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GUIDELINES ON CREDIT RISK MANAGEMENT FOR COMMERCIAL BANKS

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SECTION ONE

1. Authority

The Bank of Sierra Leone (BSL) pursuant to Section 65 of the Bank of Sierra Leone Act 2019 and Section 53 of the Banking Act 2019, hereby issues Guidelines on Credit Risk Management for Commercial Banks and Financial Holding Companies.

2. Application

These Guidelines shall apply to all commercial banks and financial holding companies licensed to conduct banking business in Sierra Leone by the Bank of Sierra Leone under the Banking Act 2019.

3. Scope

These Guidelines shall apply to all activities of Commercial Banks or financial holding companies that are exposed to credit risks.

4. Interpretation

In these Guidelines, unless the context otherwise requires-

"**Non-Performing Loan (NPL)**" is an exposure that is in default. A default is considered to have occurred with regard to a particular borrower when either, or both, of the events in sub-paragraphs (i) or (ii) have taken place:

i. the Commercial bank considers that the borrower is unlikely to pay its credit obligations in full, without recourse by the institution to actions such as realising available security.

Elements to be taken as indications of unlikeliness to pay include:

* the commercial bank or financial holding company puts the credit obligation on non-accrued status (e.g., the lending commercial bank no longer recognises accrued interest as income or, if recognised, makes an equivalent amount of provisions);

* the commercial bank or financial holding company makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the institution taking on the exposure.

* the commercial bank or financial holding company consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest, or fees.

* the commercial bank or financial holding company has applied for the borrower's bankruptcy or a similar order in respect of the borrower's credit obligation to the institution.

* the borrower has sought or has been placed in bankruptcy or afforded similar protection where this would avoid or delay repayment of any of the credit obligations to the institution.

* the commercial bank or financial holding company sells the credit obligation at a material credit-related economic loss.

ii. the borrower is 90 days or more past due on a credit obligation to the commercial bank or financial holding company.

An exposure subject to a regular repayment schedule is considered 90 days past due when:

* at least 90 calendar days have elapsed since the due date of a contractual payment which has not been met in accordance with the contractual term; and

For exposures to individuals, the definition of default may be applied at the level of a particular credit obligation, rather than at the level of the borrower. As such, default by a borrower on one obligation, does not require a commercial bank or financial holding company to treat all other obligations to the commercial bank as being in default. Each facility must be considered on its own merit.

Past-due Loan" is an exposure for which any amount due under a contract (interest, principal, fee or other amount) has not been paid in full at the date when it was due. An exposure is considered past-due from the first day of missed payment.

Forborne" is an exposure for which:

* a borrower is experiencing financial difficulty or hardship in meeting his or her financial commitments; and
* the commercial bank or financial holding company grants a concession to the borrower that it would not or otherwise consider whether or not the concession is at the discretion of the institution or the borrower.

Examples of concessions include, but are not limited to:

* extending a loan term.
* rescheduling the dates of principal or interest payments.
* granting new or additional periods of non-payment (grace period);
* reducing the interest rate, resulting in an effective interest rate below the current interest rate that borrowers with similar risk characteristics could obtain from the commercial bank or financial holding company in the market.
* capitalising arrears.
* forgiving, deferring, or postponing principal, interest or relevant fees.
* changing an amortising loan to an interest payment only.
* allowing the conversion of debt to equity of the borrower.
* deferring recovery/collection actions for extended periods of time.
* easing of covenants; and
* refinancing an existing exposure with a new contract, even if the terms of the new contract are no more favourable for the borrower than those of the existing transaction.

5.0 Credit Risk Management Framework

A commercial bank or financial holding company shall implement a credit risk management framework that is appropriate to its size, business mix and complexity. The credit risk management framework shall, at a minimum, include:

(i) a credit risk appetite statement.

(ii) a credit risk management strategy.

(iii) policies and processes supporting clearly defined and documented roles, responsibilities, and formal reporting structures for the management of credit risk.

(iv) a designated credit risk management function.

(v) a management information system that is adequate, under normal circumstances, in periods of stress, for measuring, assessing and reporting on credit risk; and

(vi) an independent review process to ensure that the credit risk management framework is effective in identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating credit risk.

6.0 Restrictions on Lending

Commercial Banks or financial holding companies shall observe, at all times, the BSL's Guidelines with respect to:

(i) Single Borrower Limits (Revised Prudential Guidelines 2022, Part V, paragraph 51).

(ii) Advances for Advances/Improvements/Alteration of Land (Revised Prudential Guidelines 2022, Part V, paragraph 52).

