STANDARD OF SOUND PRACTICE ON PROBLEM ASSET MANAGEMENT AND PROVISIONING REQUIREMENTS

UNDER THE BANKING SERVICES ACT, 2014

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Standards of Sound Practices (SSP) are guiding principles issued by the Bank of Jamaica which set out minimum expectations of the Supervisory Authority in relation to its licensees; and against which licensees can evaluate their performance.

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Responding to this Paper

This document is being circulated to DTIs and other relevant stakeholders to facilitate industry consultation and feedback. The Bank invites comments on the proposal for the principles-based guidance on a Problem Asset Management and Provisioning Requirements Framework. Comments are most helpful if they:

- indicate the paragraph and specific point to which a comment relates;
- contain a clear rationale for an amendment or state a specific area of concern;
- provide evidence to support the views expressed; and
- propose alternative regulatory approaches the Bank should consider.

Submission of Responses

Comments on the proposals will be received up to the close of business on March 31, 2018 by email to fisdfeedback@boj.org.jm

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ABBREVIATIONS

ACLR	Accumulated Credit Loss Reserve
BSA	Banking Services Act
DTI	Deposit-taking Institution
ECL	Expected Credit Loss
FHC	Financial Holding Company
IFRS	International Financial Reporting Standards
LGD	Loss Given Default
PD	Probability of Default

GLOSSARY

Term	Definition
Accumulated Credit Loss Reserve	Means the accumulated balance representing the licensee's best estimate of probable loan and other credit-related losses existing in the licensee's credit portfolio, which records additional accumulated provisions required by this Guidance. The ACLR consists of specific and general provisions for loan and other credit-related losses and may be directly charged against profits or be appropriated to a special reserve account.
Bank	Bank of Jamaica established by the *Bank of Jamaica Act.*
Deposit-taking Institution (DTI)	Means a bank, a merchant bank, or a building society.
Expected Credit Losses	Means the probability-weighted estimate of credit losses (i.e., the present value of all cash shortfalls) over the expected life of the financial instrument.
Fair Value	Means the price at which an asset is or may be exchanged on an arm's length basis between knowledgeable and willing parties. The determination of fair value is as prescribed by the existing accounting standards in Jamaica.
Financial Holding Company (FHC)	A company (a) licensed under the BSA as a FHC; and (b) under-which other companies within the financial group are held, including- a. any of that company's subsidiaries incorporated outside of Jamaica; and b. entities over which it has effective control.
Fully Secured	Means that the credit is satisfactorily secured by security of which the net market value, as defined, is sufficient to recover the debt outstanding and accrued interest and other charges, if any and the interest of the licensee (i.e. the lender) is perfected.
General Provisions	Means those provisions for loan and other credit losses, which are established against a bank's credit facilities for which specific provisions are not required on an individual or portfolio basis.
Licensee	A person or body that is licensed under the BSA.

Market Value	Refers to the appraised market value of a security as determined by an independent qualified appraiser or as otherwise determined by an exchange, industry group, pricing service or agency recognized by the Supervisor
Net Market Value	Refers to the estimated market value adjusted for all costs to dispose of the security including legal and marketing costs, market liquidity, contingencies and any other costs that may impact the full cash collection of the market value.
Non-accrual Credits	Means credits on which interest is no longer being accrued.
Provision	IFRS defines provision as a liability of uncertain timing or amount which can be measured only by using a substantial degree of estimation.
Specific Provisions	Means those provisions for loan and other credit losses, which are established for the estimated impaired losses identified against individually assessed credits or credits assessed on a portfolio basis.

EXECUTIVE SUMMARY

A good quality asset portfolio is fundamental to the financial soundness of a deposit taking institution (DTI) and by extension the stability of the banking system. A DTI's asset quality is usually a reflection of the quality of processes and procedures underpinning loans and investment decisions as well as the management and control of risks arising from those decisions, whether those assets reside on the balance sheet of the financial entity or off its balance sheet.

Experience has shown that deficient credit underwriting and risk measurement practices usually result in impairment of the loan book, which traditionally is the most material asset category on a bank's balance sheet. Additionally, unanticipated deleterious business specific, environmental and economic factors events may occur which can result in borrowers being unable to service their agreements with the institution as agreed, thereby resulting in a deterioration in income earning capacity of the asset[1]. Problem assets can adversely impact an institution's profitability, liquidity and capital position leading ultimately to insolvency and failure and if systemically important, could have a destabilizing effect on the financial system. Therefore, a DTI should have established Board approved policies, procedures and practices for identifying, monitoring and managing expected credit losses (ECLs) and, where necessary, subsequent problem assets.

In light of prudential concerns, international best practice and the Bank of Jamaica's responsibility for licensing, regulating and supervising DTIs and FHCs, the time is opportune for the establishment of a Guideline which establishes uniform standards to be followed by licensees, that is, FHCs on a consolidated basis and DTI's on a solo and consolidated basis (where applicable), to ensure that:

a. Assets are regularly evaluated using an objective grading system that is consistent with regulatory standards;
b. The prudential treatment for non-performing or problem assets is consistent with regulatory and supervisory requirements;
c. Timely and adequate provisioning and non-accrual criteria are established to recognize, measure and monitor asset impairment; and
d. Write-offs are applied to accurately reflect the capital and earnings performance of the licensee.

This Guidance is also intended to encourage the development of timely and effective work-out plans for problem assets and effective internal controls to manage such assets. This Supervisory Guidance applies to all assets carried on a licensee's balance sheet or reflected as off-balance sheet items, and is aimed at setting out the supervisory expectations related to sound problem asset management practices. This document presents minimum guidance, and should be enhanced where necessary based on, inter alia, the size, scope, interconnectedness, complexity and state of the institution's asset portfolio.

While the Guidance does not specifically deal with provisions for other business activities (e.g., trading and derivatives activities), licensees should ensure that the credit risk in these areas are prudently and appropriately measured and managed.

[1] When this occurs the asset is designated as a "problem asset" or an "impaired asset".

GUIDELINES FOR PROVISIONING

The term "provision" is commonly used in the context of items such as impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets. It is a requirement for any entity to assess at the end of each reporting period whether there is any objective evidence that any asset has been impaired. When such is the case, the amount is required to be recognized in the profit or loss account for the reporting period. This enables the presentation of a "true and fair" financial position of the entity for the period.

For regulatory purposes, an adequate Accumulated Credit Loss Reserve for anticipated loan and other credit related losses should be established. In this regard a DTI should make a minimum provision for each credit classification category at least quarterly based on a review of the institution's loan portfolio. An increase in problem assets should logically result in an increase in provisions based on regulatory standards, as guided by the entity's internal policies. Further, the licensee's assessed individual and aggregate asset loss provisions must be adequate to absorb estimated credit losses.

It should be noted that this Guidance is intended to supplement, not replace any relevant accounting standards and should therefore serve as a prudential benchmark for the adequacy of provisions that a licensee should set aside for credit losses.

DTIs should continue to use collateral and other risk mitigants to allay the deleterious impact of credit risk and therefore the levels of specific provisions required to be held against expected losses should be guided by an assessment of the effectiveness of these mitigants[2]. In this regard, DTIs should continue to offset specific provisions, where applicable, against the value of the underlying collateral. To qualify as a mitigant for the purpose of provisioning, collateral shall mean and include only those securities, cash and other property or assets in which a licensee has a perfected security interest (legal certainty), for which a market price or value can be objectively ascertained, and for which a liquid primary market, and where applicable, secondary market for disposal exists.

These guidelines should be read in conjunction with other Regulatory Guidance and Standards of Sound Practice regarding inter alia, internal governance, credit risk management, capital adequacy and disclosures as may be supplemented by the relevant technical standards adopted by the Bank.

Finally, these Guidelines will be updated based on Bank of Jamaica's implementation of the Basel II/III Framework and International Financial Reporting Standards, specifically IFRS 9, and is structured around seven principles.

