SUPERVISORY AND REGULATORY GUIDELINES: 2022
Credit Risk Management
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MANAGEMENT OF CREDIT RISK GUIDELINES

TABLE OF CONTENTS

INTRODUCTION

1. The Central Bank of The Bahamas *("*the Central Bank*")* is responsible for the licensing, regulation and supervision of supervised financial institutions ("SFIs") operating in and from within the Bahamas pursuant to The Banks and Trust Companies Regulation Act, 2020 ("the BTCRA"), and the Central Bank of The Bahamas Act, 2020 ("the CBA").

2. All SFIs are expected to adhere to the Central Bank's licensing, regulation and prudential requirements and ongoing supervisory programmes, including periodic on-site inspections, and required regulatory reporting. SFIs are also expected to conduct their affairs in conformity with all other Bahamian legal requirements.

PURPOSE

3. These Guidelines specifically address the management of the credit risk present in the business activities of SFIs within their overall corporate governance process and risk management programmes. The effective management of credit risk as a component of a comprehensive risk management programme is fundamental to the safety, soundness, and long-term viability of every SFI. These Guidelines should be read in conjunction with ***The Bahamas Capital Regulations, 2022 ("Capital Regulations"), The Banks and Trust Companies (Large Exposures) Regulations, Guidelines for the Corporate Governance of Banks and Trust Companies Licensed to do Business within and from within The Bahamas ("Corporate Governance Guidelines"), Guidelines for the Management of Capital and the Calculation of Capital Adequacy ("Capital Adequacy Guidelines")*** and ***Guidelines for the Management of Large Exposures ("Large Exposures Guidelines").*** Additionally, the Central Bank endorses the Basel Committee on Banking Supervision ("the Basel Committee") Guidance on Accounting for Expected Credit Losses (See Appendix 1). SFIs are encouraged to refer to the full Basel document at *www.bis.org*.

4. Experience indicates that adherence to sound credit granting policies and procedures goes hand in hand with financial soundness. Failure to adopt and adhere to sound credit policies and procedures is often a source of weakness in financial institutions. The major consequence which arises from a weakening of the credit risk portfolio is the impairment of capital, liquidity, or both.

5. Credit risk management should be conducted within the context of a comprehensive board-approved business plan. While these Guidelines focus on a SFI's responsibility for managing and controlling its investments, loan portfolio, and exposure to credit risk, it is not meant to imply that credit risk can be managed in isolation from other considerations such as asset/liability management considerations and the need to maintain adequate liquidity. Sound credit management involves establishing a credit

risk philosophy, and policies and procedures for prudently managing the risk/reward relationship across a variety of dimensions, such as quality, concentration, maturity, currency, collateral security, and type of credit facility.

APPLICABILITY

7. These Guidelines apply, as appropriate, to all SFIs that engage in business activities that produce credit risk, except for credit unions. They represent the Central Bank's identification of accepted best practices for effective credit risk management in SFIs. The Central Bank appreciates that the breadth of the credit risk management programme of each SFI will depend on the scope and sophistication of the activities of the SFI, the nature and complexity of its credit-related businesses, and the types and levels of the risks that it assumes. However, failure to adopt a satisfactory credit risk management programme appropriate to a SFI's business activities, constitutes an unsafe and unsound practice and could subject the SFI to regulatory sanctions and/or other supervisory intervention measures.

8. As part of its ongoing off-site supervision, on-site examination and analysis programmes, the Central Bank will periodically conduct an evaluation of each SFI's strategies, policies, procedures and the management of the business activities that generate credit and related risks (i.e., the credit risk management programme). **Central Bank's Regulations and Guidelines establish the standards against which each SFI's credit risk management programme will be evaluated.**

DEFINITIONS

9. For the purpose of these Guidelines:-

Collateral refers to eligible contingent assets that are pledged by borrowers to lenders or obligations undertaken by a third party that serve as security to reduce the expected losses if default were to occur;

Credit is the provision of funds, or promise of provision of funds, on agreed terms and conditions to a debtor who is obligated to repay the amount borrowed (together with interest thereon). Credit may be extended on a secured or unsecured basis, by way of instruments such as mortgages, bonds, consumer and corporate advances, financial derivatives and finance leases;