(iii) Exposure limit on a consolidated basis (Revised Prudential Guidelines 2022, Part V, paragraph 54).

(iv) Large exposure limit (Revised Prudential Guidelines 2022, Part V, paragraph 55).

7.0 Credit Risk Appetite

A commercial bank or financial holding company shall maintain an appropriate and well-documented credit risk appetite statement. The statement shall, at a minimum articulate:

(i) the degree of credit risk that the institution is prepared to accept (credit risk appetite);

(ii) the maximum level of credit risk that the institution is willing to operate within (credit risk tolerance);

(iii) the process for ensuring that credit risk tolerances are set at an appropriate level.

(iv) the process for monitoring compliance with credit risk tolerances and for taking appropriate action in the event it is breached, and

(v) the timing and process for review of the credit risk appetite and tolerances.

8.0 Credit Risk Management Strategy

(a) A commercial bank or financial holding company shall maintain an appropriate and well-documented credit risk management strategy that outlines the objectives guiding the institution's credit origination, credit assessment, and approval activities and also adopt the necessary policies and processes for conducting such activities.

(b) A commercial bank or financial holding company's credit risk management strategy shall reflect its credit risk appetite, credit risk profile, and market and macroeconomic conditions.

(c) A commercial bank or financial holding company's credit risk management strategy shall describe the institution's willingness to accept credit risk based on exposure type, economic or industry sector, geographical location, currency and maturity. This must also include the overall characteristics that the institution would want to achieve in its credit portfolio.

(d) A commercial bank or financial holding company's credit risk management strategy shall consider the sustainability of earnings from its credit risk activities including an acceptable risk/reward trade-off that would factor in cost of capital estimates.

9.0 The Role of the Board and Senior Management

9.1 Board Responsibilities

(a) The Board of a commercial bank or financial holding company shall review and approve, at least on an annual basis, the institution's credit risk appetite and credit risk management strategy.

(b) The Board shall regularly challenge, seek assurance and evidence from senior management that the credit risk policies, processes, and practices are consistent with the credit risk management strategy (and, in turn, the credit risk appetite) of the institution. The Board shall obtain sufficient information to confirm whether or not the credit risk profile of the commercial bank or financial holding company is consistent with the credit risk management strategy and require senior management to take appropriate and timely action if it is not.

(c) The Board shall ensure that senior management of the commercial bank or financial holding company has the capability and resources to appropriately manage the credit risk activities conducted by the bank and that such activities operate within the credit risk management strategy, credit risk policies and credit risk appetite.

9.2 Senior Management Responsibilities

(a) Senior Management of a commercial bank or financial holding company shall be responsibility for implementing the Board approved credit risk management strategy and for developing and implementing appropriate policies and processes for identifying, measuring, monitoring, reporting, and controlling or mitigating credit risk. Such policies and processes must address credit risk in all of the institution's activities both at the individual exposure and portfolio levels.

(b) Senior Management's responsibility for implementing the credit risk management strategy and for developing and implementing the credit risk policies of the commercial bank or financial holding company includes ensuring:

(i) credit origination, credit assessment and approval activities conform to the established strategy and policies.

(ii) written processes are developed consistent with the credit risk management strategy and credit risk policies.

(iii) credit origination, credit assessment and approval, and review responsibilities are clearly and properly assigned.

(iv) the strategy, policies, and processes are effectively communicated throughout the institution, and all relevant personnel clearly understand the institution's approach to originating, assessing, approving, and managing credit risk and are held accountable for complying with the established policies and processes; and

(v) there is a regular internal review of the commercial bank or financial holding company's credit origination, credit assessment and approval, and management functions. Such reviews must be conducted independently from the business function. This may involve the institution's risk management and compliance function, or an internal audit function, or qualified external parties.

10.0 Credit Risk Policies, Origination, Assessment and Appetite

10.1 Credit Risk Policies and Processes

(a) A commercial bank or financial holding company shall adopt and implement prudent and well-documented policies and processes to identify, measure, monitor, report, and control or mitigate credit risk. The full credit life cycle must be considered, including credit origination, initial and subsequent credit assessment, and approval processes, and the ongoing monitoring and management of the institution's credit exposures and portfolio.

(b) Credit risk policies shall address topics such as target markets, portfolio mix, price, and non-price terms, the structure of limits, approval authorities and overrides, waivers or exceptions, processing, and reporting. Such policies shall be well-documented, clearly defined, consistent with prudent practices and applicable laws and regulations, and adequate for the size, nature, and complexity of the commercial bank and financial holding company's activities.