RATIONALE AND OBJECTIVES

Supervisory authorities have recognized that their efficacy is dependent on the integrity of licensees' balance sheets and income statements, which in turn are contingent on the proper identification, classification and accounting treatment of expected credit losses and non-performing assets. A financial

[2] With the planned implementation of Basel II, institutions will be able to mitigate credit risk using techniques other than traditional collateral. Under the existing credit management framework, institutions are required to have in place a collateral management system however, within the Basel II/III context this requirement will be enhanced. All institutions will be required to formally establish collateral management systems and operational procedures and processes that observe the principles of purpose, documentation, consistency, legal certainty and timeliness, risk identification, valuation, inspection, verification, operations, and reporting.

institution's asset quality reflects the management and control of risks in the entity's loan and investments portfolio both on-and-off balance sheet.

Despite best efforts, deficient credit risk assessments and measurement practices have been known to impair financial institutions' asset quality. Additionally, unforeseen business specific, environmental and economic factors may result in borrowers being unable to service their institutional agreements, thereby resulting in a deterioration in asset quality. Problem assets can adversely impact the institution's profitability and liquidity which can in turn impair the financial soundness of a bank and possibly the financial system. In light of this, banks should have established policies, procedures and practices for identifying, monitoring and managing expected credit losses and, where necessary, subsequent problem assets.

Financial institutions need to recognize impaired or problem assets using both quantitative and qualitative methodologies, and to appropriately treat the assets with regard to classification, accrual of interest, adequate provisioning and disposal. This Supervisory Guidance establishes uniform standards to be followed by licensees to ensure that:

a. assets are regularly evaluated using an objective grading system that is consistent with regulatory standards;
b. prudential treatment of non-performing or problem assets is consistent with regulatory requirements and recognized accounting practices;
c. timely and adequate provisioning and non-accrual **(Schedule 1)** criteria are contemplated to recognize, measure and monitor asset impairment; and
d. write-offs are applied to accurately reflect the capital and earnings performance of the licensee.

It is also intended to encourage the development of timely and effective work-out plans for problem assets and effective internal controls to manage such assets. This Supervisory Guidance applies to all loans and investments carried on a licensee's balance sheet or reflected as off-balance sheet items, and is aimed at setting out the supervisory expectations for these licensees related to sound problem asset management practices. It presents minimum guidance, and should be enhanced where necessary based on the size, scope, interconnectedness, complexity and state of the institution's asset portfolio.

While this Guidance does not specifically deal with provisions for other business activities (e.g., trading and derivatives activities), Bank of Jamaica (the Supervisor) expects that licensees will implement the provisions contained in this document to ensure that the necessary credit risk in these areas should also be prudently measured and managed.

Notably, these provisions are intended to supplement, not replace any relevant accounting standards but are rather intended to serve as a prudential benchmark for the quantity of provisions that a licensee should set aside for credit losses. In sum, entities are expected to adopt the more conservative approach in its credit administration process.

These guidelines should be read in conjunction with the provisions of other Supervisory Guidance, Codes of Conduct and Standards of Sound Practices regarding internal governance, credit risk, capital adequacy, disclosures, supervisory review and evaluation process and requirements, and supervisory measures and powers, as supplemented by the relevant technical standards adopted by Bank of Jamaica.

STATUTORY AUTHORITY

Section 132(1)(c) of the Banking Services Act (BSA) provides that the Supervisory Committee may make Guidance for the operation of licensees, in relation to problem assets and provisioning requirements. This statutory proviso gives the Supervisory Committee and the Bank the authority to administer varied measures against an institution for inter alia, any contravention of the Bank's Supervisory Guidance.

In determining the adequacy of the systems and procedures, the Supervisor shall have regard to international standards of sound practice, Supervisory Guidance issued under the BSA, risk-management systems and tools of the licensee, and the applicable accounting framework.

SCOPE OF APPLICATION

This Guidance is generally applicable to all licensees as defined under the BSA, which are, commercial banks, merchant banks, building societies, financial holding companies, cooperative societies that operate as credit unions (to be licensed under the Bank of Jamaica (Credit Union) Regulations), as well as entities providing critical support services.

SUPERVISORY PRINCIPLES FOR PROBLEM ASSETS & PROVISIONING

Licensees must establish, implement, and maintain strategies for problem asset management appropriate for the size, scope, complexity, and nature of their activities, to enhance the problem assets framework, and these must include documented policies and procedures addressing:

1. roles of Board of Directors (Board) and Senior Management;
2. portfolio reviews and monitoring of credit quality;
3. credit risk classification and grouping;
4. problem asset identification and measurement;
5. collateralization and risk mitigation;
6. expected credit losses; and
7. mechanisms to ensure timely provisioning.

PRINCIPLE 1: ROLE OF BOARD OF DIRECTORS AND SENIOR MANAGEMENT

The Board of Directors and senior management of all licensed entities shall oversee the nature and level of credit risk that is undertaken and should fully understand their responsibilities in the oversight and management of the entity's problem assets and provisioning practices, including an effective system of internal control to consistently determine adequate allowances, and take steps to ensure that these responsibilities are successfully effected in accordance with the licensees' stated policies and procedures, and the applicable accounting framework.

1.1 Board of Directors

1.1.1 The Board should ensure that licensees have in place credit risk management policies, procedures and controls, as well as business processes which are commensurate with the size, scope and complexity of the institution's lending operations.

1.1.2 The Board should ensure that the institution has appropriate problem asset assessments and management processes, including effective internal controls and measurement models to consistently determine provisions in accordance with the licensees' stated policies and procedures, and the applicable accounting framework.

1.1.3 The Board should be kept apprised with timely and appropriate information on the status of the problem assets portfolio, including classification of assets, the level of provisions and major problem assets, including at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.

1.1.4 **The Board** of a licensee must, inter alia:

a. ensure that effective problem asset management policies and processes are developed, documented, approved, implemented and maintained. These policies and processes should be easily accessible to the employees who are responsible for implementing and/or utilizing it, and systematic and consistently applied to determine appropriate allowances;
b. at least annually, review and approve all material changes to the problem asset management strategies, policies and procedures, and related controls and systems, providing recommendations where necessary;
c. ensure that the licensee's processes and systems for identifying, classifying, monitoring and addressing impaired assets are consistent and commensurate with the size, scope and complexity of the of the institution's lending operations, and operate in accordance with stated risk appetite of the Board;
d. be satisfied that the licensee's internal control and credit review function provides adequate assurance of internal compliance with the licensee's policies and procedures on classification and impaired assets provisioning;
e. ensure the selection and appointment of qualified and competent management to administer the credit risk function;
f. understand and determine the nature and level of risk being taken by the licensee and how these risks relate to the level of general and specific provisions;
g. review all material credit facilities with an adverse classification beginning at the level of special mention quarterly, or more frequently where necessary;
h. ensure assets determined to be uncollectible have been recognized in a timely and appropriate manner through provisions or write-offs, following approved policies;
i. ensure that the internal audit function is adequately staffed and conducts periodic reviews of the problem asset management function to determine compliance with established policies and procedures;
j. review all reports presented by senior management; and
k. particularly when trend deteriorations in credit quality are anticipated, communicate frequently with the Supervisor on the condition of assets, the classification of assets, the forward-looking level of provisions, and the effectiveness of strategy to improve the institution's asset quality.

1.2 Senior Management

1.2.1 Senior management should ensure the adoption and adherence to robust methodologies that address policies, procedures and controls for assessing and measuring credit risk on all lending exposures, to inform the measurement of allowances and appropriate and timely recognition of ECLs in accordance with the applicable accounting framework.

1.2.2 Senior management should establish policies and procedures which set out the accountability and reporting structure of the ECL model validation process, internal standards for assessing and approving changes to the models, and reporting of the outcome of the model validation;

1.2.3 Senior management should ensure the institution's policies and business processes, as well as, the Board's strategy is properly implemented and consistently applied, in line with the stated risk appetite of the Board.

1.2.4 Senior management is also responsible for the development and effective implementation of the impaired assets and provisions framework and policies on asset write-offs approved by the Board.

1.2.5 The problem asset assessments and measurement processes should be forward-looking and provide the relevant information for senior management to make its experienced judgement about the credit risk of lending exposures, and the related classifications and provisions for ECLs.

