Revised Prudential Guidelines for Banks 2022

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I. PRELIMINARY

1 Authorization.

These Guidelines are issued pursuant to Section 53 of the Banking Act 2019, which empowers the Central Bank to make rules, regulations, and guidelines applicable to banks.

2 Application.

Banks licensed to conduct banking business in Sierra Leone under the Banking Act 2019 as well as financial holding companies and subsidiaries, branches and overseas operations of banks and financial holding companies.

3 Definitions.

Unless otherwise defined in this section, terms used in this guideline are to have the meaning as defined in the Banking Act 2019.

In this guideline, unless the context otherwise requires,

"**Capital Adequacy Ratio**" means the capital base divided by the total risk weighted assets multiplied by 100.

"Central Bank" or **"BSL"** means or refers to the Bank of Sierra Leone.

"Deposits": For purposes of this Guideline, deposits are as defined under Section 1 of the Banking Act

"Executive Officer" means a chief executive, managing director, deputy director, or other senior officer, regardless of title, who exercises executive authority over operations and policy of the institution or any of its principal divisions

"Forward transaction" or "forward purchase" or "forward buy" or "forward sale" means a transaction that is to be executed after more than two working days from the date the transaction is contracted or agreed.

"**Foreign currency"** means a currency other than legal tender of Sierra Leone.

"Foreign exchange business" means operating a foreign currency account, purchase or sale by means of cash, cheques, drafts, transfer or any other instrument denominated in foreign currency and the issuance of guarantees and counter guarantees.

"Loans" and "Loans and Advances" - may be used interchangeably to include any loan, discount, advance, overdraft, export bills purchased, other bills receivable or purchased, import bills, customer's liability on off-balance sheet items or any other credit facilities extended to the customer of an institution;

"Net Forward position" -The net forward position represents all amounts to be received less all amounts to be paid in the future in a particular currency as a result of foreign exchange transactions which have already taken place.

"Net owned funds" means the sum total of share capital that has been-

a) paid-up;

b) free reserves but excludes revaluation reserves; and

c) the statutory reserve fund subject to netting out accumulated losses, goodwill and unwritten-off capitalized expenditure including pre-operating expenses and deferred tax.

"Net open position" exists when the assets in a foreign currency do not equal the liabilities in that currency. The Net Open Position is the sum of

a) Net Spot Position

b) Net forward Position and

c) Net Option Position(if options are permitted)

"Net spot long position" in a foreign currency exists when the assets in a foreign currency exceed the liabilities in that currency;

"Net spot short position" exists when the liabilities in a foreign currency exceed the assets in that currency

“Off Balance Sheet Items” mean all items not shown on the balance sheet but which constitute assets and liabilities. Such risks include guarantees, acceptances, performance bonds, letters of credit, derivatives and any other items deemed to be off balance sheet items by Central Bank.

“Other Provisions” - means a balance sheet valuation account established through charges to “provision expense” in the income statement in order to reflect erosion in the value of any assets other than loans and advances being held by the institution.

“Past due” or “Overdue” - means any loan for which -

- Principal or interest is due and unpaid or
- Current accounts (overdrafts) and other credit extensions are considered “past due” when any of the conditions below exist:
    - Balance exceeds the customers approved limit, or drawing power
    - The customer’s borrowing line has expired.
    - The account has been inactive and in debit, or credits are inadequate to meet the outstanding interest for more than 30 days.

The balance outstanding (not just the amount of delinquent payments) is used in calculating the aggregate amount of “past due” loans.

“Provisions for loan losses” or “allowance for loan losses” - means a balance sheet valuation account established through charges to “provision expense” in the income statement, in order to reflect the erosion in the value of loans and advances.

“Ratio of Aggregate Exposures” means loans/advances/off-balance sheet exposure, net of provisions and margins, against the capital base.

“Renegotiated loan” may be used interchangeably with “restructured loan” to mean any loan that has been rescheduled or refinanced or rolled over in accordance with an agreement setting forth a new repayment plan on a periodic basis, or part of the principal/interest of which has been waived, or the terms of which have been altered to the benefit of the borrower, occasioned by weaknesses in the borrower’s financial condition and/or inability to service the loan as originally agreed;

“Same day transaction” or “same day purchase” or “same day buy” or “same day sale” means a transaction having same day value.

“Same day value” means the transaction to which it is referred is to be executed on the very day it is contracted or agreed.

“Spot transaction” or “spot purchase” or “spot buy” or “spot sale” means a transaction having a spot value.

“Spot value” means the transaction to which it is referred is to be executed two working days from the date it is contracted or agreed.

“Value date” of a transaction means the date on which it is to be executed.

II. CAPITAL

4 Purpose

These Guidelines are intended to ensure that each institution maintains a level of capital in accordance with Sections 27-30 of the Banking Act 2019. Such level of capital must be:-

1) adequate to protect its depositors and creditors,

2) commensurate with the risk associated with activities and profile of the institution, and;

3) promotes public confidence in the institution.