(c) Credit risk policies shall be designed and implemented within the context of internal and external factors such as the institution's market position, personnel capabilities, and technology. Appropriate operational capacity and business systems must be in place to support the credit risk management strategy before the strategy is implemented.

(d) A commercial bank or financial holding company shall have prudent and well-documented policies and processes for the early identification and management of problem exposures, including non-performing and restructured exposures and other transactions, and the maintenance of adequate provisions.

(e) A commercial bank or financial holding company shall have appropriate credit risk practices, including an effective system of internal control, to consistently determine adequate provisions in accordance with the institution's stated policies and processes and the accounting framework.

10.2 Internal Risk Appetite Limits

In addition to the requirements incorporated in the BSL Enterprise Risk Management Guidelines 2024, a commercial bank or financial holding shall develop and implement appropriate policies and processes to ensure that the credit portfolio is adequately diversified given the institution's target markets and credit risk management strategy. In particular, such policies shall establish targets for portfolio mix as well as set prudent limits on exposures to:

(i) high-risk borrowers.

(ii) high-risk credit products and activities; and

(iii) economic sectors and geographical locations, where appropriate.

10.3 Credit Origination

(a) A commercial bank or financial holding company shall recognise and address the risks arising from different credit origination channels in its credit risk management framework.

(b) Where there are material changes to origination channels, including their relative significance, a commercial bank or financial holding company shall assess the impact of these changes on its credit risk profile, and appropriately address the risks of such changes.

(c) In circumstances where a commercial bank or financial holding company's staff(s) are involved in the credit origination process, but have no ability to approve credit risk, the institution shall have a prudent policy and sound oversight processes, to ensure that reasonable inquiries have been made and steps taken to verify the accuracy and completeness of all relevant borrower information provided by the staff and the outcomes of these processes must be documented.

10.4 Credit Assessment and Approval Process

(a) A commercial bank or financial holding company shall establish sound credit assessment and approval criteria. These criteria must set out the borrowers that are eligible for credit, the extent and nature of credit the institution is willing to provide, and the terms and conditions the exposures would be subject to.

(b) A commercial bank or financial holding company shall undertake a comprehensive assessment of a borrower's credit risk which would consider and be proportionate to the nature, type, and size of the exposure. A commercial bank or financial holding company must use experienced credit judgement in adopting a scalable and flexible approach to its credit risk assessment of a borrower.

(c) A commercial bank or financial holding company shall assess credit risk primarily on the strength of a borrower's repayment capacity. The institution shall not place undue reliance on collateral provided by the borrower as a substitute for a comprehensive credit assessment.

(d) A commercial bank or financial holding company shall not place undue reliance on external credit ratings but must obtain adequate information to undertake a comprehensive credit assessment of a borrower.

(e) A commercial bank or financial holding company shall give due consideration to the integrity and reputation of the borrower as well as its legal capacity to assume liability.

10.5 Exposures to Individuals

For exposures to individuals, a commercial bank or financial holding company's credit assessment shall include consideration of the following criteria, where relevant:

(a) the purpose and structure of the exposure and sources of repayment, including making reasonable enquiries and taking reasonable steps to verify income or cash flows.

(b) the current risk profile of the borrower, including making reasonable enquiries and taking reasonable steps to verify commitments and total indebtedness.

(c) the borrower's repayment history and capacity, assessed under various scenarios such as:

(i) increase in interest rates;

(ii) a change from a fixed rate to a floating interest rate (and vice versa);

(iii) a decrease in income or cash flows, particularly for less stable income or cash flow sources.

(d) the borrower's expenses, including the collection of reasonable estimates. Expense benchmarks must not be used as a substitute for a commercial bank or financial holding company making reasonable enquiries of a borrower's expenses.

(e) the proposed terms and conditions of the exposure, including covenants designed to limit the commercial bank or financial holding company's exposure to changes in the future risk profile of the borrower to an acceptable level to the institution; and

(f) where applicable, the adequacy and enforceability of collateral, guarantees and other risk mitigants.

10.6 Exposures other than to Individuals

For exposures other than to individuals, in addition to 8.7 (a), 8.7 (b), 8.7 (c), 8.7(e), and 8.7 (f), a commercial bank's or financial holding company's credit assessment shall also include consideration of the following criteria, where relevant:

a. the borrower's business expertise, economic or industry sector and its position within that sector.

b. the borrower's historical financial and future cash flows.

c. the borrower's equity capital invested in the business; and

d. the availability and enforceability of risk mitigants other than collateral, such as hedging and insurance.

