, guarantees, and other assets or contingencies connected with credit risk;

5) "doubtful" means a classification of a non-performing credit facility that meets the criteria given in Part V Section 1 of this directive;

6) "general provision" means a loss reserve held against future, presently unidentified losses and is thus freely available to meet losses which subsequently materialize;

7) "interest in suspense" means that the interest on a non-performing credit facility is accrued or capitalized but the offsetting accounting entry is placed in a valuation reserve called "interest in suspense" rather than taken into income;

8) "loss" means a classification of a non-performing credit facility that meets the criteria given in Part V Section 1 of this directive;

9) "non-performing" means a credit facility that is not generating income and meets the criteria given in Part III Section 1 of this directive;

10) "non-accrual" means that a credit facility has been placed on a cash basis for accounting and financial reporting purposes, thus interest earned and/or due but unpaid is not credited to interest income but instead to interest in suspense;

11) "seasonal credit facility" means a credit facility where repayment is solely dependent on sale of a crop at the end of the sales period which is subsequent to an annual harvest;

12) "specific provision" means a loss reserve held against presently identified losses or potential losses and thus not available to meet losses which subsequently materialize;

13) "substandard" means a classification of a non-performing credit facility that meets the criteria given in Part V Section 1 of this directive;

14) "well secured" means that a credit facility has sufficient collateral to protect the bank from loss of principal and interest through its timely disposition under a forced liquidation programme. Such security consists of: 1) proper legal documentation; 2) a net realizable market value which is adequate to cover the amount of principal and interest outstanding, as well as the costs of collection; and 3) absence of prior liens on the collateral which could reduce its value or otherwise prevent obtaining clear title. Aspects such as lack of a clear market value or any difficulties in actual foreclosure or disposing of collateral negate a well secured status.

PART II: STATEMENT OF POLICY

Sec. 1: Objectives

1) To ensure that banks are in proper compliance with capital adequacy requirements as called for in Section 16 of the Banking Act of 1989, especially: sub-section a) valuation of assets, b) depreciation of assets, and c) provision for bad and doubtful debts;

2) To ensure banks are quantitatively identifying their non-performing credit facilities in order to help ensure collection efforts are undertaken;

3) To ensure banks present balance sheets and income statements that properly reflect the financial impact of non-performing credit facilities.

Sec. 2: Rationale

1) Banks need to, in an accounting sense, recognize problem assets using a quantitative definition of non-performing and then properly treat such assets with regard to accrual of interest, classification according to ultimate collectibility, and to make adequate provisions based on such classification;

2) The recognition of such non-performing assets stimulates collection efforts and thus helps reduce the possibility of loss on such assets;

3) Supervisory authorities worldwide have recognized that their effectiveness is dependent on the integrity of balance sheets and income statements resulting from proper identification and accounting treatment of non-performing assets; failure to set such standards can lead to fictitious profits and misleading balance sheets to the supervisory authority and other interested parties.
PART III: IDENTIFICATION OF NON-PERFORMING CREDIT FACILITIES

Sec. 1: Criteria for non-performing credit facilities

1) A non-seasonal credit facility with a pre-established repayment schedule is considered non-performing when:

a) principal or interest is due and unpaid for 180 days or more or

b) principal or interest payments equal to 180 days interest or more have been capitalized, refinanced, renegotiated, restructured or rolled over.

2) A non-seasonal credit facility without a pre-established repayment program, such as overdrafts or other forms of open-ended credit, is considered non-performing when any one of the following conditions exist:

a) credit facility exceeds the customer's established borrowing limit for 180 consecutive days or more;

b) the customer's borrowing line has expired for 180 days or more;

c) interest is due and unpaid for 180 days or more;

d) the overdraft or account is inactive, meaning that no deposits have been made or deposits are insufficient to cover the interest capitalized or otherwise charged, over an 180 day period.

3) A seasonal credit facility without a pre-established repayment program is considered non-performing when either of the following conditions exist:

a) no repayment on the seasonal credit facility is made for 90 days or more after the end of the sales period;

b) repayments within 90 days after the end of the sales period are insufficient to cover capitalized and/or accrued interest charged during the period of the credit facility;

4) The Reserve Bank may, at its discretion, choose to change the objective criteria for non-seasonal non-performing credit facilities, but to a period of not less than 90 days in the criteria given in the above subsections.

