

STATUTORY INSTRUMENTS SUPPLEMENT

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STATUTORY INSTRUMENTS

2005 No. 43.

**THE FINANCIAL INSTITUTIONS (CREDIT CLASSIFICATION
AND PROVISIONING) REGULATIONS, 2005.**

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STATUTORY INSTRUMENTS

2005 No. 43.

The Financial Institutions (Credit Classification and Provisioning) Regulations, 2005.

*(Under section 131 (1) of the Financial Institutions Act,
Act No. 2 of 2004)*

IN EXERCISE of the powers conferred on the Central Bank by section 131 (1) of the Financial Institutions Act, 2004, these Regulations are made this 16th day of February, 2005.

PART I—PRELIMINARY

1. These Regulations may be cited as the Financial Institutions (Credit Classification and Provisioning) Regulations, 2005.

2. These Regulations apply to all financial institutions in Uganda.

3. In these Regulations, unless the context otherwise requires—

“Act” means the Financial Institutions Act, 2004;

“classification” means the determination of the category of a facility using either subjective or objective criteria ;

“credit facility” means any asset or off-balance sheet item which contains credit risk, such as loans, overdrafts, advances, leases, acceptances, bills discounted, guarantees and other assets or contingencies connected with credit risk;

“doubtful” means a classification of a non-performing credit facility that meets the criteria stated in regulation 10;

“general provision” means a loss reserve held against future and presently unidentified losses and which is thus freely available to meet losses which subsequently materialise;

“hardcore” means an outstanding debit balance in an overdraft account that shows little or no fluctuations;

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

“loss” means a classification of a non-performing credit facility that meets the criteria stated in regulation 10;

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

“non-performing” means a credit facility that is not generating income and meets the criteria in regulation 10;

“normal risk” means a classification of a credit facility that meets the criteria stated in regulation 10;

“specific provision” means a loss reserve held against presently identified losses or potential losses and

thus not available to meet losses which subsequently materialise;

“substandard” means a classification of a non-performing credit facility that meets the criteria stated in regulation 10;

“watch” means a classification of a credit facility that meets the criteria stated in regulation 10;

“well secured” means that a credit facility has sufficient collateral to protect the financial institution from loss of principal and interest through its timely disposition under a forced liquidation program and the security may consist of—

(a) proper legal documentation;

(b) a net realizable market value which is adequate to cover the amount of principal and interest outstanding, as well as the costs of collection;

(c) the absence of prior liens on the collateral which could reduce its value or otherwise prevent obtaining clear title; and

(d) aspects such as lack of a clear market value or any difficulties in actual foreclosure or disposing of collateral negate a well secured status.

4. The Objectives of these Regulations are—

(a) to ensure that financial institutions are in proper compliance with capital adequacy requirements

by recognising possible impairments arising from provisions for bad and doubtful accounts;

(b) to ensure that financial institutions promptly identify their non-performing credit facilities and undertake adequate collection efforts; and

(c) to ensure that financial institutions present balance sheets and income statements that properly reflect the financial impact of non-performing credit facilities.

5. The rationale for these Regulations is that—

(a) financial institutions need to recognise problem credit facilities using a quantitative and qualitative definition of non-performing assets and to properly treat the assets with regard to accrual of interest, classify them according to ultimate collectibility and make adequate provisions based on the classification;

(b) the recognition of the non-performing assets stimulates collection efforts, thereby helping to reduce the possibility of loss on the assets; and

(c) supervisory authorities worldwide have recognised that their effectiveness is dependent on the integrity of the financial institution's balance sheets and income statements resulting from proper identification and accounting treatment of non-performing assets and failure to set the standards can lead to submission of fictitious profits and misleading balance sheets to the supervisory authority and other interested parties.

PART II—REGULATORY REQUIREMENTS

6. (1) A credit facility with a pre-established repayment schedule shall be considered non-performing if—

- (a) the principal or interest is due and unpaid for ninety days or more; or
- (b) the principal or interest payments equal to ninety days interest or more have been capitalised, refinanced, renegotiated, restructured or rolled over.

(2) A credit facility without a fixed repayment program, such as overdrafts or other forms of open-ended credit, shall be considered non-performing when any one of the following exists—

- (a) the credit facility exceeds the customer's established borrowing limit for ninety days or more;
- (b) the customer's borrowing line has expired for ninety consecutive days or more;
- (c) interest is due and unpaid for ninety days or more; or
- (d) the overdraft or account is inactive, meaning that—
 - (i) turnovers or the volume of repayments on the account during the period under review are not equivalent to, or greater than the approved credit line plus interest charges; or
 - (ii) the account has developed hardcore unless the financial institution can demonstrate that the borrower's current financial condition shows aggregate account

receivables (debtors) and merchandise inventory (stocks) equivalent to at least, twice the approved credit line.