1.2.6 The **Senior Management** of a licensee must, inter alia:

a. establish, implement, and as necessary, update suitable policies and procedures to communicate the credit risk assessment and measurement processes internally to all relevant personnel;
b. provide appropriate disclosure, and prepare a report for the Board on the condition of the credit portfolio, at least quarterly, but more frequently should senior management adjudge that the circumstances are warranted. At a minimum, the report should provide a status update on new and ongoing significant non-performing or impaired assets, the level of provisions and the status of collateral or other risk mitigants **(Schedule 2)** held against those assets, and the attendant impact or implications on the institution's capital;
c. ensure the procedures used by the licensee to establish impairment provisions on problem assets are prudent, appropriate in relation to total credit risk exposure, and based on cash flow projections that take into account economic conditions;
d. consider relevant facts and circumstances, including forward-looking information, that are likely to cause ECLs to differ from historical experience and that may affect credit risk and the full collectability of the institutions' cash flows;
e. ensure that loans are appropriately valued using forward-looking approaches, uncollectable credits written-off, and expected or probable losses adequately provided for;
f. ensure licensees utilize a database on the market values of accepted collateral, including movable assets, is developed, implemented, maintained, and updated at least annually, or more frequently depending on evident market conditions or other extenuating circumstances;
g. ensure that internal valuations of collateral (other than real estate) held against all material credits classified as non-performing or impaired are conducted at least annually;

h. ensure that independent valuations of collateral (only real estate) held against material credits are conducted at least once every three years or more frequently when significant changes in the real estate market are detected;
i. maintain effective systems, business processes and controls for identifying, measuring, monitoring, and addressing loan quality problems in a timely manner;
j. ensure portfolio reviews are conducted at least annually;
k. ensure a report on all credit facilities categorized as special mention, substandard or doubtful are placed on a watch-list which is to be monitored by the asset committee on an ongoing basis; and
l. be able to demonstrate that it understands and is appropriately considering inherent risks when pricing lending exposures.

1.3 Asset Committee

1.3.1 An **Asset Committee** should be established to have oversight of the deteriorating and/or problem assets. This committee should be charged with:

a. reviewing of problem assets and assets with weaknesses based on identified factors that could possibly undermine repayment;
b. developing strategies to improve the institution's asset quality;
c. establishing timelines for reporting to senior management on asset quality and attendant trend deteriorations, classification of assets, status of collateral and levels of provisions;
d. evaluating the effectiveness of implemented strategies on specific intervals and taking corrective actions where necessary;
e. evaluating collateral securing the loans which should take into consideration the market and forced sale values, location of the collateral and the marketability and liquidity of same; and
f. oversight, amendment and reporting on watch-listed credits. Watch-listed credits should be provided to senior management and the Board periodically.

PRINCIPLE 2: PORTFOLIO REVIEWS AND MONITORING OF CREDIT QUALITY

All licensees must have adequate processes, resources and systems in place for ongoing oversight and regular review of the overall composition and quality of the credit portfolio, asset classifications, and the condition of impaired assets; including a system of independent, ongoing assessments of its credit risk management processes, impaired assets status and adequacy of provisioning levels, the results of which should be communicated directly to the board of directors and senior management.

2.1 Internal Reviews

2.1.1 Licensees shall ensure that credit risk management policies, procedures, information systems and controls provide for the systematic and regular monitoring of the credit risk to which it is exposed.

2.1.2 The level and the intensity of portfolio reviews and monitoring should reflect the impact of potential credit exposures, both individually and aggregate of facilities, on the earnings and capital of the licensed entity.

2.1.3 Licensees shall conduct frequent internal reviews of their credit portfolios and measurement models of problem assets and ECLs, for asset classifications and provisioning; and submit

recommendations to the Board to address any weaknesses. These reviews must be subject to independent oversight.

2.1.4 Policies, procedures, internal business processes and systems, as well as controls governing portfolio reviews and the monitoring of credit quality must at all times be commensurate with the scope, size and complexity of loan operations undertaken by the licensee.

2.1.5 Licensees must conduct consistent regular reviews of their problem assets both on- and off-balance sheet (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.

2.1.6 Reviews shall be conducted on a credit by credit (individual item) basis except for homogeneous credit facilities below a certain materiality threshold (e.g. retail loans, credit card receivables). These homogeneous facilities may be pooled together with all other facilities that have not been considered or provided for on an individual basis (e.g. "pass" and "special mention").

2.1.7 For the purposes of this Guidance, at a minimum, all of the following categories within the credit portfolio must be reviewed monthly:

a. large, complex and higher risk asset items;
b. large off-balance sheet credit commitments;
c. past due and non-performing credit facilities; and
d. loans on the watch-list.

2.1.8 When assessing the credit portfolio, where applicable the following information must be evaluated or considered:

a. The original amount of the credit facility or advance, the terms, interest rate, current balance, status, and purpose;
b. The track record of the borrower or issuer including the service of previous borrowings;
c. Contractual payment delinquencies and potential problem facilities;
d. The credit rating or score of the borrower;
e. The manner in which the project was financed;
f. The collateral secured including, up to date appraisals, legal assignments and insurances;
g. The performance of credit facilities or advances to members within the group in which the borrower or issuer belongs; and
h. For a company, balance sheet, debt/service ratio, cash flow and other financial data on the business and of any guarantors of the issuer or borrower.

2.2 External Reviews

2.2.1 An independent external body should annually review the licensee's credit quality to identify and assess the institution's asset quality. The organization consulted to conduct the review should be sufficiently independent and experienced to conduct the review.

2.2.2 This external review body shall conduct at least annually, reviews of the problem asset management process to ensure its effectiveness. The independent review should cover:

a. Credit risk of lending exposures;

b. Changes in credit risk and related ECL allowance;
c. Problem assets update;
d. Recovery processes;
e. Provisioning adequacy;
f. The management and disposal of collateral or other risk mitigants;
g. Reporting processes; and
h. The effectiveness of business relationships with external agencies and consultants where applicable.

2.2.3 Loan approval limits should be revised periodically by independent assessment to include actual valuations of the performance of authorized personnel and the performance of credit facilities over the life of the loan.

PRINCIPLE 3: CREDIT RISK CLASSIFICATION AND GROUPING

All licensed entities should have an established credit risk classification system, including polices and processes and documented thresholds, to: classify the credit risk inherent in all on- and off-balance sheet activities, provide insight into the licensee's credit quality and Board approved risk appetite, improve portfolio management and act as early warning system for asset impairment.

3.1 Credit Risk Classification Systems, Policies & Processes

3.1.1 Licensees should have polices and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels.

3.1.2 All licensees should adopt a credit risk classification system that includes an appropriate number of risk classifications to ensure that the system adequately captures all graduation of risk and for supervisory reporting purposes.

3.1.3 A licensee's credit risk classification system should encompass as much of its portfolio as possible, including off-balance sheet exposures. Homogenous risk classification facilities which have the same risk characteristics on a portfolio basis is acceptable.

3.1.4 Licensees should ensure that for applicable exposures, the credit risk classification system covers both performing and impaired assets to provide for the migration of an exposure from fully performing to loss status.

3.1.5 Licensees shall ensure a regular independent review function to provide assurances about the reliability of the classification systems and processes is established.

3.1.6 A licensee's credit risk classification system shall include arrangements for the periodic validation of the classification model to ensure the continual delivery of reliable information and the adequate collation of exposures of varying credit quality.

3.1.7 Licensees should clearly define each credit risk classification, and designate the personnel responsible for the design, implementation, operation and performance of the system as well as those responsible for periodic testing and validation.

3.2 Credit Risk Classification Grading

3.2.1 Licensees shall ensure that in the credit risk classification system, in relation to poorer quality facilities, these must include at least four (4) categories along the lines indicated below:

a. ‘special mention’, where clients are experiencing difficulties which, if they persist, could result in losses – such clients should be subject to special monitoring, including more frequent review and management scrutiny;
b. ‘substandard’, where definable weaknesses are evident which could jeopardize repayment, particularly of interest – the licensee is relying heavily on available security;
c. ‘doubtful’, where the situation has deteriorated to such a degree that collection of the facility amount in full is improbable and the licensee expects to sustain a loss; and
d. ‘loss’, where facilities are considered uncollectible within a reasonable time frame – this should be viewed as a transitional category for facilities which have been identified as requiring write-off during the current reporting period.