5) The criteria for non-performing credit facilities apply regardless of what security is held on the facility.

6) Credit facilities to the Government of Malawi or unconditionally guaranteed by the Government of Malawi are exempt from non-performing status.

Sec. 2: Reporting of non-performing credit facilities to the Reserve Bank

1) Each bank is to report on a quarterly basis to the Reserve Bank its non-performing credit facilities based on the criteria in Part III, Section 1.

2) Failure to report non-performing credit facilities on a timely and accurate basis may subject a bank to the remedial measures and/or administrative sanctions in Part VIII of this directive.

Sec. 3: Repayment schedules of non-performing credit facilities

1) Upon meeting the criteria of non-performing as given in Part III Section 1, credit facilities without a pre-established repayment schedule are to be converted to a pre-established repayment schedule of monthly payments not to exceed 1 year;

2) Banks may apply to the Reserve Bank for prior exemption from subsection 1) above for specific credit facilities with such application stating the reason why such non-performing facilities should not be converted to a repayment schedule.

PART IV - INCOME RECOGNITION

Sec. 1: Interest Accrual

1) All categories of non-performing credit facilities based on the criteria in Part III Section 1 are to be placed on a non-accrual basis, that is interest due but uncollected should not be accrued to income but instead shown as interest in suspense.

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

3) Only when all outstanding due and unpaid obligations of a non-performing credit facility have been paid up to date, may the credit facility be returned to an accrual basis.

4) The above subsections apply regardless of security held on a credit facility.

PART V - CLASSIFICATION AND PROVISIONING

Sec. 1: Criteria for SUBSTANDARD, DOUBTFUL, & LOSS Classification

1) All non-performing credit facilities are to be classified by banks according to the criteria of this Section, with the exception of seasonal credit facilities as given in subsection 4) below or unless prior permission of the Reserve Bank is given under Part V Section 3 (3) of this directive.

2) Banks are to determine if the criteria chosen is subjective or objective, with the more severe method to be the norm.

3) When a bank chooses a subjective classification that is milder than the objective criteria would call for, it must justify such choice in writing to the Reserve Bank, with the Reserve Bank having the authority to call for the more severe classification.

4) With regard to seasonal credit facilities, which meet the non-performing criteria under Part III Section 1 (3) of this directive, classification and provisioning of these facilities is not mandatory until the criteria of that subsection is 180 days or more.

5) Criteria for SUBSTANDARD classifications are as follows:

a) SUBJECTIVE CRITERIA: Credit facilities which display well defined credit weaknesses that jeopardize the liquidation of the debt. Substandard credit facilities are not protected by the current sound worth and paying capacity of the borrower. Weaknesses may include: inadequate cash flow to service the debt; under-capitalization or insufficient working capital; absence of adequate financial information or security documentation; irregular payment of principal and/or interest; and inactive overdrafts/other accounts where credit entries (deposits) fail to cover interest charges;

b) OBJECTIVE CRITERIA: Non-performing credit facilities, as defined, on which principal and/or interest remain outstanding (unpaid) for 180 days or more, but less than 1 year.

c) The Reserve Bank may, at its discretion, change the objective criteria in subsection b) but to a period not less than 90 days.

6) Criteria for DOUBTFUL classifications are as follows:

a) SUBJECTIVE CRITERIA: Credit facilities which in addition to the weaknesses existing in substandard credits, have deteriorated to the extent that full repayment is unlikely or that realizable security values will be insufficient to cover the bank's exposure.

b) OBJECTIVE CRITERIA: Non-performing credit facilities, as defined, on which principal and/or interest remain outstanding (unpaid) for 1 year or more, but less than 2 years unless such assets are well secured by irrevocable guarantees of the Government of Malawi or first class international banks approved by the Reserve Bank, and the collection in full by drawing on these guarantees is assured.

c) The Reserve Bank may, at its discretion, change the objective criteria in subsection b) but to a period not less than 180 days.