(3) The criteria for non-performing credit facilities applies regardless of what security is held on the facility, for example, cash-backed security will not change the non-performing status of a credit facility, although cash held as security may be deducted from the outstanding balance of the credit facility before determining specific provisions.

(4) If a financial institution has more than one credit facility to a borrower and any of the facilities becomes non-performing, the financial institution shall consider all other outstanding credit facilities to the borrower as non-performing.

7. (1) A financial institution shall report, on a quarterly basis, to the Central Bank, the level of non-performing credit facilities and disclose the names of large non-performing and bad debtors using the forms set out in Schedules 1 and 2.

(2) Failure to report non-performing credit facilities and the names of large non-performing and bad debtors within thirty days after the end of the reference quarter on a timely and accurate basis may subject a financial institution to the remedial measures or administrative sanctions in Part III.

8. (1) Upon meeting the non-performing criteria under regulation 10, overdrafts and other credit facilities without a pre-established repayment schedule are to be converted to a reasonable amortization schedule consistent with the borrower's financial condition.

(2) The conversion of overdrafts and other credit facilities without pre-established repayment schedule into term loans shall not change the classification category and the corresponding level of provisions.

(3) To facilitate review of overdraft accounts, a financial institution shall maintain an analysis sheet for each account showing monthly balances and a summary of movements indicating the total amount and number of deposits and withdrawals and accruals and repayments of interest charges.

9. (1) All categories of non-performing credit facilities based on the criteria stipulated in regulation 10 shall be placed on a non-accrual basis, that is interest due but uncollected should not be accrued as income, but instead should be shown as interest in suspense.

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

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

(4) Subregulations (1), (2) and (3) shall apply regardless of security held on a credit facility.

10. (1) Credit facilities shall be classified into the following five categories—

- (a) Normal Risk (Pass);
- (b) Watch (Special Mention);
- (c) Substandard;
- (d) Doubtful; and
- (e) Loss.

(2) Non-performing credit facilities shall include Substandard, Doubtful and Loss categories and shall be classified by financial institutions according to the criteria

prescribed in these Regulations, unless prior approval of the Central Bank has been obtained under regulation 14(4).

(3) A financial institution shall apply subjective or objective criteria, with the more severe method to be the norm.

(4) Significant departure from the primary source of repayment, too liberal repayment terms, and modification of credit terms and conditions to cure delinquency shall warrant adverse classification even when the credit facility appears current or up-to-date.

(5) Criteria for Normal Risk (Pass) classification are as follows—

(a) subjective criteria includes all of the following—

(i) where the financial condition of the borrower is sound;

(ii) where there is adequate documentation to support the granting of credit, such as current financial statements, cash flows, credit checks and evaluation report on collateral held; and

(iii) if the account is supported by collateral, the collateral shall be unimpaired.

(b) objective criteria includes all the following—

(i) a credit facility with fixed repayment which is up-to-date in payments; and

(ii) an overdraft or credit facility without fixed repayment which is operating within the approved limit; with unexpired credit line; with interest charges covered by deposits; with no hardcore and showing turnovers which are

equivalent to, or greater than the approved credit line plus interest charges.

(6) Criteria for Watch (Special Mention) classification are as follows—

(a) subjective criteria includes any of the following—

- (i) a credit facility which is currently up-to-date but evidence suggests that certain factors could, in the future, affect the borrower's ability to service the account properly or impair the collateral;
- (ii) a credit facility which may deteriorate because of current market conditions affecting the sector or industry; or
- (iii) a renegotiated credit facility which is up-to-date in repayments and adequately secured for a minimum of one year after rescheduling and during which period there would have been no inherent weaknesses affecting repayment.

(b) objective criteria includes any of the following—

- (i) for a credit facility with fixed repayment dates; when the principal or interest is due and unpaid for one month to less than ninety days; the interest charges for thirty days to less than ninety days have been capitalized, refinanced or rolled - over; or
- (ii) for an overdraft or credit facility without fixed repayment dates; when the approved limit has been exceeded for thirty days to less than ninety days; the

credit line has expired for thirty days to less than ninety days ; the interest charge for thirty days to less than ninety days has not been covered by deposits; or the account had turnovers which did not conform to the business cycle.