Credit Risk means risk associated with a SFI's on and off-balance sheet exposures, and includes any risk to the earnings or capital arising from the potential that a borrower or counterparty will fail to perform on a loan or extension of credit;

Credit Risk Management is the process of managing and controlling the impact of credit risk-related events on the SFI; this management involves identifying, understanding, quantifying, and monitoring the degree of potential loss and pre-emptively taking appropriate measures to minimise the risk of loss to the SFI;

Credit Risk Mitigation means any technique (prescribed in the Capital Adequacy Guidelines, paragraph 39) used by a SFI to reduce the credit risk associated with any exposure held by the reporting SFI;

Financial Difficulties means current or impending conditions that impair or may impair the ability of a borrower to meet existing or future financial obligations;

Foreclosed Asset is an asset acquired by a SFI, in full or partial settlement of a loan or similar facility secured by real property, through enforcement of collateral security arrangements;

Fully-Secured Facility is a credit facility whereby the net current market value of the associated collateral is sufficient to ensure that the SFI will recover the principal and any accrued interest due;

Impaired Asset is a credit facility for which a significant increase in credit risk has occurred since the purchase or origination of the asset; or there is no longer reasonable assurance of timely collection of the full amount (e.g. principal and interest) without the bank's realisation of collateral, regardless of the number of days the exposure is past due;[1]

Loan to Value Ratio means the current amount of a property loan divided by the value of the property multiplied by 100%;

Net Current Market Value is defined as the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction after proper marketing of the asset and deduction of all disposal costs;

Past Due Asset refers to an asset whereby the borrower has not met a contracted payment of principal and interest or is otherwise outside of contracted arrangements;

Restructured Asset refers to an asset in which the original contractual terms have been modified to provide for concessions of interest or principal for reasons related to the financial difficulties of a counterparty;

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[1] A credit-impaired asset refers to an impaired asset that is classified as a Stage 3 Asset for the purposes of the IFRS 9 Standard.

Total Debt Service Ratio refers to a borrower's total monthly debt and non-discretionary obligations divided by a borrower's gross monthly income multiplied by 100%; and

Write-off is the process whereby a SFI directly reduces the gross carrying value of a financial asset when the SFI has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof.

ROLE OF THE BOARD OF DIRECTORS AND SENIOR MANAGEMENT

10. The Board of Directors ("the Board") is responsible for ensuring that the SFI has the appropriate credit risk practices and effective internal controls which are commensurate with the size, nature, and complexity of its lending exposures so that allowances are determined in accordance with the stated policies and procedures, the International Financial Reporting Standards ("IFRS 9") accounting framework, and the Central Bank's ***"Corporate Governance Guidelines"***. The Board should ensure that adequate controls over credit risk exist and that there is an appropriate credit risk environment. The revision and approval of credit risk policies, appropriate risk tolerances, and credit limits should be included in the Board's Annual Review Process.

11. The Board should at minimum ensure that the credit policies and procedures implemented by senior management are aligned to the risk profile and strategy of the SFI; this includes periodic reporting of material risks (e.g. watch listed credits).

12. Senior management is responsible for ensuring the appropriate implementation of the SFI's policies/processes and the Board's strategy. Senior management should periodically report to the Board the results of the credit risk assessment and measurement process, including estimates of the expected credit loss ("ECLs") allowances.

EXPECTED CREDIT LOSSES PROVISIONING FRAMEWORK

13. The IFRS 9 *Financial Instruments* includes a new loan loss provisioning standard based on ECLs. It requires more forward-looking and robust methods for identifying, measuring, monitoring, and controlling credit risk exposures. The previous International Accounting Standards 39 ("IAS39") was an incurred loss model that required institutions to recognise losses on assets when observable evidence of impairment was identified.

14. The Central Bank notes that in many jurisdictions the prudential provisioning frameworks are not aligned to the financial accounting frameworks. In these cases,

SFIs must refer to the *Fourth Schedule* of the ***Capital Regulations***. The implementation of accounting policies and the preparation of financial statements are senior management's responsibility, thus the Central Bank will not pre-approve a SFI's ECL accounting models. Notwithstanding the aforementioned approach, it is important to note that:-

i. The Central Bank reserves the right through supervisory discretion to respond to any perceived shortfall in credit provisioning by a SFI. The Central Bank may for example require the SFI to increase its minimum capital requirement, or to reduce its reported loan portfolio value to make up any prudent shortfall.

ii. The Central Bank expects that SFIs will effectively manage their accounting provisioning and other risks and reporting elements covered within these Guidelines, resulting in a sound and comprehensive credit risk management environment.