10.7 Collaterals and Guarantees

(a) A commercial bank or financial holding company shall have prudent credit risk policies (See Annex A) covering the acceptability of various forms of collateral, appropriate processes for the valuation of such collateral (including the valuation of collateral prior to entering into exposure and the ongoing valuation of collateral, where appropriate), and an appropriate process to ensure that collateral is, and continues to be, enforceable and realisable.

(b) A commercial bank or financial holding company shall ensure all valuations are done independently of the institution.

The valuation of collateral must reflect fair values, taking into account prevailing market conditions such as the time taken for the liquidation or realisation of collateral.

(c) A commercial bank or financial holding company shall also ensure that the valuation of collateral such as land takes into account, to the extent possible, the likelihood of external events, including but not limited to fire, drought, and flood, which may impact the valuation of the asset taken as collateral.

(d) A commercial bank or financial holding company shall have appropriate mechanisms in place for regularly assessing the value of collateral, guarantees and other risk mitigants.

(e) A commercial bank or financial holding company shall ensure all collaterals are perfected and security interests registered at the Sierra Leone Collateral Registry (Bank of Sierra Leone).

(f) A commercial bank or financial holding company shall ensure a guarantor has a clear understanding of the risks involved in the exposures.

10.8 Credit Approval and Experienced Credit Judgement

(a) A commercial bank or financial holding company shall have an established process in place for:

(i) approving new exposures (including prudent credit standards)

(ii) renewing and refinancing existing exposures; and

(iii) identifying the appropriate approval authority for the size and complexity of the exposures.

(b) A commercial bank or financial holding company shall document the credit assessment and approval process and identify the approval authority for each exposure, so that it is clear which personnel are accountable for the individual credit decision.

(c) A commercial bank or financial holding company shall ensure personnel involved in the credit assessment and approval process have appropriate experience and knowledge to exercise prudent credit judgement commensurate with the nature, size, and complexity of the transaction in which they are involved.

(d) A commercial bank or financial holding company shall have prudent credit risk policies and processes with respect to overrides, waivers, or exceptions, including clear identification of approval authorities and limits that reflect the maximum level of allowable overrides, waivers, or exceptions.

(e) Exposures originated as overrides, waivers, or exceptions to, or otherwise not in compliance with, credit risk policies shall be reported immediately to the institution's risk committee, compliance, internal audit, and risk management functions.

(f) A commercial bank or financial holding company shall seek the approval of the Bank of Sierra Leone for all overrides, waivers, and exceptions that could exceed the statutory limit indicated by the regulatory instruments and/ or directives.

10.9 Credit Administration, Measurement, and Monitoring

(a) A commercial bank or financial holding company shall have an appropriate system for the ongoing administration of its credit portfolio.

(b) A commercial bank's or financial holding company's credit administration system must have regard to:

(i) the efficiency and effectiveness of credit administration operations, including monitoring, documentation, contractual requirements, covenants, and collateral.

(ii) the accuracy and timeliness of information provided to management information systems.

(iii) adequate segregation of duties.

(iv) the adequacy of controls over all credit administration processes; and

(v) compliance with credit risk policies and processes as well as applicable laws and regulations.

(c) A commercial bank or financial holding company shall ensure its credit administration system captures all the information necessary to ascertain the current financial condition of the borrower as well as sufficient information to track all credit decisions made and the history of each exposure. A commercial bank's or financial holding company's credit risk review function shall determine that credit administration is complete and that all approvals and other necessary documents have been obtained.

(d) A commercial bank or financial holding company shall have an appropriate system for monitoring the condition of individual exposures, including determining the adequacy of provisions.

(e) A commercial bank or financial holding company shall have in place an appropriate system for monitoring the overall composition and quality of the credit portfolio including identification of any risk concentration.

(f) A commercial bank or financial holding company shall have an appropriate information system and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system must provide adequate information on the composition of the commercial bank's credit portfolio, including the identification of any concentrations of risk.

10.10 Credit Risk Grading Systems

(a) A commercial bank or financial holding company shall have in place an internal credit risk grading system, proportional to the scope, scale and complexity of its operations.

(b) A commercial bank or financial holding company shall have prudent policies and processes governing the development, validation, operation and oversight of its credit risk grading system. Coverage of the credit risk grading system must extend to as much of the institution's credit portfolio as possible, including off-balance sheet exposures.

(c) The credit risk grading system must meaningfully assess and differentiate risk and be able to rank risk consistently and through time.

(d) A sufficient number of risk grades shall be included to ensure that the system adequately captures the gradation of risk and the definitions and criteria for each risk grade must be plausible and intuitive.