(7) Criteria for substandard classifications are as follows—

(a) subjective criteria includes any of the following—

- (i) credit facilities display well-defined credit weaknesses that jeopardize the liquidation of the debt such as inadequate cash flow to service the debt, undercapitalized or insufficient working capital, absence of adequate financial information or security documentation and irregular payment of principal or interest; or
- (ii) credit facilities that are not protected by the current sound net worth and paying capacity of the borrower.

(b) objective criteria includes any of the following—
non-performing credit facilities meeting the criteria specified in regulation 6, on which principal or interest remain unpaid or where credit line is exceeded or expired, for ninety days to less than one hundred and eighty days.

(8) Criteria for Doubtful Classifications are as follows—

(a) subjective criteria includes any of the following—

- (i) where the collection of the debt in full is highly questionable or improbable; or
 - (ii) credit facilities which, in addition to the weaknesses existing in substandard credits, have deteriorated to the extent that full repayment is unlikely or that realizable security values will be insufficient to cover the financial institution's exposure;
- (b) objective criteria includes non-performing credit facilities meeting the criteria specified in regulation 6 on which principal or interest remains unpaid or where credit line is exceeded or expired, for one hundred and eighty days to less than one year.

(9) Criteria for Loss Classifications are as follows—

- (a) subjective criteria which includes any of the following—
- (i) credit facilities that are considered uncorrectable or which may have some recovery value but it is not considered practicable nor desirable to defer write-off (even though partial recovery may be effected in the future);
 - (ii) an account classified as Doubtful with little or no improvement over the period it has been classified as such; and
- (b) objective criteria which includes non-performing credit facilities meeting the criteria specified in regulation 6, on which principal or interest remains unpaid or where credit line is exceeded or expired, for one year or more.

Specific provisions

11. (1) Financial institutions shall maintain specific provisions for all non performing credit facilities.

(2) All credit facilities classified as Substandard, Doubtful or Loss shall be subject to specific provisions, regardless of whether the subjective or objective criteria were used in determining classification.

(3) Specific provisions for substandard assets shall be maintained at not less than 20% of the outstanding balance of the credit facility.

(4) Specific provisions for doubtful assets shall be maintained at not less than 50% of the outstanding balance of the credit facility.

(5) Specific provisions of loss assets shall be maintained at 100% of the outstanding balance of the credit facility; the loss assets are to be written off against accumulated provisions within ninety days of being identified as loss, unless approval of the Central Bank to defer write-off has been obtained.

(6) The outstanding balance consists of principal, interest which has been capitalized and all other charges, fees and other amounts, which have been capitalized to the outstanding balance; interest in suspense may be deducted from the outstanding balance before determining the provisions.

General provisions

(7) In addition to specific provisions, financial institutions are required to maintain a general provision of at least 1% of their total outstanding credit facilities net of specific provisions and interest in suspense.

(8) The provisioning level shall be reviewed at least on a quarterly basis and shall be reported to the Central Bank using the forms specified in regulation 7.

12. (1) For special types of homogenous credit facilities where it is often not practicable to investigate the credit worthiness of each individual borrower on a regular basis, the classification and provisioning shall be determined by the financial institution on a portfolio basis by applying formulae approved by the Central Bank that take into consideration factors such as analysis of arrearages, ageing of balances, past loss experience, current economic conditions and other relevant circumstances.

(2) For micro finance loans, which shall be properly segregated and identified in the books of the financial institution, the credit classification and provisioning requirements issued under the Micro Finance Deposit-Taking Institutions Act, 2003 shall apply.

13. A restructured credit facility is a facility which has been refinanced, rescheduled, rolled-over, or otherwise modified because of weaknesses in the borrower's financial position or the non-payment of the debt as arranged and shall be subject to the following conditions—

- (a) the existing financial position of the borrower can service the debt under the new condition;
- (b) an account classified as Doubtful or Loss shall not be restructured unless an up-front cash payment is made to cover, at the least, unpaid interest, or there is an improvement in the security or collateral taken which will make the restructured account, including unpaid interest, a well-secured account;
- (c) a commercial credit facility shall not be restructured more than twice over the life of the

original facility; and a mortgage or personal credit facility, not more than twice in a five-year period;

(d) a restructured credit facility shall not be reclassified upward for a minimum of one year following the new arrangements; and

(e) a restructured credit facility shall not be restored to accrual status unless there is evidence of a relative improvement in the borrower's condition and debt service capacity and only after a one year period of sustained payment performance.

14. (1) A financial institution shall evaluate the status of security or collateral on any credit facility once payment of principal or interest falls into arrears or becomes irregular.

(2) A financial institution shall initiate procedures to realise any security or collateral once a credit facility becomes non-performing.