3.2.2 The credit risk grade a licensee assigns upon initial recognition of a lending exposure may be based on the following non-exhaustive criteria:

a. Product type;
b. Credit standards;
c. Place of issue;
d. Terms and conditions;
e. Type of issuer/debtor/guarantor;
f. Place of establishment of the issuer/debtor/guarantor;
g. Insurance;
h. Liquid primary or secondary markets;
i. Currency;
j. Cross-border use and movability;
k. Collateral type and amount;
l. Security interest in the collateral registry.

3.2.3 Assigned credit risk grades may subsequently change on either a portfolio or an individual basis, due to additional relevant factors such as, but not limited to, changes in industry outlook, business growth rates, consumer sentiment and changes in economic forecasts (such as interest rates, unemployment rates and commodity prices) as well as weaknesses in underwriting identified after initial recognition, or departure from the listed primary source of repayment.

3.2.4 Additional guidance on the classification categories listed above is available in **Schedule 2**. The factors listed in Schedule 2 are intended to help licensees determine the most appropriate classification for facilities using all the factors listed therein.

3.2.5 Credit risk classifications should be reviewed at least annually, more frequently where necessary, to reasonably ensure classifications are accurate and current. Also, credit risk classifications should be reviewed on receipt of relevant new information or a change in expected credit risk, and credit risk classifications for individually assessed lending exposures that are higher-risk or credit-impaired should be reviewed more frequently than annually.

3.2.6 ECL estimates must be updated on a timely basis to reflect changes in credit risk classifications for either groups of exposures or individual exposures.

3.2.7 It is not necessary for all factors to be present for a particular classification to be selected. Most deteriorating facilities may exhibit characteristics of more than one classification category. As such, licensees should take a holistic view of all the factors in determining the most appropriate classification category.

3.2.8 Should an on-or off-site examination of a loan or asset of a licensee result in a lower grading by the Supervisor than by the licensee, the licensee shall (i) re-classify the asset to the lower grade assigned by the Supervisor; and (ii) make provisions as required. Any subsequent upgrades, or additional downgrades, shall be made if circumstances are demonstrated to the satisfaction of the Supervisor.

3.2.9 Collateral or other risk mitigants, as a secondary source of repayment, should be considered in determining the severity of the asset's classification grade.

3.2.10 The licensee must provide the Supervisor with full access to information concerning the classification of assets in relevant detail, within such period as may be agreed by the Supervisor.

3.3 Credit Risk Classification Grouping

3.3.1 The credit risk classification system should be robust and capture all lending exposures to allow for an appropriate differentiation of credit risk and grouping of lending exposures within the credit risk rating system, reflect the risk of individual exposures and, when aggregated across all exposures, the level of credit risk in the portfolio as a whole.

3.3.2 Groups should be sufficiently granular to allow licensees to group exposures into portfolios with shared credit risk characteristics, so that licensees can reasonably assess changes in credit risk and thus the impact on the estimate of ECL.

3.3.3 A licensee's methodology for grouping exposures to assess credit risk (such as by instrument type, product terms and conditions, industry/market segment, geographical location or tenure of instrument) should be documented and subject to appropriate review and internal approval.

3.3.4 Lending exposures should be grouped according to shared credit risk characteristics so that changes in the level of credit risk respond to the impact of changing conditions on a common range of credit risk drivers.

3.3.5 Licensees must periodically review the basis of grouping, to ensure that exposures within the group remain homogeneous in terms of their response to credit risk drivers, as grouping implemented upon initial recognition will not necessarily be appropriate in subsequent periods given the potential for change in the relevant characteristics and attendant impact on the level of credit risk for the group.

3.3.6 Exposures must not be grouped in such a way that an increase in the credit risk of particular exposures is masked by the performance of the group as a whole.

3.3.7 Licensees should disclose the methods used by management to satisfy itself that lending exposures are appropriately grouped, such that these groups continue to share credit risk characteristics.

PRINCIPLE 4: IDENTIFICATION, MEASUREMENT AND MANAGEMENT OF PROBLEM ASSETS

All licensed entities should adopt, document and adhere to sound methodologies, established polices and processes, including documented thresholds, as well as information systems and other organizational resources, to measure and manage the credit risk inherent in all on- and off-balance sheet activities, to enable the early identification of impaired assets, and reflect realistic repayment and recovery expectations.

4.1 Polices and Processes

4.1.1 A licensee must formulate and document policies and processes for the timely identification, management and assessment of expected credit losses, and where necessary, consequent impaired or problem assets.

4.1.2 Licensees' credit risk identification processes should ensure the proper identification of factors that impact changes in credit risk and estimates and measurement of ECL, including consideration of credit risk inherent in new products and activities.

4.1.3 Institutions should have policies and procedures that identify and guide the management of problem assets. These policies and procedures should be approved by the Board and should include, but not be limited to the following:

a. The authority and responsibility of officers and specific bodies (e.g. committees);
b. The level and frequency of reporting and monitoring;
c. The strategies to be utilized to manage problem assets and any specific order of strategy application;
d. Collateral management and disposal;
e. Debt collection mechanisms; and
f. The ability and rules associated with, where applicable, the use of external agents (to include licensed credit bureaus and reputable audit firms) and professionals to provide advice on problem assets management.

4.1.4 Licensees must establish internal limits or thresholds, in accordance with board approved policies and stated risk appetite, for the purpose of identifying significant credit risk exposures, and to regularly review the level of the threshold.

4.1.5 Licensees must have a clearly-established process in place for the restructuring **(Schedule 4)** and disposal of problem assets, as well as returning of a credit facility to unimpaired status **(Schedule 5),** in line with well-established policies and procedures.

4.2 Identification of Problem Assets

4.2.1 An asset must be identified as a problem asset when there is reason to believe that the timely collection of all amounts due, including principal and interest, will not be forthcoming in accordance with the contractual terms.

4.2.2 For the purposes of paragraph 4.1.4, the existence of the following factors will, as a minimum, constitute "reason to believe" and require an asset (on- or off-balance sheet) to be regarded as impaired:

a. A facility is 90 days past due unless otherwise well-secured;
b. A licensee to which facilities have been provided is subject to administration or resolution proceedings, unless the facilities are otherwise well secured;
c. A write-off has been taken on an asset even if it is not in breach of contractual requirements. This does not apply in the case of some restructured facilities and assets acquired through enforcement of security; and
d. With respect to off-balance sheet facilities, the licensee is unlikely to receive timely payment of the full amounts which it has exchanged or is contracted to advance.

4.2.3 Where an asset has been identified as impaired (on an individual or collective basis), a licensee must raise provisioning levels to cover any shortfall in cash flows contractually due to be received.

4.2.4 Licensees must have organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations.

4.2.5 At a minimum a licensee should conduct quarterly impairment assessments of its credit portfolio for the purposes of annual and interim financial reporting or more frequently where there is evidence to suggest impairment of the credit portfolio. These assessments should be documented and available to the Supervisor for review at any time.

4.3 Measurement

4.3.1 In determining measures of impairment, licensees must have a realistic and comprehensive view of all of its business activities (including both on- and off-balance sheet exposures), taking into account all available information on a timely basis.

4.3.2 Each licensee's Board shall ensure that the measures of impaired or problem assets, and the levels of specific provisions reported to the Supervisor are prudent and reasonable.

4.3.3 Policies and procedures covering the measurement of impairment of facilities, and the provisioning levels which flow from such impairment, must be well documented with clear explanations of supporting analysis and rationale, and include the level and type of data and other information required to enable a licensee to meet the objectives underpinning its measurement of impaired assets.

4.3.4 Impairment measurement policies and procedures of licensees shall include the role and responsibilities of the Board and senior management in determining and monitoring the adequacy of measures of impaired facilities and, in turn, specific provisions reported to the Supervisor.

4.3.5 All licensees shall indicate the basis to be used for determining whether assets are managed on an individual or portfolio (collective) basis, and whether measures of impairment and provisions are to be assessed on an individual or collective basis. This incorporates the processes to be followed

when deciding to make a change in the assessment of provisions from a collective basis to an individual facility basis.

4.4 Management of Problem Assets

4.4.1 When engaging in problem asset management all licensees are required to subscribe to the general standards of sound practices in relation to credit risk management.