10.11 Stress Testing

(a) A commercial bank or financial holding company shall take into consideration potential future changes in economic conditions when assessing individual exposures and its credit portfolio and must assess its credit risk exposures under stressed conditions.

(b) A commercial bank or financial holding company shall undertake regular portfolio level and risk-specific stress testing of its credit exposures.

(c) The complexity and granularity of a commercial bank's or financial holding company's stress testing shall take into account the nature and scale of the institution's credit portfolio.

(d) A commercial bank or financial holding company shall conduct stress testing at a sufficiently granular level to enable adequate sensitivity to the risk characteristics of different exposure types. Scenarios used for stress testing must include severe but plausible adverse conditions.

(e) A commercial bank or financial holding company shall consider the results of stress testing in its overall limit setting and monitoring process.

(f) Stress testing analyses shall include contingency plans regarding actions the Board and senior management may take given certain scenarios.

(g) A Commercial bank's or financial holding company's stress testing arrangements must include well-documented and sound policies and processes governing the stress testing program, including the timely communication of information on scenarios, key assumptions, results and capital impacts to the institution's Board and Senior Management.

(h) Stress testing models shall be appropriately validated and checked independently or by an appropriately qualified external party.

11.0 Controls over Credit Risk

11.1 Review of Credit Risk Management Processes

A commercial bank or financial holding company shall establish a system of independent, regular reviews of the institution's credit risk management processes and practices and the results of such reviews shall be communicated directly to the Board and Senior Management.

11.2 Internal controls and limits

(a) A commercial bank or financial holding company shall ensure that the credit origination, credit assessment and approval function are properly managed and that credit exposures are within levels consistent with internal and regulatory limits.

(b) The institution shall establish and enforce internal controls and other practices to ensure that overrides, waivers, or exceptions to policies, processes and limits are reported immediately to the appropriate level of authority for action.

11.3 Systems for Remedial Action

(a) A commercial bank or financial holding company shall have an appropriate system in place for early remedial action on problem exposures, managing problem exposures and similar workout situations. The institution's collections systems shall bring together a borrower's arrears profile and be able to be scaled to manage high volumes in a time of stress.

(b) A commercial bank or financial holding company shall have an effective workout program for problem exposures, with the segregation of the workout function from the area that originated the exposure. The institution shall also have an effective strategy and appropriate organisational resources and personnel in place to manage these exposures.

(c) A commercial bank or financial holding company shall have prudent policies and processes that assist the institution to recover as much of exposure as is reasonably achievable within the requirements established by law and also having regard to Financial Consumer Protection Guidelines expectation as to how borrowers are to be treated. The institution shall consider the risk to its reputation in such circumstances.

11.4 Classification of Exposures and Provisions

(a) A commercial bank or financial holding company shall have prudent policies and processes for classifying its credit risk exposures for prudential reporting purposes and in accordance with the Prudential Guidelines for commercial banks and for establishing appropriate and robust provisioning in line with International Financial Reporting System (IFRS). The institution's system for classification and provisioning shall take into account on- and off-balance sheet exposures.

(b) Commercial banks or financial holding companies shall review its exposures at an individual level and at a portfolio level to ensure appropriate classification of exposures, provisioning levels, and write-offs, following the provisions of the Revised Prudential Guidelines 2022 (Part III, par. 22).

(c) A commercial bank or financial holding company shall have sound policies and processes that reflect realistic repayment and recovery expectations and ensure that provisions and write-offs are timely, taking into account market and macroeconomic conditions.

(d) The Board of a Commercial bank or financial holding company shall obtain timely and appropriate information on the condition of the institution's credit portfolio, including the classification of exposures as performing and non-performing and the level of provisions and its equivalent in line with IFRS. The information shall include, at a minimum, results of the latest credit risk review process, comparative trends in the overall quality of exposures, and measurements of existing or anticipated deterioration in asset quality and expected credit losses.

(e) A commercial bank or financial holding company shall ensure that valuation, classification, and provisioning for material non-performing exposures are conducted on an individual exposure basis.

(f) A commercial bank or financial holding company shall regularly assess trends and concentrations in risk and risk build-up in relation to credit exposures taking into account any observed concentration in the risk mitigation strategies adopted and the potential effect on the efficacy of the mitigant in reducing losses. A commercial bank or financial holding company shall consider the adequacy of provisions in light of this assessment.

11.5 Non-Performing Loans

(a) For the purposes of these Guidelines, Non-Performing Loans shall be measured in accordance with BSL's Revised Prudential Guidelines for Commercial Banks, 2022 paragraph 28. For off-balance sheet exposures, the whole exposure is the entire notional amount.