CREDIT RISK MANAGEMENT FRAMEWORK

15. SFIs should develop and implement procedures to identify, monitor and control the characteristics and quality of their credit portfolios. SFIs should also maintain a comprehensive credit manual with procedures and adequate information systems for measuring credit risk. This should include measuring credit risk that is inherent on the off-balance sheet products such as guarantees issued and received, derivatives in credit equivalent terms, loan commitments, etc. SFIs are expected to monitor the condition of individual credits to facilitate the identification of problem credits and determine the adequacy of provisions and reserves. SFIs should clearly articulate their credit risk tolerance, including how much, and what types of risk they are prepared to undertake.

16. The credit manual should also stipulate sound, well-defined criteria for granting credit, including a thorough understanding of the borrower or counterparty, the purpose and structure of the credit, and its source of repayment. The credit manual should outline the documentation for compliance with statutory requirements, the formal risk assessment for new products, the administration of the portfolio inclusive of sound internal controls, effective risk mitigation, and a well-defined credit collection and arrears management process.

17. Failure to establish adequate procedures to effectively monitor and control the credit function within the established guidelines can result in an inefficient allocation of resources, processing gaps and significant other costs, in addition to credit losses. Compromising effective credit policies and procedures is a major cause of servicing costs and credit losses.

18. The complexity of the credit risk measurement tools will depend on the nature and degree of the inherent risks of the products involved. These should be flexible to help SFIs identify risk concentrations. At minimum, a SFI's monitoring system should be capable of analysing its credit portfolio by the following characteristics:-

i. Size of exposure;
ii. Exposure to groups of connected parties;
iii. Individual product lines;
iv. Sectors (geographic, industrial);
v. Borrowers' demographic profiles;
vi. Account performance;
vii. Internal credit ratings;
viii. Outstanding versus undrawn commitments;
ix. Types and coverage of collateral; and
x. Interest rate sensitivity (i.e. fixed or floating), etc.

19. The Total Debt Service Ratio ("TDSR") is a lending metric that SFIs should use to assist with their assessment of a borrower's capacity to repay a loan. The TDSR applies to all personal loans, and must not exceed 50% unless specific regulatory approval is granted to the SFI by the Central Bank. SFIs using other methods to compute the TDSR will be responsible for demonstrating comparability with this standard. These Guidelines do not apply to commercial lending and the Central Bank reserves the right to periodically review the TDSR based on economic needs and international best practices.

TDSR shall be calculated as follows:-

$$\text{TDSR} = \left(\frac{Total\ Monthly\ Debt\ obligations}{Ordinary\ Monthly\ Income}\right) \text{ x } 100\%$$

The table below provides a framework for the TDSR inputs:-

DEBT OBLIGATIONS	INCOMES
Loan payments	Rental Income
Insurance premium payments	Bonuses/Gratuities
Rent expense	Investment Income
Maintenance costs	
Real property tax payment	

20. The methodology for computing the TDSR should be standardised, with all SFIs taking into account the following monthly non-discretionary obligations as prescribed in the table:

i. Loan payments (consumer loans, mortgages, the minimum payment for all credit card and overdraft limits);

ii. Insurance premium payments (e.g. life insurance or chattel if used as collateral and homeowner's insurance);
iii. Rent expense;
iv. Maintenance costs[2]; and
v. Real property tax (for properties that exceed the exempted value).

21. When calculating the TDSR, ordinary monthly income is defined as the sum of wages and gratuities, guaranteed rental and investment income. A 40%, 50%, and 50% haircut should be applied to rental income, gratuities, and investment income respectively.

22. SFIs are to require a minimum equity contribution of 15% on all personal loans, with the exception of those secured with mortgage indemnity insurance which has an equity of 5%. The 15% equity contribution does not apply to cash secured credit facilities. The Central Bank recognises that there will be some instances where SFIs will exercise some degree of flexibility in enforcing the 15% equity requirement, based on their internal risk assessment framework. However, these are to be exceptions based on prudent considerations.

