

# **PRUDENTIAL CREDIT GUIDELINES**

LOAN CLASSIFICATION CRITERIA

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SUSPENSION OF INTEREST

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**Revised June 1997**



## 1. ANNUAL (FINANCIAL YEAR) CLASSIFICATION OF LOANS AND ADVANCES

Financial institutions operating with the ECCB Region would be required to conduct an annual review of their credit portfolio. This should represent at least 70% of the portfolio and should include all **Large Credits<sup>1</sup>, Past Due Loans, Non-performing Loans and Overdrafts and Other Problem Credits**. The information reviewed would include:

- (a) The original amount of the loan/advance, the terms, the interest rate, the current balance and status and the purpose of the loan/advance.
- (b) The business of the borrower, balance sheets, cash flows and other financial data both on the business and the guarantors.
- (c) An evaluation of the project being financed.
- (d) The security taken, including up to date appraisals, legal assignments, insurances etc.
- (e) Track record of the borrower including the servicing of previous borrowings.
- (f) If part of a group, the performance of loans/advances to other members of the group.

Following the annual review of the portfolio the loans/advances should be classified by the financial institution, based on the criteria detailed below and the required provision made. In addition, report all recoveries, charge-offs and rescheduled loans for the period.

### LOAN CLASSIFICATION CRITERIA

The five categories used to classify a financial institution's portfolio are as follows.

**Pass, Special Mention, Substandard, Doubtful and Loss.**

#### **PASS**

*All of the following:*

- Loan repayments current or not more than 30 days in arrears.
- Financial condition of the borrower is sound.
- Adequate credit documentation to support borrowings.
- Collateral for loan is unimpaired.
- Loans (both principal and interest) which are fully secured by cash or government securities.

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<sup>1</sup> Large credits are relative to the institution.

- Overdrafts operating within the approved limits and showing good fluctuations.

**SPECIAL MENTION** *Any one or more of the following:*

- Currently up to date but evidence suggests that certain factors could in the future affect the borrower's ability to service the loan properly or impair the collateral.
- Inadequate credit documentation to support borrowings or other deviation from prudent lending practices.
- Loan repayments in arrears, for *between 30 - 90 days* and/or non-compliance with other terms of the loan.
- Collateral not fully in place or loan up to date but inadequately secured.
- Overdraft exceeds the approved limit for short periods.
- Loans which could deteriorate because of market conditions affecting the sector.
- Rescheduled or refinanced loans which are up to date and adequately secured, for a minimum of 1 year after rescheduling.

**SUBSTANDARD** *Any one or more of the following:*

- Well defined credit weaknesses e.g. borrowers cash flow insufficient to service the debt as arranged, several renewals with capitalization of interest.
- Loans at least 90 days and more in arrears (non-performing loans).
- Primary source of repayment insufficient to service debt and bank has to look at secondary sources, such as collateral or refinancing, for repayment.
- Adequately secured<sup>2</sup> overdraft, continuously in excess of the approved limit.

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<sup>2</sup>

**Adequately secured means that the security is sufficient to protect the financial institution from loss of principal and interest following disposal in a forced sale situation.**

- Adequately secured overdraft, with a hardcore and fluctuations which do not conform to the business cycle.
- Portion of doubtful debt which is fully secured.
- Non-performing loans to Government and other non-performing loans fully secured by Government *or Government securities or by cash.*

**DOUBTFUL**

**All the weaknesses of substandard plus any one or more of the following:**

- Loans at least 180 days in arrears, unless fully secured.
- Collection of the debt in full, highly questionable or improbable.
- Possibility of a loss, but some factors exist which could improve the situation.
- Overdraft continuously in excess of limit, minimum activity in the account and security insufficient to cover outstandings.

**LOSS**

**Any one or more of the following:**

- Loans considered uncollectible.
- Loans at least 365 days in arrears unless fully secured.
- Loans which may have some recovery value but it is neither practical nor desirable to defer write off.

**2.**

**PROVISIONING GUIDELINES**

Provision for anticipated loan losses should be given for all classified credit, using the percentages provided below. Indicate both specific and general provision at the bottom of the schedule in the space provided.

In order to determine an adequate level of provision for anticipated losses on loans, a minimum provision should be assigned to each of the loan classification categories, following the annual review of the loan portfolio. The following minimum levels of provisions are provided for use in the region:-

**Classification**

**Level of Provision**

Pass	0%
Special Mention	0%
<i>Substandard (Loans and advances to Government or fully secured by Government or Government securities or by Cash)</i>	0%
Substandard ( <i>Other</i> )	10%
Doubtful	50%
Loss	100%

### Unclassified Credit

In addition a 1% provision should be provided for the percentage of the portfolio not reviewed.

### **3. SUSPENSION OF INTEREST**

Interest should not be accrued on loans classified as non-performing (i.e. where principal and interest have not been paid for ninety days or more) unless such loans are adequately secured and full collection is expected within three months. Neither should interest be accrued on overdrafts when the approved limit has been reached and/or when credits to the account are insufficient to cover interest accruals for at least a three month period.

Interest on loans to Government *would continue to accrue interest up to the approved limit*, and interest on loans guaranteed by Government *or collateralised by Government securities or by cash*, would continue to accrue interest up to the limit of the guarantee *or up to the value of the collateral*.

A non accrual loan may be restored to accrual status when all arrears of principal and interest have been paid or when it otherwise becomes well secured and in the process of collection. In the case of overdrafts, accrual status is restored when the account is operating within the limit and all interest arrears have been cleared or when it otherwise becomes well secured and in the process of collection.

Accrued, uncollected interest should be reflected in an "interest in suspense" account on the balance sheet.

### **4. WRITE-OFF PROCEDURES**

Loans must be written off to a memorandum account, three months after being classified as a loss.

### **5. RENEGOTIATED LOANS**

Renegotiated loans and advances are credits which have been refinanced, rescheduled, rolled over or otherwise modified because of weaknesses in the borrower's financial position and/or the nonrepayment of the debt as arranged. Loans should only be renegotiated under the following conditions:

- the existing financial position of the borrower can service the debt under the new conditions.
- loans classified doubtful or loss should not be renegotiated unless an upfront cash payment is made or there is an improvement in the security taken.
- commercial loans should not be renegotiated more than twice over the life of the original loan and mortgage and personal loans not more than twice in a five year period.
- renegotiated loans should not be reclassified upward for at least one year following the new arrangements.
- the security for renegotiated loans inclusive of capitalised interest, should cover the full amount of the renegotiated loan.

ANNUAL (FINANCIAL YEAR) CLASSIFICATION OF LOANS AND ADVANCES<sup>3</sup>

\$000's

CLASSIFICATION	NO. OF ACCOUNTS	AMOUNT OUTSTANDING	LOAN LOSS PROVISION \$
Pass			
Special Mention			
Substandard			
Doubtful			
Loss			
<b>TOTAL</b>			

ITEM	NO. OF ACCOUNTS	AMOUNT (\$)
Recoveries		
Charge-Offs		
Rescheduled Loans		

General Loan Loss Provisions:

Specific Loan loss Provision

**\*TOTAL**


**\*These items should coincide with Items 19, 20(a) and (b) on the BS1 schedule for the corresponding reporting period**

<sup>3</sup> To be submitted three (3) months after the end of the financial year.