(b) Collateral and other risk mitigation arrangements must not directly influence the categorisation of exposure as non-performing.

(c) Collateral may be considered, along with other factors, in assessing whether a borrower is likely to pay. Collateralisation must not influence the past-due status, including the counting of past-due days and the determination of the exposure as non-performing. An exposure must be classified as non-performing where it meets the definition of non-performing (Revised Prudential Guidelines 2022, Part III, paragraph 27) even if the collateral value exceeds the amount of the past-due exposure.

11.6 Off-balance Sheet Exposures

(a) A commercial bank or financial holding company shall classify off-balance sheet exposures as non-performing where the institution has cause to believe that it is unlikely to recoup, in a timely manner, the full amounts it may be required to advance.

(b) Commitments shall also be classified as non-performing if the creditworthiness of a borrower has deteriorated to an extent that the timely repayment in full by the borrower of any potential drawdown or associated interest payments or fees is unlikely.

11.7 Reclassification of Non-Performing Loans to Performing

(a) The reclassification of an exposure from non-performing to performing shall follow the criteria prescribed in the BSL Revised Prudential Guidelines of 2022, Part III, paragraph 25 (1), (2), (3) for not forborne exposures, and Part III, paragraph 24 (1), (2), (3) for forborne exposures.

Notwithstanding, a Commercial Bank or financial holding company shall not reclassify a non-performing exposure as performing in the following circumstances:

(i) repossession of collateral on a non-performing exposure, until the collateral is actually disposed of, and the commercial bank or financial holding company realises the proceeds; or

(ii) extension or granting of forbearance measures to an exposure that is already identified as non-performing subject to the relevant exit criteria established in the Revised Prudential Guidelines 2022 paragraph 24 for non-performing exposures.

(b) The reclassification of a non-performing exposure as performing shall be made on the same level (such as a borrower or transaction approach) as when the exposure was originally categorised as non-performing.

11.8 Forborne Exposures

(a) Any forbearance measure applied to an exposure must be supported by a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. Renegotiation of an exposure shall not be used to obscure the poor quality of a loan or other financial instrument's performance or avoid an increase in provisions.

(b) Commercial banks or financial holding companies shall develop a policy on their forbearance. The policy shall cover at least:

(i) the process and procedures for granting forbearance measures, including responsibilities and decision-making.

(ii) a description of available forbearance measures, including those embedded in contracts.

(iii) information requirements for assessing the viability of forbearance measures.

(iv) documentation of forbearance measures granted.

(v) the process and metrics for monitoring the efficiency and effectiveness of forbearance measures.

(c) Commercial banks or financial holding companies shall regularly review their forbearance policies and options based on the collective monitoring of the performance of different forbearance measures, including the examination of potential causes and instances of re-defaults.

(d) Forbearance measures may be granted on performing or non-performing exposures. When restructure is applied to a non-performing exposure, the exposure must continue to be classified as non-performing. When forbearance is applied to a performing exposure, the commercial bank must observe the provisions contained in the Revised Prudential Guidelines 2022, paragraph 24 (4).

(e) A commercial bank or financial holding company shall monitor the appropriate categorisation of exposures on which forbearance has been granted more than once. When a restructured exposure under the probation period is granted new forbearance, this shall trigger a restart of the probation period.

11.9 Criteria for Exit from the Restructured Exposures Category

A commercial bank or financial holding company shall classify a forborne exposure as such until it meets the criteria contained in the Revised Prudential Guidelines 2022, paragraph 24 (1), (2), (3), (5).

11.10 Credit Risk and Accounting for Expected Credit Losses

(a) In accordance with the BSL IFRS Guidelines, a commercial bank or financial holding company shall adopt, document, and adhere to sound methodologies that address policies, processes and controls for assessing and measuring credit losses on all exposures. The measurement of provisions must build on robust methodologies and result in the appropriate and timely recognition of expected credit losses in accordance with Sierra Leonean Accounting Standards, as established in the Banking Act of 2019.

(b) In accordance with the BSL IFRS Guidelines, a commercial bank or financial holding company shall have sound policies and processes in place to appropriately validate models used to assess and measure expected credit losses.

(c) In accordance with the BSL IFRS Guidelines, a commercial bank or financial holding company shall use experienced credit judgement, particularly in the robust consideration of reasonable and supportable forward-looking information, including macroeconomic factors, in its assessment and measurement of expected credit losses.