23. The presence of mortgage indemnity insurance is not a substitute for sound underwriting practices. Prudential limits should only be exceeded on an exceptional basis and in accordance with the SFI's Board approved risk appetite. Although mortgage indemnity insurance is not a prudential requirement for high ratio mortgages, the Central Bank expects that SFIs' underwriting standards effectively assess the risks of all prospective credit facilities. Additionally, high LTVs would have a capital impact as this would increase the SFI's risk-weighted assets calculation.

24. SFIs should be conscious of business and economic cycles and regularly stress-test their portfolios against adverse market scenarios. Adequate contingency planning should be developed in conjunction with stress-testing.

25 SFIs should keep the functions of credit initiation, approval, review, administration, payments, and delinquency management as separate as possible. SFIs should ensure that a credit authority is required and designated for all types of credit exposures, including the use of credit derivatives for hedging or income generation. Approval limits should relate to some combination of the elements of paragraph 18.

26. Delegated credit authority be individual, pooled, or shared within a committee. The delegation of credit authority needs to be clearly documented, and should include:-

[2] Specifically for lending related to condominiums where the declaration requires a non-discretionary obligation to pay homeowners association maintenance fees.

i. The absolute and/or incremental approval authority being delegated;

ii. The officers, positions or committees to whom authority is being delegated;

iii. The ability of recipients to further delegate risk approval; and

iv. The restrictions, if any, placed on the use of delegated risk-approval.

27. In controlling credit risk, SFIs can utilise certain mitigation techniques; these would include the assignment of eligible collateral as prescribed in Regulation 17 of the ***Capital Regulations***.

28. Additionally, SFIs are expected to utilise the Credit Bureau as a tool to better understand the creditworthiness of their individual clients. SFIs should factor in the credit risk scores of clients obtained from the Credit Bureau into their rating of prospective clients and use the credit reports to monitor the risk profile of existing loan portfolios.

ASSET CLASSIFICATION

29. SFIs are required to develop and use credit risk grading systems ("CRGS") in managing credit risk. The grading system should be consistent with the nature, size and complexity of the SFI's activities; the level of granularity will vary depending on these activities.

30. The Central Bank does not wish to impose a standard CRGS for all SFIs. Rather, the Central Bank will rely upon the system adopted by each SFI, provided that the system adopted is satisfactory to the Central Bank.

The following factors should be considered when developing the CRGS:-

i. Coverage should extend to as much of a SFI's portfolio as possible, including off-balance sheet exposures;

ii. For applicable exposures, the system should cover both performing and non-performing assets to provide for the migration of an exposure from fully performing to loss status;

iii. Connected parties should generally be classified on a group basis;

iv. A regular independent review function to provide assurances about the integrity of the grading process should be established;

v. Arrangements for the periodic validation of the grading model to ensure that it continues to deliver reliable information and adequately distinguishes between exposures of varying credit quality; and

vi. A sufficient number of risk grades to ensure that the system adequately captures the gradation of risk; and upon analysis, SFIs should be able to identify transitions throughout different asset classes such as:-

a. Satisfactory - the credit is current and its original source of repayment and collateral support is adequate. Timely repayment of the outstanding credit facility is not in doubt. Repayment is prompt and the credit facility does not exhibit any potential weakness in repayment capability, business, cash flow or financial position of the borrower and there is full expectation that the principal and interest will be collected in full.

b. Special Mention - the credit is of acceptable quality, however, potential weaknesses exist that if not corrected in a timely manner, may adversely affect repayment by the borrower at a future date and warrant close attention by the SFI. Characteristics of special mention credit facilities may include inter alia:-

(1) A declining trend in the operations of the borrower that signals a potential weakness in the financial position of the borrower, but not to the point that repayment is jeopardised; and

(2) Economic and market conditions that may unfavourably affect the profitability and business of the borrower in the future.

c. Substandard - the credit facility exhibits define weaknesses that may jeopardise repayment on existing terms and involves more than a normal risk of loss due to one or a combination of factors, namely:-

(1) Unsatisfactory debt servicing record or inability of the borrower to meet contractual repayment terms of the credit facility;

(2) Weak financial condition, or the inability of the borrower to generate sufficient cash flow to service the payments;

(3) The facility's principal and/or interest has not been serviced for 90 days or more;

(4) Insufficiency of collateral;