7) Criteria for LOSS classifications are as follows:

a) SUBJECTIVE CRITERIA: Credit facilities that are considered uncollectible and of such little value that there continuation as bankable assets is not warranted. Such classification does not mean the asset has absolutely no recovery value, but rather that it is neither practical nor desirable to defer writing off this basically worth-less assets, even though partial recovery may be effected in the future. Banks should not retain assets on their books while attempting long-term recoveries. Losses should be taken in the quarter in which they are identified as uncollectible.

b) OBJECTIVE CRITERIA: Non-performing credit facilities, as defined, on which principal and/or interest remain outstanding (unpaid) for 2 years or more, unless such assets are well secured by the Government of Malawi or irrevocable guarantees of first class international banks approved by the Reserve Bank, and collection in full by drawing on these guarantees is assured.

c) The Reserve Bank may, at its discretion, change the criteria in subsection b) but to a period not less than 1 year.

Sec. 2: Provisions on Classified Credit Facilities

1) Banks are to establish specific provisions for non-performing credit facilities as defined.

1)2) All classified credit facilities are to be subject to specific provisions, regardless of whether the subjective or objective criteria were used in determining classification.

1)3) Specific provisions for substandard assets are to be maintained at not less than 20% of the outstanding balance.

1)4) Specific provisions for doubtful assets are to be maintained at not less than 50% of the outstanding balance.

1)5) Specific provisions for loss assets are to be maintained by 100% of the outstanding balance. Such assets to be written off the books in the following quarter to that in which they are classified loss, unless prior permission of the Reserve Bank has been obtained.

1)6) The outstanding balance is to consist of principal, interest which has been capitalized, and all other charges, fees, and other amounts which have been capitalized to the outstanding balance.

1)7) In addition to specific provisions, banks are encouraged to maintain a general provision of at least 1% of the total outstanding of credit facilities, net of specific provisions and unearned interest. Until such time as general provisions can be set up from pre-tax profits, the general provision requirement may be satisfied in the form of a 1% minimum of all credit facilities held within retained profits. This requirement is in effect unless prior permission of the Reserve Bank has been given to exempt such bank from maintaining a general provision.

1)Sec. 3: Security with Regard to Classification and Provisioning

1) All banks are to evaluate the status of security on any credit facility once payment of principal and/or interest falls into arrears or is irregular.

2) Banks are to initiate procedures to realize security once a credit facility is in non-performing status.

3) When a bank regards a non-performing credit facility as well secured, as defined, it may apply to the Reserve Bank for exemption from the classification and provisioning guidelines of this directive, stating its reasons for such exemption. In determining whether or not to grant such exemption, the Reserve Bank may call for additional information.

PART VI - INSPECTIONS BY THE RESERVE BANK AND EXTERNAL AUDITS

Sec. 1: Inspections and/or External Audits to Determine Accuracy of Reporting and Compliance

1) As authorized in Section 22 of the Banking Act, the Reserve Bank may undertake inspections of banks, and such inspections may include reviews to determine if reporting of non-performing credit facilities and provisioning for such facilities has been accurately reported to the Reserve Bank and is in compliance with this directive.

2) When such reporting is determined to be inaccurate, the Reserve Bank may call for revisions to such returns to reflect an accurate position.

3) The Reserve Bank may impose any or all of the remedial measures and/or administrative sanctions in Part VIII of this directive with regard to inaccurate or untimely reporting and/or non-compliance to the sections of this directive.

4) The Reserve Bank may call upon external auditors to determine if a bank is reporting accurately and/or is in compliance with this directive, as part of the external audit.

Sec. 2: Determination of Classification and Provisioning

1) If, in the course of an inspection, the Reserve Bank determines that a non-performing credit facility has not been properly classified by bank management, it may call for such classification and subsequent provisioning, provided, in the judgement of Reserve Bank Inspectors, the classification it calls for fits within the subjective or objective criteria of this directive.

PART VII - COMPLIANCE TO CAPITAL ADEQUACY REQUIREMENTS

Reserve Bank Directive on Capital Adequacy

1) No bank can be determined by the Reserve Bank to be in compliance with its directive on Capital Adequacy Requirements unless it is in full compliance with this directive.

2) When the Reserve Bank determines that a bank is not in compliance with this directive, it may call for adjustments to balance sheets, income statements and the capital adequacy computation return with regard to non-accrual of interest and adequate provisions as it sees fit.