(d) In accordance with the BSL IFRS Guidelines, a commercial bank shall have an appropriate credit risk assessment and measurement process that provides it with a sound basis for common systems, tools, and data to assess credit risk and to account for expected credit losses.

12.0 Supervisory Limits

(a) Where BSL considers that a commercial bank or financial holding company is taking excessive credit risk relative to its financial or operational capacity to manage or absorb that risk, BSL may set limits on particular exposures or categories of exposures that may be held by that institution, including but not limited to limits on growth or limits on the share of the institution's portfolio, or may require the commercial bank or financial holding company to cease a particular type of lending or credit activity. (Bank of Sierra Leone Act 2019, Part VII, paragraph 44(1)).

(b) If BSL considers that there is an excessive level or growth in higher-risk lending or credit activity more broadly, BSL may set limits on particular types of lending to be complied with by all commercial banks or financial holding companies or a specified class of commercial banks or financial holding company.

13.0 Adequacy of Credit Risk Management and Provisions

Where BSL considers a Commercial bank's or financial holding company's policies, processes and practices across its credit risk activities do not meet the requirements of these Guidelines or otherwise considers its credit risk management deficient, BSL may require the institution to amend credit risk management policies, processes, and practices, or adopt appropriate credit risk management policies, processes and practices, or increase the levels of provisions or write-offs reported, or otherwise increase its capital adequacy.

14.0 Special Purpose Engagements

BSL may require a commercial bank or financial holding company to appoint an independent party to review and provide a report to BSL on all or a particular aspect of the institution's credit risk management, including provisioning practices. BSL may, however, request such a report without prior consultation with a commercial bank or financial holding company. BSL may set the terms of the review and at the institution's expense.

15.0 Effective Date

These Guidelines shall become effective on the date of their publication in the Gazette

Annex A. Collateral valuation

1. Collateral can include guarantees, insurance arrangements and, importantly, security held over various forms of assets. This Annex applies to all forms of collateral, including all types of assets taken as security. A commercial bank or financial holding company shall apply this Annex, having regard to the nature and type of security held.

2. A commercial bank or financial holding company shall have in place a written policy and procedures governing the valuation of property collateral. The policy and procedures should be fully aligned with the credit institution's RAF.

3. The policy and procedures shall cover the valuation of all immovable and movable collateral.

4. The policy and procedures shall be approved by the Bank's Board of Directors and shall be reviewed from time to time.

5. A commercial bank or financial holding company shall ensure that assets to be taken as security are accurately identified and documented in exposure documentation. A commercial bank or financial holding company shall ensure that the relevant legal requirements are met to maintain the institution's security position and to provide for its enforcement. This includes the institution confirming that:

   (a) the borrower has, or will have when the exposure is extended, clear title to the assets.

   (b) the characteristics of the collateral are as they have been represented; and

   (c) assets serving as collateral, where relevant, are appropriately insured at the time of origination and this insurance is maintained under the contractual terms of the exposure.

   (d) the collateral is perfected and also registered at the Collateral Registry(Bank of Sierra Leone).

6. Valuation of security must be undertaken on any exposure prior to drawdown and, where appropriate, on an on-going basis.

7. In the event that the fair value of security is based on observable market values, a commercial bank's or financial holding company's policies and processes must have regard to:

   (a) when observable market prices would be used;

   (b) the basis for selecting the market prices to be used;

   (c) the impact of market liquidity on the pricing of assets and the timing of their disposal; and

   (d) costs which would arise in accessing and disposing of assets held as collateral.

8. In determining the fair value of security, a commercial bank or financial holding company shall utilise the valuations of suitably qualified external valuers. Policies and processes covering the fair value of security must address the circumstances in which such valuations would be sought.

9. A commercial bank or financial holding company shall establish robust selection and review mechanisms on its external security valuator. Factors that shall be considered in the selection process include:

    a. professional qualifications required;

    b. relevant experience and breadth of expertise to cover both standard and specialized security assessment including knowledge of the local environment; and

    c. appropriate professional insurance cover.

10. Policies and processes shall also provide for the formulation of instructions for the conduct of valuations. Each valuation request shall be the subject of specific instructions to the appraiser or valuer. These instructions shall cover (as relevant in each instance) appropriate issues such as valuation purpose, valuation basis required, valuation for insurance purposes, valuation method, market summary/commentary and form of report required.

11. If a commercial bank or financial holding company uses valuations in determining the fair value of security, the institution shall require valuers and appraisers, in preparing their valuation reports, to adopt the valuation standards and practices of any relevant professional bodies.