(5) Uncertainty with respect to the ability of the borrower to comply with the agreed repayment terms. This uncertainty may be a result of unfavourable economic and market conditions or operating problems that would affect the profitability and business of the borrower in the future; and

(6) A credit facility that is currently performing but has weaknesses that raise doubt on the borrower's ability to comply with the terms and conditions of the credit. This includes difficulties experienced by the borrower in repaying other credit facilities.

d. Doubtful - The outstanding credit facility exhibits more severe weaknesses than those in a "substandard" credit facility, such that the prospect of full recovery of the outstanding credit facility from collateral or other assets of the borrower is questionable and the prospect of a loss is high, yet the exact amount remains undeterminable.

e. Loss - The outstanding credit facility is considered uncollectable, and little can be done to recover the outstanding amount from any collateral or assets of the borrower generally.

31. Comparable rating systems may also be used. Appendix 2 may be used to map a SFI's existing CRGS to the standard system detailed in paragraph 30.

IMPAIRMENT RECOGNITION

32. When an impaired asset is measured at amortised cost on the basis of expected future cash flow discounted at the asset's effective interest rate, changes in the estimated recoverable amount arising subsequent to initial recognition of impairment should be reflected in the income statement in the current period. The reductions in the carrying amount of the impaired asset should be recognised as an impairment loss in the statement of income in the period in which the impairment is identified.

33. When an impaired asset is measured on the basis of the fair value of the collateral underlying the asset or an observable market price for the asset fair changes in the estimated recoverable amount arising subsequent to initial recognition of impairment should be reflected in the income statement in the current period as a charge or credit for asset impairment.

34. Changes in the fair value of financial assets classified as fair value through other comprehensive income ("FVOCI") should be recognised in equity (other than impairment losses and forex gains and losses) until the asset is removed from the books, at which time the cumulative gain or loss previously recognised in equity should be recognised in profit and loss. The loss allowance for assets classified as FVOCI shall be recognised in other comprehensive income and shall not reduce the carrying amount of the financial asset in the balance sheet.

35. SFIs should measure expected credit losses as the present value of all cash shortfalls, which is the difference between the cash flows according to the contract and the expected cash flows. Under the ECL model, originated or purchased assets transition through three stages of impairment: Stage 1, 2, and 3 (See Appendix 2). SFIs are required to calculate provisions for all credit facilities. Stage 3 assets are considered credit impaired. Loans that are credit-impaired when purchased should be recognised originally at their fair value, with no associated allowance for credit losses. Only subsequent cumulative changes in lifetime ECLs, since original recognition, should be recognised in the allowance for credit losses. If the credit quality of these loans improves and the lifetime ECLs are less than the previous reporting period, the SFI should record a negative provision; this negative provision should be recorded in full, even if the new loss estimate is less than the credit loss estimate at purchase or origination.

36. The credit treatment for off-balance sheet exposures will be in accordance with the ***Capital Adequacy Guidelines***. The principal off-balance sheet exposures to be captured by these Guidelines are likely to be direct credit substitutes and commitments. Direct credit substitutes (e.g. guarantees and standby letters of credit) are usually converted into on-balance sheet items when called. However, there may be circumstances when the SFI is reasonably certain that such instruments will be called upon at a future date because of uncertainty about the counterparty. In such cases, the off-balance sheet exposure should be regarded as impaired except for instances where the instruments are fully cash secured.

37. The assessment of impairment for pools of loans should be based on all available and relevant information. SFIs are likely to identify multiple components of collective loan impairment, such as historical loss experience, current environmental conditions, attributes of a defined group of borrowers, and characteristics affecting the collectability of a pool or portfolio of loans.

38. SFIs should treat counterparties as connected where they are linked by cross guarantees, common ownership or management, ability to control, financial interdependency, or other connections which, in the SFI's assessment, would lead it to regard the assets as representing a common risk.

39. Where a SFI provides multiple facilities to a single counterparty and one of the facilities is impaired, the SFI may wish to classify all facilities to the counterparty as impaired where there is a reasonable expectation that the source of repayment has also been impaired. Similarly, if one party of a group of connected parties has an impaired facility with a SFI, the SFI may wish to treat all facilities to the related parties in the group as impaired where there is a reasonable expectation that the source of repayment has also been impaired. Extension of the impairment classification is not required if:-
    i. the various facilities are not cross-collateralised, and there are no cross guarantee arrangements between the related parties; or
    ii. there are cross-collateral and guarantee arrangements but, in aggregate, there is sufficient security among the group of related parties to ensure ultimate collectability of all principal and interest on both the impaired and performing exposures.