PART VIII: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

Sec. 1: Remedial Measures

1) When the Reserve Bank determines that a bank is not in compliance with this directive, it may impose remedial measures as specified under Section 31 of the Banking Act.

2) When the Reserve Bank determines that under the guidelines given in this directive, a bank is unsound and/or its capital is impaired, as defined in the directive for capital adequacy requirements, it may petition the High Court to sanction procedures called for under Section 32 of the Banking Act.

Sec. 2: Administrative Sanctions - In addition to the remedial measures available to it as given above in Part III Section 1, the Reserve Bank may impose any or all of the following administrative sanctions with regard to a bank that is not in compliance with this directive or its compliance with this directive indicates that the bank is in unsound condition:

1) Prohibition from declaring and/or paying dividends;

2) Suspension of the establishment of new branches and/or expansion into new banking or financial activities;

3) Suspension of access to credit facilities of the Reserve Bank;

4) Suspension of lending operations;

5) Suspension of the opening of letters of credit;

6) Suspension of the acceptance of new deposits;

7) Suspension of the acquisition of fixed assets.

PART IX: EFFECTIVE DATE

With effect from 30 June, 1993

Questions relating to this directive should be addressed to the Bank Supervision Department of the Reserve Bank.
MAP Chikaonda (DR)
GOVERNOR

DIRECTIVE

NO.DO1-93/AQ

PRUDENTIAL GUIDELINES ON ASSET QUALITY FOR BANKS

Arrangement of Sections

PART IV

Income Recognition

SECTION

Interest Accrual

PART V

Classification and Provisioning

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1. Criteria for Substandard, Doubtful and Loss Classification

2. Provisions on Classified Credit Facilities

3. Security with regard to Classification and Provisioning

PART VI

Inspection by the Reserve Bank and External Auditors

SECTION

1. Inspections and/or External Audits to determine accuracy of reporting and compliance

2. Determination of Classification and Provisioning

PART VII

Compliance to Capital Adequacy Requirements

SECTION

Reserve Bank Directive on Capital Adequacy

PART VIII

Remedial Measures and Administrative Sanctions

SECTION

1. Remedial Measures

2. Administrative Sanctions

PART IX

Effective Date

SECTION

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DIRECTIVE NO.DO1-93/AQ
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Sec. 4: Interpretation - In this Directive unless the context otherwise requires

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2) "banking business" is as defined in Section 2 of the Banking Act of 1989;

3) "classification" means the category of a non-performing credit facility, using either subjective or objective criteria to determine its ultimate collectibility;

4) "credit facility" means any asset or off-balance-sheet item which contains credit risk, to include: loans, overdrafts, advances, leases, acceptances, bills discounted, guarantees, and other assets or contingencies connected with credit risk;

5) "doubtful" means a classification of a non-performing credit facility that meets the criteria given in Part V Section 1 of this directive;

6) "general provision" means a loss reserve held against future, presently unidentified losses and is thus freely available to meet losses which subsequently materialize;

7) "interest in suspense" means that the interest on a non-performing credit facility is accrued or capitalized but the offsetting accounting entry is placed in a valuation reserve called "interest in suspense" rather than taken into income;

8) "loss" means a classification of a non-performing credit facility that meets the criteria given in Part V Section 1 of this directive;

9) "non-performing" means a credit facility that is not generating income and meets the criteria given in Part III Section 1 of this directive;

10) "non-accrual" means that a credit facility has been placed on a cash basis for accounting and financial reporting purposes, thus interest earned and/or due but unpaid is not credited to interest income but instead to interest in suspense;

11) "seasonal credit facility" means a credit facility where repayment is solely dependent on sale of a crop at the end of the sales period which is subsequent to an annual harvest;

12) "specific provision" means a loss reserve held against presently identified losses or potential losses and thus not available to meet losses which subsequently materialize;

13) "substandard" means a classification of a non-performing credit facility that meets the criteria given in Part V Section 1 of this directive;

14) "well secured" means that a credit facility has sufficient collateral to protect the bank from loss of principal and interest through its timely disposition under a forced liquidation programme. Such security consists of: 1) proper legal documentation; 2) a net realizable market value which is adequate to cover the amount of principal and interest outstanding, as well as the costs of collection; and 3) absence of prior liens on the collateral which could reduce its value or otherwise prevent obtaining clear title. Aspects such as lack of a clear market value or any difficulties in actual foreclosure or disposing of collateral negate a well secured status.