4.4.2 All policies must be supported by accounting and documentation procedures, where necessary, and information systems to ensure integrity.

4.4.3 Licensees shall determine and communicate to the Supervisor the characteristics used to group assets on a collective basis for purposes of managing and/or assessing provisioning.

4.4.4 Licensees shall develop the approaches to be followed in the management of arrears and the write-down or write-off of impaired assets.

4.4.5 To mitigate common causative factors[3] resulting in asset impairment, licensees need to enhance loan and investments or treasury operations. Areas for enhancement include:

a. The credit underwriting and administration processes.
b. The quality/rating of investments acquired. Risk assessments should not be limited to rating agencies' rating but include the entity's own risk assessment and analysis. Policies should stipulate the type of securities that the financial institution can invest in.
c. More frequent valuation of the investment portfolio.
d. The diversification policies in line with the entity's risk appetite and tolerance. Investments diversification should encapsulate:
   - Issuers (single or related).
   - Geographic distribution.
   - Characteristics of securities (e.g. corporate, government securities, bonds etc.)
   - Credit ratings (specifically low ratings)
e. The analysis process for identifying, evaluating, selecting and investing in securities.
f. Ongoing monitoring of the issuer(s) (and related parties/groups where applicable) and the security portfolio and individuals securities.

4.4.6 Licensees shall have established policies and procedures in place, authorized by the required internal body and/or senior management, to guide the proficiency of the relevant internal debt collections department or, where necessary, external debt collection agencies. In employing the services of an external debt collection agency, licensees should ensure that customer confidentiality is maintained. The business relationship between licensees and the debt collection agency should be based on a legal agreement/contract which identifies the roles and responsibilities, fees and covenants.

[3] Weak documentation, lack of perfected collateral, issuing of loans without proper collateral and credit underwriting, and poor financial analysis of borrowers and issuers of securities/investments

PRINCIPLE 5: COLLATERALIZATION AND OTHER RISK MITIGANTS

Licensees must have appropriate mechanisms, policies and procedures in place to establish, record, effectively assess, monitor and control the eligibility and recognition of risk mitigants held against facilities provided to licensees, including guarantees and collateral. Further, all licensees should on at least an annual basis, establish for individual and homogenous exposures, the market value of risk mitigants associated with credit exposures (on- and off-balance sheet) for senior management and Board review.

5.1 Polices and Processes

5.1.1 Licensed entities shall ensure that the policies and procedures guiding the risk mitigation process are linked to the licensee's credit quality assessment, approval and management process and provide for a consistent application across the entity.

5.1.2 Licensees should have Board approved risk mitigating policies and procedures determined by best practices, to establish, record, effectively assess and monitor the value of collateral or other risk mitigants. These policies and procedures must include as a minimum:

a. The definition of marketable and non-marketable assets;
b. The acceptability and eligibility of various forms of collateral or other risk mitigants, and the circumstances in which they may be used;
c. The prudent and accurate valuation of collateral or other applicable risk mitigants prior to entering into any contract, and over the life of the contract, having regard to the time, costs and difficulties involved in generating payments through access to risk mitigants;
d. The procedures for ensuring that the applicable risk mitigants are, and continue to be, certain, enforceable and realizable; and
e. A documented process for collection of payments in distressed situations.

5.1.3 Licensees should have appropriate mechanisms in place for regularly assessing the market value of risk mitigants, including guarantees and collateral.

5.1.4 The legal mechanism by which collateral or other risk mitigants are given must be robust and ensure that the lender has clear rights over the proceeds from the collateral or other risk mitigant, including a framework that allows the potential lender to have a perfected first priority claim over the risk mitigant.

5.1.5 Where the Supervisor assesses that practices being applied by a licensee to the recognition and valuation of risk mitigants may result in its inappropriate recognition, and consequently a misstatement of provisioning levels and regulatory capital, or which otherwise may reflect adversely on the licensee’s safety and soundness, the Supervisor may, direct the licensee to:

a. Adjust its policies, procedures and valuation methodologies or practices;
b. Increase levels of provisioning reported to the Supervisor; or
c. Hold higher levels of capital.

5.1.6 Licensees shall have well documented, Board approved policies outlining the extent to which the value of collateral and other risk mitigants affect ECL.

5.1.7 Institutions shall have approved policies and procedures for the management and disposal of collateral or other applicable risk mitigants.

5.2 Eligibility of Risk Mitigants

5.2.1 Licensees shall hold at all times adequate collateral or other risk mitigants with values which are not dependent on the performance of the borrower, but rather on the underlying capacity of the borrower to repay the debt from other sources, to protect the entity against the risks associated with lending operations.

5.2.2 Licensees shall conduct sufficient legal review to ensure that potential claims on collateral or other risk mitigants are binding on all parties and legally enforceable in all relevant jurisdictions. Any claim on given collateral or other risk mitigant must be properly filed on a timely basis, clearly documented, meet all relevant legal requirements, and be realizable within a practical timeframe.

5.2.3 Collateral or other risk mitigants accepted by licensees must be valued at or less than the current fair value[4] under which the property could be sold under private contract between a knowledgeable and willing seller and an arm's-length buyer on the date of valuation.

5.2.4 All licensees shall, on a frequent basis, or at least annually, monitor the values of, and the specific exposures (either immediate or contingent) attributable to the item being utilized as collateral or other risk mitigant. Frequency of monitoring shall be increased where the market is subject to significant changes in conditions. An external body shall annually review the values of the collateral.

5.2.5 Licensees must periodically assess whether the types and volume of collateral or other risk mitigants used, pose a concentration risk and whether it is within the tolerance levels defined in the Board approved policies and processes.

5.2.6 Licensees shall demonstrate to the satisfaction of the Supervisor, that there are liquid primary, and where applicable, secondary markets for disposal of all collateral or other risk mitigants in an expeditious and economically efficient manner. A reassessment of this condition must be effected both periodically and when information indicates material changes in the market.

5.2.7 Market prices for risk mitigants shall be well established, independently verifiable and attainable by licensees, with realized values of these risk mitigants not deviating significantly from established market prices.

5.2.8 Licensees shall ensure that reliance on collateral or other risk mitigants is not a substitute for an appropriate assessment of a party to a facility, in particular, the party's ability to meet its contractual obligations, or compensate for insufficient information about a party.

[4] The determination of fair value is as prescribed by the existing accounting standards in Jamaica.

5.2.9 Eligible collateral may include, but is not limited to those securities, cash and other property or assets in which it has a perfected security interest, as outlined in in **Schedule 3**.

PRINCIPLE 6: EXPECTED CREDIT LOSSES

Licensees should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring credit risk on all lending exposures, and validating models used to assess and measure expected credit losses. The measurement of allowances should build upon those robust methodologies and result in the appropriate and timely recognition of expected credit losses in accordance with the applicable accounting framework.

6.1 Polices and Processes

6.1.1 Licensees must have appropriate policies and processes to validate models used to assess and measure expected credit losses. These policies and procedures shall set out the accountability and reporting structure of the model validation process, internal standards for assessing and approving changes to the models, and reporting of the outcome of the model validation.

6.2 ECL Assessment and Measurement

6.2.1 Licensees must ensure the use of robust methodologies in the estimation of ECL that consider varying potential scenarios and not rely solely on subjective, biased or overly optimistic considerations. This includes the development and documentation of its process to generate relevant scenarios to be used.

6.2.2 The ECL estimate should always incorporate the expected impact of all reasonable and supportable forward-looking information, including macroeconomic factors, that affects credit risk and collectability. Further, it shall reflect an unbiased and probability-weighted amount that is determined by evaluating the range of possible outcomes as well as incorporating the impact of the time value of money.

6.2.3 Licensees must ensure procedures used to measure ECL are robust and timely and take into account criteria such as updated valuations of credit risk mitigants (and, in particular, collateral), cash flow estimates based on assessments of borrower-specific factors and current and future macroeconomic conditions, together with other relevant forward-looking information that affects the expected collectability of the licensee's lending exposure;

6.2.4 Licensees should be able to demonstrate that the forward-looking information factored into the ECL estimation process has a link to the credit risk drivers for particular exposures or portfolios.