40. SFIs are not required to treat exposures to family members arising from retail relationships as related for the purposes of these Guidelines provided an independent relationship can be shown to exist.

41. SFIs are expected to effectively monitor their exposures to ensure that non-performing credit facilities are promptly identified to mitigate credit risk. For non-performing loans in excess of five years, SFIs are required to provision at 100%.

42. SFIs should ensure that when credit-impaired assets are reclassified to performing assets, that this decision is based on objective evidence. A credit facility may be returned to performing status when all of the following conditions are met:-

    i. All past due principal and interest payments have been made current;

    ii. The borrower's financial situation has improved and the remaining payments according to the credit facility agreement are expected;

    iii. The borrower has resumed paying the full amount of the rescheduled contractual principal and interest for at least six months; and

    iv. All remaining payments are deemed collectable within the contractually stipulated timeframe.

43. The renegotiation (refinancing, rescheduling, renewal or other modifications) of credit agreements arising from weaknesses in the borrower's financial position or inability to repay[3] would be allowable under the following conditions:-

i. The borrower can demonstrate the capacity to service the credit facility under the new conditions of the contract;

ii. Where a credit facility has been renegotiated, it should not receive a more favourable categorisation unless a continuous repayment period and collection in accordance with the contractual terms have been demonstrated for at least six months;

iii. Any loan rescheduling involving capitalization of interest (whereby uncollected interest is added to unpaid principal at the payment date or maturity of a credit facility or advance) may require an increase in the value of the collateral to cover the capitalized interest where applicable;

iv. The new credit facility resulting from the capitalisation of interest will be offered only if the borrower can demonstrate the capacity to service the facility under the new conditions of the contract; and

v. Credit facilities with the least likelihood of recovery[4] would not be eligible for renegotiation unless such facilities have either an improvement in the facility collateral or the borrower makes an up-front cash payment.

44. Notwithstanding paragraph 43(iii), modifications to assets that result in derecognition or write off of the previous asset are to be classified as newly originated exposures and provisions are to be calculated using the Stage 1 Asset ECL measure.

[3]Financial Difficulty Indicators:

(a) A counterparty is currently past due on any of its material exposures;
(b) A counterparty is not currently past due, but it is probable that the counterparty will be past due on any of its material exposures in the foreseeable future without the concession, for instance, when there has been a pattern of delinquency in payments on its material exposures;
(c) A counterparty's outstanding securities have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange due to noncompliance with the listing requirements or for financial reasons;
(d) On the basis of actual performance, estimates and projections that encompass the counterparty's current capabilities, the SFI forecasts that all the counterparty's committed/available cash flows will be insufficient to service all of its loans or debt securities (both interest and principal) in accordance with the contractual terms of the existing agreement for the foreseeable future;
(e) A counterparty's existing exposures are categorised as exposures that have already evidenced difficulty in the counterparty's ability to repay in accordance with the supervisory categorisation scheme in force or the credit categorisation scheme within a SFI's internal credit rating system;
(f) A counterparty is in non-performing status or would be categorised as nonperforming without the concessions; and
(g) The counterparty cannot obtain funds from sources other than the existing banks at an effective interest rate equal to the current market interest rate for similar loans or debt securities for a non-troubled counterparty;

[4] Under the Standard CRGS: doubtful or loss categories.

45. The following concessions can lead to an asset being classified as "restructured":-

i. A reduction in the principal amount of the asset, or the amount payable at maturity, as set down in the original facility agreement;

ii. Forbearance in the form of a below market rate of interest;

iii. A reduction of interest payable by the counterparty, including forgiveness of interest (whether or how interest is accrued, is up to the SFI). The counterparty may be unaware of any changes in the accrual of interest, and only knows about paid, payable, and overdue/ penalties;

iv. A deferral or extension of interest and/or principal payments, including capitalisation of interest; or

v. An extension of the original maturity date(s) at a stated interest rate lower than the current market rate for new debt with a similar risk.