(3) Cash-back security or collateral in the form of hold-outs on deposits or other funds with the financial institution may be deducted from the outstanding balance of a credit facility before applying specific provisions.

(4) When a financial institution regards a non-performing credit facility as well-secured, it may apply to the Central Bank for exemption from the classification and provisioning criteria, stating its reasons for the exemption and in determining whether or not to grant the exemption, the Central Bank may call for additional information.

(5) A well-secured credit facility shall not be exempt from being considered as a non-performing account.

15. (1) The Central Bank may undertake inspections of financial institutions to determine whether reporting of non-performing credit facilities is accurate and interest accrual for the credit facilities are in compliance with these Regulations.

(2) If, in the course of an inspection, the Central Bank determines that a non-performing credit facility has not been properly classified by the management of a financial institution, the Central Bank may call for the classification and corresponding provisioning.

(3) When any report set out in the Schedules to these Regulations is determined to be inaccurate, the Central Bank may call for revisions to the returns to reflect an accurate position.

(4) The Central bank may also call upon external auditors to determine whether a financial institution is reporting accurately or is in compliance with these Regulations.

16. (1) A financial institution shall not be in compliance with the minimum on-going capital requirements unless it is in full compliance with these Regulations.

(2) When the Central Bank determines that a financial institution is not in compliance with these Regulations, it may call for adjustments to the balance sheets, income statements and the capital adequacy computations with regard to non-accrual of interest and adequate provisions.

PART III—REMEDIAL MEASURES AND ADMINISTRATIVE
SANCTIONS

17. When the Central Bank determines that a financial institution is not in compliance with these Regulations, it may impose any or all the corrective actions under the Act.

18. In addition to the remedial measures under regulation 17, the Central Bank may impose any or all of the following administrative sanctions with regard to a financial institution that is not in compliance with these Regulations or whose compliance with these Regulations indicates that the financial institution is in unsound condition—

- (a) requirement calling for infusion of additional capital to absorb probable losses;
 - (b) prohibition from declaring or paying dividends;
 - (c) suspension of lending, investment or other credit extension operations;
 - (d) suspension of the establishment of new branches or expansion into new banking or financial activities;
 - (e) suspension of access to credit facilities of the Central Bank;
 - (f) suspension of the opening of letters of credit;
 - (g) suspension of the acceptance of new deposits; or
 - (h) suspension of the acquisition of fixed assets.
-

SCHEDULES

SCHEDULE 1

REGULATIONS 7(1), AND 15 (3)

**QUARTERLY REPORT ON LARGE NON-PERFORMING
AND BAD DEBTS WRITTEN OFF**

Name of Financial Institution

Quarter ended

Due: 30 days after quarter-end

Name of debtors / group of debtors	Outstanding amount (over shs.0.5billion)	Classifi- cation	Provisions	Economic sector
I NON-PERFORMING				
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
TOTAL				
II. BAD DEBTS WRITTEN OFF				
1.				
2.				
3.				
4.				
5.				
TOTAL				

* Includes both on and off Balance sheet exposures.

Submitted by:

Name

Position

Signature

Date

SCHEDULE 2

REGULATIONS 7 (1), AND 15 (3)

.....

(Name of Financial Institution)

QUARTERLY REPORT ON CREDIT CLASSIFICATION
AND PROVISIONING

Quarter Ended _____

Due: 30 days after quarter-end

	Loans	Overdrafts	Other credits	Total
I. AGEING ANALYSIS				
1. Current (up-to-date in payments)				
2. Past due (principal or interest or credit line)				
(a) 1 – 89 days				
(b) 90 – 179 days				
(c) 180 – 364 days				
(d) 1 year or more				
Total Portfolio				
II CLASSIFICATION				
1. Performing				
(a) Normal risk (pass)				
(b) Watch (special mention)				

Sub-total				
2. Non-peforming				
(a) substandard				
(b) Doubtful				
(c) Loss				
(d) Sub-total				
3. Total portfolio				
4. Interest-in-suspense				
III REQUIRED PROVISION				
1. Specific provisions				
(a) Substandard (20%)				
(b) Doubtful (50%)				
(c) Loss (100%)				
(d) Total specific provision				
2. General Provisions				
1% of total outstanding credit facilities net of specific provision and interest in suspense.				
Total required provisions (III.I.d. plus III.2)				
IV PROVISIONS PER BOOKS				
V PROVISIONS SHORTFALL (III.3 less IV)				

Submitted by:.....

Name

Position

.....

.....

Date

Signature

E. TUMUSIIME –MUTEBILE,
Governor, Bank of Uganda.