6.2.5 Licensees shall identify and document the ECL assessment and measurement methods (such as a loss rate method, probability of default (PD) or loss-given-default (LGD) method, or another appropriate and established method) to be applied to each exposure or portfolio. The ECL estimation technique used should be the most appropriate in the particular circumstances, and typically should be aligned with how the licensee manages the credit risk exposure.

6.2.6 Licensees shall include a process for evaluating the appropriateness of significant inputs and assumptions in the ECL assessment and measurement method chosen. Licensed entities should

also document the reasons why the selected method is appropriate, given the application of different ECL measurement methods to different portfolios and types of individual exposures.

6.2.7 Licensed institutions must exercise care when determining the level of ECL allowances to be recognized for accounting purposes to ensure that the resulting estimates are appropriate (i.e. consistent with neutrality and neither understated nor overstated).

6.2.8 Licensees should implement sound and robust credit risk methodologies with the objective that the overall balance of the allowance for ECL is developed in accordance with the applicable accounting framework and adequately reflects ECL within that framework.

6.3 ECL Model Validation

6.3.1 Licensees should have robust policies and procedures in place to validate the accuracy and consistency of its model-based rating systems and processes and the estimation of all relevant risk components, at the outset of model usage and on an ongoing basis.

6.3.2 All licensed institutions must ensure model validation is conducted when the ECL models are initially developed and when significant changes are made to the models, and reviewed at least annually. There should be comprehensive documentation of the model validation framework and process.

6.3.3 Model validation should be performed independently of the model development process and by employees with the necessary experience and expertise, and all findings and outcomes of model validation should be reported in a prompt and timely manner to senior management.

6.3.4 An independent review of the model validation process should be conducted to evaluate its overall effectiveness and independence of the model validation process from the model development process. The findings of the review should be reported in a prompt and timely manner to senior management.

6.3.5 Licensees must implement an effective model validation process to ensure that the credit risk assessment and measurement models are able to generate accurate, consistent and unbiased predictive estimates on an ongoing basis.

6.3.6 Licensees must ensure existing processes and systems are evaluated and, where necessary, modified to collect and analyze relevant information affecting the assessment and measurement of ECL, including the maintenance of appropriate reports, details of reviews performed, and identification and descriptions of the roles and responsibilities of the personnel involved.

PRINCIPLE 7: MECHANISMS TO ENSURE TIMELY PROVISIONING

All licensed institutions should formulate and implement adequate policies, procedures and information systems for the establishment of appropriate and robust provisioning levels, taking into account off-balance sheet exposures, and ensuring provisions are timely and reflect the impact of realistic economic conditions.

7.1 Polices and Processes

7.1.1 Licensees should ensure that the framework and methodology for establishing allowances, whether determined collectively or individually, are robust.

7.1.2 Each licensee shall maintain adequate records to support its determination of loan loss potential and provisions and make such records available to the Bank for inspection on request. If a review by the Bank concludes that additional provisions are required for individual loans or for the loan portfolio in aggregate, the licensee will be instructed to make the necessary adjusting entries.

7.1.3 Each licensee shall have policies and procedures to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions and past loss experience.

7.2 Provisioning Methodology

7.2.1 In order to establish an adequate Accumulated Credit Loss Reserve (ACLR) for anticipated loan and other credit related losses, a minimum provision is to be made by a licensed institution for each credit classification category at least quarterly following management's review of the institution's portfolio.

7.2.2 An increase in problem assets should result in an increase in provisions based on the Supervisor’s regulations and standards, as well as, the entity’s internal policies.

7.2.3 A licensee’s aggregate amount of individual and collectively assessed asset loss provisions must be adequate to absorb estimated credit losses.

7.2.4 The licensee must provide the Supervisor with full access to information concerning the amount of provisions held against the various categories in relevant detail, within such period as may be agreed by the Supervisor.

7.2.5 For the purposes of these Guidelines, the Supervisor may, by notice in writing, direct the licensee to vary the level of provisions to a level which is more consistent with that licensee’s risk profile, should the Supervisor adjudge that a licensee is insufficiently prudent in its approach to its own provisioning policies or is significantly at variance with the industry’s best practice provisioning policies.

7.2.6 When determining provisioning levels, facilities with the following characteristics are exempt:

a. Fully guaranteed by the Government of Jamaica, that is explicit, unconditional, legally enforceable and irrevocable over the life of the credit exposure in question;

b. Fully guaranteed by a sovereign state, other than the Government of Jamaica, with an investment grade rating from a credit rating agency approved by the Regulator for Jamaica, which said guarantee is explicit, unconditional, legally enforceable and irrevocable over the life of the credit exposure in question;
c. Extended directly to the Central Government of Jamaica;
d. Fully secured at all times by cash in Jamaican Dollars or other currencies readily convertible to Jamaican Dollars, delivered to the licensee and placed with it in a pledged special account;
e. For a period of less than one month and fully secured by investments that are investment grade, as rated by a credit rating agency approved by the Bank of Jamaica, so, however, that the licensee shall give the Bank of Jamaica prior notice of such exposure being incurred;
f. An interbank exposure of less than one month; or
g. An exposure arising from the underwriting of securities that are held for less than 90 days.

7.3 Determination of General Provisions[5]

7.3.1 If an entity determines that no objective evidence of impairment exists for an individually assessed credit facility, it should include the asset in a group of credit facilities with similar credit risk characteristics for determining a general provision.

7.3.2 Licensees should utilize a database to maintain knowledge of the market values of collateral accepted (including movable assets) on each facility not exempted under paragraph 7.2.6. An example of an appropriate database is one that, inter alia:

a. is updated at least annually, or more frequently depending on evident market conditions or other extenuating circumstances;
b. defines the acceptability and eligibility of collateral or other risk mitigants; and
c. provides prudent and accurate valuations of collateral or other applicable risk mitigants;

7.3.3 Licensees must develop and document credit risk models (bottom up and top down) to inform the amounts of general provisions to be applied.

7.3.4 Licensees should consider the relatively higher risks associated with certain types of lending such as credit card facilities, unsecured personal loans, hire purchase and leasing contracts in setting the level of general provisions.

7.3.5 A minimum general provision of 1% should be applied to the sum of all the credit facilities that have not been assigned a specific provision including all the credit facilities categorized as *Pass* and *Special mention*.

7.3.6 Licensees may determine, or the Supervisor may recommend that the general provision be increased from the minimum of 1% where serious weaknesses in credit administration are identified, or based on an assessment of the following factors:

a. The effectiveness of the licensee's risk management and credit policies, internal and external audit, loan reviews and credit inspections in maintaining a high quality asset portfolio;

[5] General Provisions are those provisions for loan and other credit losses, which are established against a bank's credit facilities for which specific provisions are not required on an individual or portfolio basis.

b. The licensee's experience of loan and investment losses, its success in realizing security on problem credits in a timely manner without incurring substantial loss and the outlook for recoveries;
c. The licensee's credit risk models used for provisioning; and
d. The quality of financial information and credit files maintained in relation to each credit facility on each borrower and the present economic conditions within the industry sectors or country where the credit facilities, including investment portfolios, are concentrated and the expected impact of political, economic and climatic circumstances on the collectability of the facility in the foreseeable future.

7.4 Determination of Specific Provisions[6]

7.4.1 Licensees should provide specifically for credits where losses are certain or likely. A Specific Provision is to be established against the estimated net loss in respect of each credit classified "Substandard", "Doubtful" and "Loss". The percentages to be provided will depend on the particular circumstances shown in **Table 1**.

Table 1: Descriptions of Specific Provisions to be established against Specific Credit Classifications

Classification	Provision Required
Substandard	the greater of 1% of total credit or 20% of estimated net loss
Doubtful	the greater of 1% of total credit or 50% of estimated net loss
Loss	the greater of 1% of total credit or 100% of estimated net loss

7.4.2 Where applicable, in determining specific provisions the nature and value of the underlying risk mitigant should be considered.

7.5 Fully Secured Credits

7.5.1 Where a non-accrual credit or portion thereof is fully secured, but collateral remains unrealized for a period of twelve months (i.e. nine months after non-accrual), except as otherwise stated below, a provision of 50% should be established against the credit balance due. Where collateral remains unrealized for a further six months (i.e. fifteen months after non-accrual), except as otherwise stated below, this provision should be increased to 100%.