46. If after a restructuring, there still remains considerable doubt about the recovery of principal and interest, and the asset is not "fully-secured", it should be regarded as a Stage 3 asset.

47. In each case, the underlying evidence should support the view that there is no reasonable doubt about the ultimate collectability of principal and interest. This should be appropriately documented in a written assessment that addresses the current credit evaluation of the borrower's financial condition and other factors affecting prospects for repayment and maintained on the credit file.

48. Overdrafts and revolving credits are impaired where one of the following factors exists:-

i. The contracted interest payment and/or principal have been past due for 90 days or more, and this was not as a result of any special client arrangement; or

ii. The facility has operated, on average, in excess of the authorised limit for a period of 90 days or more, and the SFI has not approved an increased limit even if only on a temporary basis.

TREATMENT OF INTEREST

49. For Stage 1 and 2 Assets, interest income should be recognised on the gross carrying value of the asset. For Stage 3 Assets, interest is accrued on the amortised cost (Gross carrying value less the Expected Credit Losses) at the original effective interest rate.

The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the instrument to the gross carrying amount of the instrument. The rate considers all contractual terms but does not consider ECLs.

50. Conversely, interest revenue for purchased or originated credit-impaired loans (that is, irrespective of whether they are in Stage 1, 2 or 3) are calculated based on the credit-adjusted effective interest rate on the amortised cost amount of the loan from initial recognition. When an asset is impaired the interest revenue calculated changes as of the beginning of the next reporting period.

51. Where relevant documentation stipulates the order of priority in which cash receipts are to be treated, the SFI should follow that treatment, unless an agreement has been reached with the client to vary the priority of repayment in the facility documentation. Where the documentation is silent, then in the absence of any legislation, court orders, or regulations governing priority, cash received should be applied in the following priority:-

i) Statutory charges;
ii) Penalty interest and fees;
iii) Overdue interest and fees;
iv) Current interest and fees; and
v) Principal

WRITE-OFFS

52. An account shall be written off three months after being categorised as a loss. A record of bad debts written off should be maintained in a memorandum account. A write off constitutes a derecognition event.

53. To maintain a complete record of write-offs and recoveries in the allowance for loan impairment account, write-offs and recoveries related to impaired assets should be recorded through this account rather than being recorded directly as a charge or credit for asset impairment in the income statement. Write-offs and recoveries that are charged or credited to the allowance account during an accounting period, are reflected as a charge or credit for asset impairment in the income statement at the end of the period when the ending balance in the allowance account is established.

54. Subsequent payments, whether designated as interest or principal, received on an impaired facility should be recorded as a reduction of the recorded investment in the facility. When the recorded investment in the facility is completely written off, the subsequent payments should be credited to the allowance for impaired assets.

DISCLOSURE

55. In addition to the disclosure requirements of IFRS 9, the following information should be disclosed in the financial statements:-

    i. The total recorded investment in individual assets identified as impaired and the amount of the related allowance for impairment, analysed by groups of facilities with similar characteristics;

    ii. The total recorded investment in foreclosed assets held for sale and the amount of the related allowance for asset impairment;

    iii. The recorded investment in each group of assets against which an allowance for asset impairment has been established collectively and the provisions for the current period;

    iv. The net charge or credit to income in respect of asset impairment, identifying separately recoveries of assets written off in previous periods;

    v. Write-offs of assets during the reporting period, identifying separately amounts related to facilities restructured during the reporting period;

    vi. The amount of restructured assets, analysed by groups of facilities with similar characteristics;

    vii. The basis of determining the amount of the allowance for impaired assets as well as the events and conditions considered in determining the charge to income for the period in respect of the provisions should be disclosed;

    viii. A continuity schedule of the allowance for impairment, identifying separately the total amount of allowances; and the total amount of allowances against individual assets and groups of assets.

56. A facility cannot be split into unimpaired and impaired portions for the purpose of reducing the recorded investment in impaired assets that is required to be disclosed unless this is done to reflect a change in the underlying legal agreements. The existence of a guarantee or insurance (irrespective of the status of the guarantor or provider of insurance) does not preclude a facility from being disclosed as an impaired asset when reasonable assurance does not exist of the timely collection of the full amount of principal and interest.