PART II: STATEMENT OF POLICY

Sec. 1: Objectives

1) To ensure that banks are in proper compliance with capital adequacy requirements as called for in Section 16 of the Banking Act of 1989, especially: sub-section a) valuation of assets, b) depreciation of assets, and c) provision for bad and doubtful debts;

2) To ensure banks are quantitatively identifying their non-performing credit facilities in order to help ensure collection efforts are undertaken;

3) To ensure banks present balance sheets and income statements that properly reflect the financial impact of non-performing credit facilities.

Sec. 2: Rationale

1) Banks need to, in an accounting sense, recognize problem assets using a quantitative definition of non-performing and then properly treat such assets with regard to accrual of interest, classification according to ultimate collectibility, and to make adequate provisions based on such classification;

2) The recognition of such non-performing assets stimulates collection efforts and thus helps reduce the possibility of loss on such assets;

3) Supervisory authorities worldwide have recognized that their effectiveness is dependent on the integrity of balance sheets and income statements resulting from proper identification and accounting treatment of non-performing assets; failure to set such standards can lead to fictitious profits and misleading balance sheets to the supervisory authority and other interested parties.

PART III: IDENTIFICATION OF NON-PERFORMING CREDIT FACILITIES

Sec. 1: Criteria for non-performing credit facilities

1) A non-seasonal credit facility with a pre-established repayment schedule is considered non-performing when:

a) principal or interest is due and unpaid for 180 days or more or

b) principal or interest payments equal to 180 days interest or more have been capitalized, refinanced, renegotiated, restructured or rolled over.

2) A non-seasonal credit facility without a pre-established repayment program, such as overdrafts or other forms of open-ended credit, is considered non-performing when any one of the following conditions exist:

a) credit facility exceeds the customer's established borrowing limit for 180 consecutive days or more;

b) the customer's borrowing line has expired for 180 days or more;

c) interest is due and unpaid for 180 days or more;

d) the overdraft or account is inactive, meaning that no deposits have been made or deposits are insufficient to cover the interest capitalized or otherwise charged, over an 180 day period.

3) A seasonal credit facility without a pre-established repayment program is considered non-performing when either of the following conditions exist:

a) no repayment on the seasonal credit facility is made for 90 days or more after the end of the sales period;

b) repayments within 90 days after the end of the sales period are insufficient to cover capitalized and/or accrued interest charged during the period of the credit facility;

4) The Reserve Bank may, at its discretion, choose to change the objective criteria for non-seasonal non-performing credit facilities, but to a period of not less than 90 days in the criteria given in the above subsections.

5) The criteria for non-performing credit facilities apply regardless of what security is held on the facility.

6) Credit facilities to the Government of Malawi or unconditionally guaranteed by the Government of Malawi are exempt from non-performing status.

Sec. 2: Reporting of non-performing credit facilities to the Reserve Bank

1) Each bank is to report on a quarterly basis to the Reserve Bank its non-performing credit facilities based on the criteria in Part III, Section 1.

2) Failure to report non-performing credit facilities on a timely and accurate basis may subject a bank to the remedial measures and/or administrative sanctions in Part VIII of this directive.

Sec. 3: Repayment schedules of non-performing credit facilities

1) Upon meeting the criteria of non-performing as given in Part III Section 1, credit facilities without a pre-established repayment schedule are to be converted to a pre-established repayment schedule of monthly payments not to exceed 1 year;

2) Banks may apply to the Reserve Bank for prior exemption from subsection 1) above for specific credit facilities with such application stating the reason why such non-performing facilities should not be converted to a repayment schedule.

PART IV - INCOME RECOGNITION

Sec. 1: Interest Accrual

1) All categories of non-performing credit facilities based on the criteria in Part III Section 1 are to be placed on a non-accrual basis, that is interest due but uncollected should not be accrued to income but instead shown as interest in suspense.