7.5.2 Where collateral consists of both tangible and intangible movable assets, such as highly specialized plant or equipment, inventory, accounts receivable, cash flows, livestock, crops and others, the Supervisor may, after giving due consideration to the conditions attendant, extend the period over which full provision is achieved, up to but not exceeding twenty-four months (i.e. twenty-one months after non-accrual).

7.5.3 Where collateral consists of real estate, the Supervisor may, after giving due consideration to the conditions attendant, extend the period over which full provision is achieved, up to but not exceeding twenty-seven months (i.e. twenty-four months after non-accrual).

[6] Specific provisions are those provisions for loan and other credit losses, which are established for estimated impaired losses identified against individually assessed credits or credits assessed on a portfolio basis.

SCHEDULE 1

NON-ACCRUAL CREDITS

Non-Accrual Criteria

1. A credit must be classified as non-accrual where a payment is contractually three months or more in arrears.

Income Recognition Criteria

2. When a credit is classified as non-accrual, all previously accrued but uncollected interest is to be reversed against income in the accounting period in which the credit is classified as non-accrual. The amount reversed must thereby include all recorded but uncollected interest in the year-to-date and prior periods.

3. Where a credit has been classified as non-accrual, subsequent interest payments must be dealt with as follows:-

   a. where a Write-off has been made, credit (increase) Accumulated Loan Loss Reserve Account - Recoveries up to the amount of the Write-off. Where a Specific Provision has been established, credit (decrease) the loan principal and reverse the Specific Provision (debit the Accumulated Loan Loss Reserve account and credit the Provisions for Loan and Other Credit Losses account.)
   b. when Write-offs and Specific Provisions have been fully extinguished, credit interest income on a cash basis until the credit meets the criteria for returning to accrual status.

4. Where the amount of the Specific Provision is reduced or eliminated as a result of the payment of interest on a non-accrual credit, the institution should re-evaluate the requirement for a Specific Provision after the payment has been taken into account.

Changes in Classification

5. Non-accrual credits may revert to accrual status when all payments become fully current, the facility is consistently performing in accordance with its repayment terms for a minimum period of twelve months and senior credit management has determined that there is no reasonable doubt about ultimate collectability of remaining principal and interest.

SCHEDULE 2

CREDIT CLASSIFICATION

Credits in an institution's portfolio are to be allotted to the Classes: I - Standard; II - Potential Problem Credit/Special Mention; III - Sub-Standard; IV - Doubtful and V - Loss. While the payment status is normally the first reference point in establishing classification, the other criteria should be considered on an equal basis in determining ultimate credit classification. Allotment according to the descriptive Criteria for each class is as follows:

Class	**Criteria**
1. Standard	(a) Credits which are up to one month in arrears.
	(b) The financial condition of the borrower and of the project are in no way impaired, and allow for appropriate levels of cash flows/income flows to meet debt payments.
	(c) There is adequate credit documentation to support borrowings, e.g. current financial statements, cash flow statements, credit checks.
	(d) Value and liquidity of the collateral for the credit are in no way impaired, and represent tangible security with a current market value sufficient to cover the institution's exposure (principal and interest).

Credits meriting the 'Standard' classification will be limited to:

i) Credits (both principal and interest) fully secured by cash/government securities/other fully marketable collateral.

ii) Credits with repayments in arrears of up to one month.

iii) Overdrafts operating within approved limits and showing good fluctuations.

iv) Unsecured credit within statutory credit exposure limits and with payments up to date.

v) Renegotiated/Rescheduled credits which are fully secured and up to date for a minimum of 12 month after renegotiation/rescheduling and with no inherent credit weaknesses.

Class	Criteria
2. Special Mention	(a) Credits with repayments in arrears for one month and under three months and/or noncompliance with other terms of the credit. (b) Credit is currently up to date and collateral values presently protect the institution's exposure but evidence suggests that certain factors could, in future, affect the borrower's/project's ability to service the credit properly or impair the collateral. (c) Inadequate credit/collateral documentation to support borrowings or other deviations from prudent lending practices exist. (d) Collateral not fully in place or the credit is up to date but not fully secured. (e) Credits which could deteriorate due to sector/market conditions. (f) Renegotiated/Rescheduled credits which are fully secured and up to date for a minimum of 6 months after renegotiating/rescheduling and with no inherent credit weaknesses. (g) Overdrafts which exceed the approved limits for short periods without the prior approval of the institution.

Class

3. Sub-Standard

Criteria

(a) Two or more "Potential Problem Credit" criteria in effect.

(b) Credits with repayments in arrears for three months or more.

(c) Well-defined credit weaknesses or weaknesses in the sector of the borrower such that its cash flow is insufficient to service debt as arranged.

(d) Primary source of repayment is insufficient to service the debt and the institution must look to secondary sources, such as collateral or refinancing, for repayment.

(e) The fully secured portions of non-performing credits which would otherwise have been classified "Doubtful" or "Loss".

(f) Non-performing credits for which both principal and accumulated interest are fully secured by cash, Irrevocable

Class	Criteria
Undertakings from the Ministry of Finance (Jamaica), Guarantees of the Government of Jamaica and such other	Government Guarantees specified from time to time by the Supervisor.
	(g) The fully secured portion of overdrafts which are continuously in excess of their approved limits and which exhibit inadequate fluctuations and deposit patterns which do not conform to the normal cycle of the borrower's business. (Once classified as "Substandard", the overdraft should be converted to a "Substandard" credit, be reflected as such on the balance sheet and be subject to revised conditions of payment).

Class	**Criteria**
4. Doubtful	Credit is "Substandard" plus any one of: (a) Credits with repayments in arrears for six months and under twelve months. (b) Collection of the debt in full is highly questionable or improbable. (c) There is the possibility of a loss; however, some mechanisms exist which could improve the situation, such as sale of the borrower company or legal action. (d) The unsecured portion of overdrafts which are continuously in excess of their approved limits and which exhibit little or no fluctuation in the account.

Class	**Criteria**
5. Loss	One or more of: (a) Credits with repayments in arrears for twelve months and over. (b) Credits considered uncollectible due to insolvency of the borrower. The borrower's financial position and/or that of the project financed is insufficient to service/retire outstanding debt. There exists virtual certainty of non-recovery of the credit.

SCHEDULE 3

DEFINITION OF COLLATERAL

1. Financial assets comprising:-

i. Cash in accordance with the eligibility requirements outlined in the First Schedule to these Regulations;
ii. Life insurance policies assigned to the bank and for which there is supporting evidence of this assignment. The value of the life insurance policy is determined by its net cash surrender value;
iii. Securities issued or guaranteed by the Bank of Jamaica or the Government of Jamaica and held under the control of the bank;
iv. Debt securities issued by:

   a. Sovereigns and public sector entities and rated at least BB- or its equivalent by Standard and Poors or equivalent rating by a credit rating agency recognized by the Supervisor for the purposes of this Regulation;
   b. Corporation which has been rated at least BBB- for long term securities and at least A-3/P-3 for short-term securities by Standard and Poors or equivalent rating by a credit rating agency recognized by the Supervisor for the purposes of this Regulation;

The value of a financial asset listed at (iii) and (iv) above, is determined by its fair value;

v. The quantum of a Parliamentary Guarantee issued by the Government of Jamaica and held under the control of the Licensee;
vi. The quantum of an Irrevocable Letter of Credit issued by a corporation at paragraph (iv), above in this regulation, and held under the control of the licensee;
vii. (a) Shares listed on a Stock Exchange recognized by the Supervisor but only where such shares are held under the control of the bank and are valued based on their market value as measured by their last bid price;

   (b) A 2.5% minimum adjustment must be applied to the total market value to reflect the shares' full recoverable amount/net market value where the shares have been traded within the last 20 business days. However where the shares have not been traded within this specified period of time then a 25% adjustment shall be applied to the total market value of the shares. Where the licensee has evidence to support a greater adjustment then this must be applied.

viii. (a) Units in a collective investment scheme which is registered with the Financial Services Commission and held under the control of the licensee. In the case of such units their values will be determined by the last market prices.

(b) A 2.5% minimum adjustment must be applied to the total market value to reflect the shares' full recoverable amount or net market value. Where the bank has evidence to support a greater adjustment this must be applied.