57. Although not necessarily regarded as impaired assets, SFIs are required to disclose the amount of past due facilities as a routine part of their quarterly reporting requirements to the Central Bank.

58. When reporting impaired assets to the Central Bank, SFIs should include provisions for off-balance sheet exposures.

59. Identification of loans that are classified as amortised cost, fair value through other comprehensive income or fair value through profit and loss.

60. Exemption from these disclosure requirements may be granted in circumstances where the Central Bank has agreed, in writing, with the SFI that the cost of disclosure is disproportionately greater than the benefit it provides.

CENTRAL BANK OF THE BAHAMAS ASSESSMENT PROCESS

61. The Central Bank's assessment of a SFI's compliance with these Guidelines will be conducted as the Central Bank sees fit, normally including:-

    i. The Central Bank's assessment of SFIs' credit risk management policies, provisioning policy and associated methodologies against the assessment criteria identified in this Guideline. Emphasis will be placed on the understanding and degree of oversight of the provisioning process applied by senior management and the Board of each SFI; and

    ii. The Central Bank's assessment of the overall reasonableness of the level of provisioning.

62. SFIs having a credit risk management methodology and/or level of provisioning that is assessed as "Not Acceptable" at the sole discretion of the Central Bank will be required to submit an action plan and timeline for compliance with the Guideline. Until such time as the SFI achieves an "Acceptable" or better rating, the SFI may be subject to enhanced monitoring of its risk management processes. Also, SFIs that do not achieve an "Acceptable" rating for the level of provisioning may be expected to provide an additional level of capital or equivalent to minimise the adverse effects of insufficient provisioning levels. This capital may be provided by a deduction from a SFI's regulatory capital.

Appendix 1

Guidance on Accounting for Expected Credit Losses
Basel Committee on Banking Supervision (February 2015)

<u>Supervisory requirements for sound credit risk practices that interact with expected credit loss measurement</u>

Principle 1: A bank's board of directors (or equivalent) and senior management are responsible for ensuring that the bank has appropriate credit risk practices, including effective internal controls, commensurate with the size, nature and complexity of its lending exposures to consistently determine allowances in accordance with the bank's stated policies and procedures, the applicable accounting framework and relevant supervisory guidance.

Principle 2: A bank should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring the level of credit risk on all lending exposures. The robust and timely measurement of allowances should build upon those methodologies.

Principle 3: A bank should have a process in place to appropriately group lending exposures on the basis of shared credit risk characteristics.

Principle 4: A bank's aggregate amount of allowances, regardless of whether allowance components are determined on a collective or an individual basis, should be adequate as defined by the Basel Core Principles, which is an amount understood to be consistent with the objectives of the relevant accounting requirements.

Principle 5: A bank should have policies and procedures in place to appropriately validate its internal credit risk assessment models.

Principle 6: A bank's use of experienced credit judgment, especially in the robust consideration of forward-looking information that is reasonably available and macroeconomic factors, is essential to the assessment and measurement of expected credit losses.

Principle 7: A bank should have a sound credit risk assessment and measurement process that provides it with a strong basis for common systems, tools and data to assess and price credit risk, and account for expected credit losses.

Principle 8: A bank's public reporting should promote transparency and comparability by providing timely, relevant and decision-useful information.

Supervisory evaluation of credit risk practices, accounting for expected credit losses and capital adequacy

Principle 9: Banking supervisors should periodically evaluate the effectiveness of a bank's credit risk practices.

Principle 10: Banking supervisors should be satisfied that the methods employed by a bank to determine allowances produce a robust measurement of expected credit losses under the applicable accounting framework.

Principle 11: Banking supervisors should consider a bank's credit risk practices when assessing a bank's capital adequacy. This guidance is intended to set forth supervisory requirements on accounting for expected credit losses that do not contradict applicable accounting standards established by standard setters.

Appendix 2

Classification Levels					
	Performing Exposures		Non-Performing Exposures		
IFRS 9 ECL Level	Stage 1	Stage 2	Stage 3		
ECL Provisioning Measure	12Month ECL	Lifetime ECL	Lifetime ECL		
Standard Asset Classification	Satisfactory	Special Mention	Substandard	Doubtful	Loss
Days Past Due *Lagging Indicator of default	$x < 30$ DPD	$30 \leq x < 90$ DPD	$90 \leq x < 360$ DPD		