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

3) Only when all outstanding due and unpaid obligations of a non-performing credit facility have been paid up to date, may the credit facility be returned to an accrual basis.

4) The above subsections apply regardless of security held on a credit facility.

PART V - CLASSIFICATION AND PROVISIONING

Sec. 1: Criteria for SUBSTANDARD, DOUBTFUL, & LOSS Classification

1) All non-performing credit facilities are to be classified by banks according to the criteria of this Section, with the exception of seasonal credit facilities as given in subsection 4) below or unless prior permission of the Reserve Bank is given under Part V Section 3 (3) of this directive.

2) Banks are to determine if the criteria chosen is subjective or objective, with the more severe method to be the norm.

3) When a bank chooses a subjective classification that is milder than the objective criteria would call for, it must justify such choice in writing to the Reserve Bank, with the Reserve Bank having the authority to call for the more severe classification.

4) With regard to seasonal credit facilities, which meet the non-performing criteria under Part III Section 1 (3) of this directive, classification and provisioning of these facilities is not mandatory until the criteria of that subsection is 180 days or more.

5) Criteria for SUBSTANDARD classifications are as follows:

a) SUBJECTIVE CRITERIA: Credit facilities which display well defined credit weaknesses that jeopardize the liquidation of the debt. Substandard credit facilities are not protected by the current sound worth and paying capacity of the borrower. Weaknesses may include: inadequate cash flow to service the debt; under-capitalization or insufficient working capital; absence of adequate financial information or security documentation; irregular payment of principal and/or interest; and inactive overdrafts/other accounts where credit entries (deposits) fail to cover interest charges;

b) OBJECTIVE CRITERIA: Non-performing credit facilities, as defined, on which principal and/or interest remain outstanding (unpaid) for 180 days or more, but less than 1 year.

c) The Reserve Bank may, at its discretion, change the objective criteria in subsection b) but to a period not less than 90 days.

6) Criteria for DOUBTFUL classifications are as follows:

a) SUBJECTIVE CRITERIA: Credit facilities which in addition to the weaknesses existing in substandard credits, have deteriorated to the extent that full repayment is unlikely or that realizable security values will be insufficient to cover the bank's exposure.

b) OBJECTIVE CRITERIA: Non-performing credit facilities, as defined, on which principal and/or interest remain outstanding (unpaid) for 1 year or more, but less than 2 years unless such assets are well secured by irrevocable guarantees of the Government of Malawi or first class international banks approved by the Reserve Bank, and the collection in full by drawing on these guarantees is assured.

c) The Reserve Bank may, at its discretion, change the objective criteria in subsection b) but to a period not less than 180 days.

7) Criteria for LOSS classifications are as follows:

a) SUBJECTIVE CRITERIA: Credit facilities that are considered uncollectible and of such little value that there continuation as bankable assets is not warranted. Such classification does not mean the asset has absolutely no recovery value, but rather that it is neither practical nor desirable to defer writing off this basically worth-less assets, even though partial recovery may be effected in the future. Banks should not retain assets on their books while attempting long-term recoveries. Losses should be taken in the quarter in which they are identified as uncollectible.

b) OBJECTIVE CRITERIA: Non-performing credit facilities, as defined, on which principal and/or interest remain outstanding (unpaid) for 2 years or more, unless such assets are well secured by the Government of Malawi or irrevocable guarantees of first class international banks approved by the Reserve Bank, and collection in full by drawing on these guarantees is assured.

c) The Reserve Bank may, at its discretion, change the criteria in subsection b) but to a period not less than 1 year.

Sec. 2: Provisions on Classified Credit Facilities

1) Banks are to establish specific provisions for non-performing credit facilities as defined.

1)2) All classified credit facilities are to be subject to specific provisions, regardless of whether the subjective or objective criteria were used in determining classification.

1)3) Specific provisions for substandard assets are to be maintained at not less than 20% of the outstanding balance.

1)4) Specific provisions for doubtful assets are to be maintained at not less than 50% of the outstanding balance.

1)5) Specific provisions for loss assets are to be maintained by 100% of the outstanding balance. Such assets to be written off the books in the following quarter to that in which they are classified loss, unless prior permission of the Reserve Bank has been obtained.