12. A commercial bank or financial holding company shall have policies and processes directed at ensuring the reliability of the valuation processes and valuations received in respect of security held. This will involve independent and regular internal reviews of valuations results by appropriate audit personnel and, where appropriate, formal reviews by an independent valuer.

13. A commercial bank's or financial holding company's policies and processes shall provide for regular assessment of security values so as to ensure that the fair value of security underpinning provisioning and reserves, and any security coverage measures applied to exposures, is timely and reliably reflects values which a commercial bank or financial holding company might realise if needed. This is especially important where exposures are secured by assets that are susceptible to significant changes in value, or where the margin for diminution of value of security is small.

Valuation of immovable Assets

14. For the purposes of determining the fair value of security involving property, a commercial bank or financial holding company must assume:

    (a) a property presented as collateral shall be accessible at all times;

    (b) the period for marketing a property would be up to 12 months, although a longer period (up to a maximum of 24 months) may be adopted for specialized or unusual properties when professional valuers advise that this is appropriate; and

    (c) market conditions and asset values remain static over the marketing period. Marketing periods must be retrospective and assumed to have elapsed at the date of valuation, rather than incorporating any improved market conditions.

15. Assets shall be based on fair values. In determining fair values, a commercial bank or financial holding company shall use conservative estimates in imputing future income streams, such as lease payments which are not already contracted. A commercial bank or financial holding company shall ensure key assumptions used in the valuation approach are appropriate, reasonable and there is sufficient evidence to support the assumptions.

16. In determining fair values, any valuation based on the highest and best use rather than existing use must be adequately supported and documented. Where applicable, the valuation report must set out how the highest and best use was determined.

17. In some circumstances, it may be difficult to determine the fair value of the assets that have not yet achieved a stable income, or assets that are experiencing fluctuations in income. In such cases, a forecast of expected cash flows must be used to estimate the value of the asset. The discount rates used in calculating the value of security must reflect the opportunity cost, determined by way of comparison with prevailing returns on competing investments, of holding the property, assuming a long-term holding. Capitalisation rates must reflect expectations about the long-term rate of return investors require under normal, orderly, and sustainable market conditions.

Valuation of movable Assets

18. For movable assets, Commercial banks or financial holding companies shall, in accordance with the relevant regulation, periodically assess the liquidity of the assets. If there is material volatility in the market prices, the institution should demonstrate that the valuation of the collateral is sufficiently conservative.

19. For movable assets, Commercial banks or financial holding companies shall, in accordance with the relevant regulation, conduct a sufficient legal review confirming the enforceability of the collateral, including an assessment of the legal right to enforce and liquidate the collateral in the event of default, within a reasonable timeframe.

20. A commercial bank or financial holding company shall have databases of transactions to enable the proper assessment, monitoring and control of credit risk, to respond to requests from management and supervisors, and to enable the provision of information in periodic reports and other timely and comprehensive documentation. In particular, databases should comply with the following requirements:

(a) sufficient depth and breadth, in that they cover all the significant risk factors.

(b) accuracy, integrity, reliability, and timeliness of data.

(c) consistency - they should be based on common sources of information and uniform definitions of the concepts used for credit risk control.

(d) traceability, such that the source of information can be identified.

Valuation of Foreclosed Assets

21. Foreclosed assets received should be valued in accordance with the Revised Prudential Guidelines 2022 and in consideration of the IFRS accounting treatment as set out in IFRS 5.7 and 5.8.

22. When the estimated recoverable amount (fair value) is not obtained by reference to an active market but is based on a valuation technique, some adjustments are necessary, in particular as a result of two factors:

(a) The condition or location of the assets. Risk and uncertainty regarding the asset should be incorporated in the fair value estimation.

(b) A commercial bank or financial holding company shall incorporate into its calculation, the previous experience of the entity's realisation of the differences between amounts arrived at using the valuation technique and the final amounts obtained. The assumptions made in order to measure this adjustment may be documented and should be available to the supervisor on request.

23. When a commercial bank's or financial holding company's foreclosed assets are still under construction and a decision is reached to complete construction before selling the asset, they should demonstrate the merits of such a strategy and the cost shall not exceed the fair value less costs to complete. Otherwise, the foreclosed asset should be sold as is, where is taking into account an appropriate illiquidity discount.

24. When a foreclosed asset has exceeded the average holding period for similar assets for which active sales policies are in place, the commercial bank or financial holding company shall revise the illiquidity discount applied in the valuation process. In these circumstances, the institution should refrain from recognizing write-backs/reversals of existing accumulated impairment on the asset.

25. Valuation of foreclosed assets should be performed annually.