2. Real estate, but only where;

i. Ownership by the borrower or the guarantor is established;
ii. The licensee has a legally registered charge on the real estate as evidenced by the relevant documentation duly stamped and registered with the relevant Government Office;
iii. The property carries peril insurance duly noting the licensee's interest but only where the property consists of buildings;
iv. The estimated market value of such real estate is determined after applying the following adjustment, based on the age of the most recently conducted valuation as outlined in the table below, to the independent qualified appraiser's determination of the market value of the real estate at the time this valuation was conducted, and

Table 2: Table of Valuation Applicable To Real Estate

Age of Real Estate Valuation	Commercial Real Estate Adjustments	Residential Real Estate Adjustments
Less than 12 months old	0%	0%
Between 12 months and less than 24 months old	20%	10%
Between 24 months and less than 36 months old	30%	20%
Older than 36 months	50%	50%

v. A 25% minimum adjustment is applied to the estimated market value as determined by (iv) above to reflect the real estate's full recoverable amount or net market value. Where the licensee has evidence to support a greater adjustment, this must be applied.

3. Motor Vehicles, but only where:

i. Ownership by the borrower or the guarantor is established,
ii. The licensee is the first legally registered lien holder as evidenced by a bill of sale duly stamped and registered with the relevant Government Office and the licensee's lien is duly noted on the relevant motor vehicle title;

iii. The motor vehicle is comprehensively insured and the licensee's lien duly noted on the relevant motor vehicle insurance policy;

iv. The estimated market value of such motor vehicle is determined after applying the following adjustment, based on the age of the most recently conducted valuation as outlined in the table below, to the independent qualified appraiser's determination of the market value of the motor vehicle at the time this valuation was conducted, and

Table 3: Table of Valuation Applicable To Motor Vehicles

Age of Motor Vehicle Valuation	**Adjustments**
Less than 12 months old	0%
Between 12 months and less than 24 months old	20%
Between 24 months and less than 36 months old	40%
Between 36 months and 48 months old	60%
Between 48 months and 60 months old	80%
Older than 60 months old	100%

v. A 10% minimum adjustment is applied to the estimated market value as determined by (iv) above to reflect the motor vehicle's full recoverable amount or net market value. Where the licensee has evidence to support a greater adjustment this must be applied.

4. Plant or equipment of the borrower that is used in the transaction of borrower's business, but only where:

i. Ownership by the borrower or guarantor is established,

ii. The licensee is the first legally registered holder as evidenced by a bill of sale duly stamped and registered with the relevant Government Office,

iii. The property or equipment is comprehensively insured and the licensee's lien duly noted on the relevant insurance policy,

iv. The estimated market value of such plant or equipment is determined after applying the following adjustment, based on the age of the most recently conducted valuation as outlined in the table below, to the independent qualified appraiser's determination of the market value of the plant or equipment at the time this valuation was conducted, and

Table 4: Table of Valuation Applicable To Plant Or Equipment

Age of Valuation	Adjustments
Less than 12 months old	0%
Between 12 months and 24 months old	50%
Older than 24 months	100%

v. A 10% adjustment is applied to the estimated market value as determined by (iv) above to reflect the plant or equipment's full recoverable amount or net market value. Where the licensed entity has evidence to support a greater adjustment then this must be applied.

5. Floating Charges subject to approval by the Supervisor and only in instances where the assets attached can be clearly identified and related values firmly established.

6. Any other asset designated by the Supervisor by notice.

7. Guarantees, but only where supported by any financial assets and/or other property listed at (a) to (f) above,

8. The Supervisor may from time to time vary the discounts to be applied to the market value and/or the estimated market value of a security, on a case by case basis, due to evident market conditions or other extenuating circumstances. The failure of a licensee to provide the Supervisor with evidence to support a security's compliance with the required conditions outlined above will result in the Supervisor's non-recognition of the asset as a security to the debt.

SCHEDULE 4

RESTRUCTURING OF LOANS

A restructured credit facility is one which, due to deterioration in the borrower's financial condition, the contractual terms have been modified to reflect concessions granted by the licensee that it would not otherwise consider. Such modifications must be agreed to in writing by the licensee which provided the credit to be restructured and the borrower, and may include any one or more of, but not limited to, the following concessionary terms:

a. A reduction in the originally agreed principal amount and/or interest rate;
b. A write-off of a portion of the principal and/or interest outstanding;
c. A deferral or extension of interest and/or principal repayments;
d. Capitalization of interest;
e. Extension of the tenor of the credit facility;
f. The substitution of a new guarantor for the original guarantor and/or the addition of a new debtor.

Where the licensed entity considers the addition of a new debtor to an existing credit facility pursuant to a restructuring exercise, the new debtor shall be subject to the licensee's full credit risk assessments that would have been or are applicable to the original debtor and such a credit facility would qualify as a performing credit based on a positive credit risk assessment.

Credit facilities may only be restructured when:

a. The existing financial position of the borrower(s) clearly demonstrates the capacity to service the debt under the new terms of the contract;
b. There is little or no doubt as to the ultimate collection of all principal and interest; and
c. An initial cash payment is made or an improvement in security is taken.

Where the modified terms include capitalization of interest, the licensee shall ensure that the security value is adequate to cover the total balance outstanding under the restructured credit and the interest capitalized should be treated as deferred income and transferred to the profit and loss account only when it has been realized.

All restructured credit facilities must be approved by the licensee's Board of Directors or the appropriate delegated committee of the board. The entity's records should clearly indicate the reasons for restructuring and the new concessionary terms and conditions granted.

Restructured credit should be reported to the Supervisor. A credit facility must not be restructured more than twice in a five year period for mortgage and personal loans and not more than twice over the life of commercial loans.

Where subsequent to the restructuring of a credit, reasonable doubt arises regarding the collectability of all amounts due under the contractual terms of the restructured agreement, the credit shall be considered as further impaired and shall be measured accordingly.

Any restructured loan which subsequently becomes overdue for the payment of principle or interest, in full or in part, for 90 days or more according to the terms of the restructured loan agreement shall be placed in non-accrual status and shall remain in non-accrual status until the borrower pays from his own funds all overdue principal and interest.

Where concessionary terms are granted for reasons other than the financial difficulties of the borrower and the concessionary terms are equivalent to new debt with similar credit risk characteristics, then the debt shall not be considered a restructured credit facility but a refinanced credit facility. Credit facilities shall only be refinanced when the existing financial position of the borrower demonstrates a capacity to service the debt under the new terms of the contract.

SCHEDULE 5

RETURNING A CREDIT FACILITY TO UNIMPAIRED STATUS AND LIMITATIONS ON CREDIT FACILITY RENEGOTIATIONS

Returning a Credit Facility to Unimpaired Status

A credit facility may be returned to unimpaired status when all of the following conditions are met:

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

b. The remaining payments according to the credit facility agreement are expected;

c. The borrower has resumed paying the full amount of the rescheduled contractual principal and interest for a minimum of twelve consecutive months; and

d. All remaining contractual payments are deemed collectable in a timely manner.

Limitations on Credit Facility Renegotiations

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

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

b. Credit facilities classified as doubtful or loss would not be eligible for renegotiation unless such facilities have either an improvement in the facility collateral or an up-front cash payment;

c. In no case should the interest on the renegotiated facility be below the institution's average cost of funds;

d. Commercial credit facilities can be renegotiated only twice over the life of the original facility and mortgage facilities and not more than twice in a five year period;

e. Where a credit facility has been renegotiated, it should not be immediately given a more favorable classification unless a continuous repayment period and collection in accordance with the contractual terms have been demonstrated for a minimum period of one year;

f. 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) would require an increase in the value of the collateral to cover the capitalized interest, where applicable; and

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

Restructuring the terms of a credit facility may facilitate its return to 'unimpaired' status. However, financial institutions must guard against unjustified or premature facility upgrades. Internationally and

regionally, most regulators require a period of observation before a renegotiated credit facility can be reclassified upwards.

The limitations on credit facility renegotiations in the recommendations above are intended to place parameters on the treatment of facility upgrades and upward reclassification, in order to ensure that the credit portfolio is accurately represented.