1)6) The outstanding balance is to consist of principal, interest which has been capitalized, and all other charges, fees, and other amounts which have been capitalized to the outstanding balance.

1)7) In addition to specific provisions, banks are encouraged to maintain a general provision of at least 1% of the total outstanding of credit facilities, net of specific provisions and unearned interest. Until such time as general provisions can be set up from pre-tax profits, the general provision requirement may be satisfied in the form of a 1% minimum of all credit facilities held within retained profits. This requirement is in effect unless prior permission of the Reserve Bank has been given to exempt such bank from maintaining a general provision.

1)Sec. 3: Security with Regard to Classification and Provisioning

1) All banks are to evaluate the status of security on any credit facility once payment of principal and/or interest falls into arrears or is irregular.

2) Banks are to initiate procedures to realize security once a credit facility is in non-performing status.

3) When a bank regards a non-performing credit facility as well secured, as defined, it may apply to the Reserve Bank for exemption from the classification and provisioning guidelines of this directive, stating its reasons for such exemption. In determining whether or not to grant such exemption, the Reserve Bank may call for additional information.

PART VI - INSPECTIONS BY THE RESERVE BANK AND EXTERNAL AUDITS

Sec. 1: Inspections and/or External Audits to Determine Accuracy of Reporting and Compliance

1) As authorized in Section 22 of the Banking Act, the Reserve Bank may undertake inspections of banks, and such inspections may include reviews to determine if reporting of non-performing

credit facilities and provisioning for such facilities has been accurately reported to the Reserve Bank and is in compliance with this directive.

2) When such reporting is determined to be inaccurate, the Reserve Bank may call for revisions to such returns to reflect an accurate position.

3) The Reserve Bank may impose any or all of the remedial measures and/or administrative sanctions in Part VIII of this directive with regard to inaccurate or untimely reporting and/or non-compliance to the sections of this directive.

4) The Reserve Bank may call upon external auditors to determine if a bank is reporting accurately and/or is in compliance with this directive, as part of the external audit.

Sec. 2: Determination of Classification and Provisioning

1) If, in the course of an inspection, the Reserve Bank determines that a non-performing credit facility has not been properly classified by bank management, it may call for such classification and subsequent provisioning, provided, in the judgement of Reserve Bank Inspectors, the classification it calls for fits within the subjective or objective criteria of this directive.

PART VII - COMPLIANCE TO CAPITAL ADEQUACY REQUIREMENTS

Reserve Bank Directive on Capital Adequacy

1) No bank can be determined by the Reserve Bank to be in compliance with its directive on Capital Adequacy Requirements unless it is in full compliance with this directive.

2) When the Reserve Bank determines that a bank is not in compliance with this directive, it may call for adjustments to balance sheets, income statements and the capital adequacy computation return with regard to non-accrual of interest and adequate provisions as it sees fit.

PART VIII: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

Sec. 1: Remedial Measures

1) When the Reserve Bank determines that a bank is not in compliance with this directive, it may impose remedial measures as specified under Section 31 of the Banking Act.

2) When the Reserve Bank determines that under the guidelines given in this directive, a bank is unsound and/or its capital is impaired, as defined in the directive for capital adequacy requirements, it may petition the High Court to sanction procedures called for under Section 32 of the Banking Act.

Sec. 2: Administrative Sanctions - In addition to the remedial measures available to it as given above in Part III Section 1, the Reserve Bank may impose any or all of the following administrative sanctions with regard to a bank that is not in compliance with this directive or its compliance with this directive indicates that the bank is in unsound condition:

1) Prohibition from declaring and/or paying dividends;

2) Suspension of the establishment of new branches and/or expansion into new banking or financial activities;

3) Suspension of access to credit facilities of the Reserve Bank;

4) Suspension of lending operations;

5) Suspension of the opening of letters of credit;

6) Suspension of the acceptance of new deposits;

7) Suspension of the acquisition of fixed assets.

PART IX: EFFECTIVE DATE

With effect from 30 June, 1993

Questions relating to this directive should be addressed to the Bank Supervision Department of the Reserve Bank.

MAP Chikaonda (DR)
GOVERNOR