5 Minimum capital ratio.

Pursuant to section 27 (1) of the Banking Act 2019, unless a higher minimum ratio has been set by Central Bank pursuant to section 27(2) of the Banking Act 2019, every institution shall, at all times, maintain

1) Tier 1/Core capital of not less than seven and a half per cent (7.5%) of total risk weighted assets; and

2) A total capital of not less than fifteen per cent (15%) of its total risk weighted assets plus risk weighted off- balance sheet items.

3) The above ratios are subject to review and may be changed from time to time.

6 Components of (Tier 1/Core) Capital

The following items are to be included in core capital:

1) **Paid-up ordinary share capital/Assigned Capital.** This is the nominal value of the issued, fully paid, unimpaired, ordinary shares.

2) **Non-repayable share premium/(discount).** This is the difference between the nominal price and purchase price of shares, which is not refundable/ recoverable.

3) **Retained Earnings/Accumulated losses.** These are retained earnings or accumulated losses from the profits/losses of the prior years. They should however exclude reserves arising from revaluation of investment properties and cumulative unrealized gains and losses on financial instruments.

4) **Non-cumulative irredeemable preference shares.** These are shares, which have a standing claim on the company every year, but the claim is not carried forward in the event of not been paid and they are not redeemable.

5) **Statutory Reserves**. The reserve fund required by Section 30 of the Banking Act, 2019. Statutory reserve funds should be only adjusted when a transfer is made for the purposes of the statutory accounts.

Pursuant to Section 30 of the Banking Act 2019, banks are encouraged to hold at all times statutory reserve funds of not less than 50% of their paid-up capital. Consequently, no bank shall be allowed to appropriate any amount from its statutory reserve fund to any other source if such amount is less than 50 % of its paid up capital

6) **Other reserves.** These are other reserves which have not been included above. Such reserves should be permanent, unencumbered, un-callable and thus able to absorb losses. Further, the reserves should exclude cumulative unrealized gains and losses on available-for-sale instruments.

7 Deductions from core capital.

In calculating core capital, the following items are to be excluded:

1) **Investments in subsidiary institutions and equity instruments of other institutions**. To prevent multiple uses of the same capital resources in different institutions both in Sierra Leone and abroad, the institutions should deduct any investment in subsidiaries conducting banking business and equity instruments of other institutions.

2) **Goodwill**. This is the difference between the value of the business as a whole and the aggregate of the fair values of its separable net assets at the time of acquisition.

3) **Other intangible assets**. These are assets without physical existence, e.g. patents, copyrights, formulae, trademarks, franchise, etc. However, computer software should not be deducted.

4) **Current year to date unaudited losses.**

8 Supplementary capital (Tier 2)

Items to be included in supplementary capital include:

1) **Revaluation reserves** of fixed assets, land and buildings based on independent and professional appraisal as to the market value of such assets. Only 25% of revaluation reserves should be included after obtaining the approval of Central Bank.

2) **Current year's 50% unaudited after-tax profits**, after deducting adequate provisions for loans and advances, depreciation, amortization and other expenses. Any proposed or interim dividends must be taken into account. This should however exclude reserves arising from revaluation of investment properties and cumulative unrealized gains and losses on financial instruments.

3) **Cumulative irredeemable preference shares** with a standing claim on the institution that is carried forward if not paid in the current year.

4) **Convertible notes, debentures, bonds, loans and similar investments** that evidence the bank's promise to pay a sum on maturity, but which can be converted into shares any time before maturity at the option of the bank.

5) **Perpetual subordinated debt** in the form of loan capital which is not redeemable.

6) **Limited life redeemable preference shares** with limited life of at least five years.

7) **Subordinated term debt** including loan capital, bonds, commercial paper or debt equity with original maturity period of five years and above. The combined total amount of subordinated term debt and limited life redeemable preferred shares eligible for inclusion in Tier Two Capital shall be limited to a maximum of 50% of the amount of Tier One Capital. During the last five years to maturity, a cumulative discount (or amortization) factor of 20% per year will be applied to reflect the diminishing value of these instruments as a continuing source of strength.

8) **Excess Loan Loss Reserve** appropriated from retained earnings. This will only apply if provisions computed under Risk classification of Assets and Provisioning Guideline are in excess of impairment losses computed under International Financial Reporting Standards. However, loan loss reserve qualifying as supplementary capital should not exceed 1.25% of the total value of risk weighted assets.

9) **General Provision** restricted to a maximum of 1.25% of the risk weighted assets, allowable as part of Tier 2 Capital where the bank's specific provision for bad and doubtful debts has been made to the satisfaction of the Central Bank.

8.1 Limit on supplementary capital.

Where supplementary capital exceeds core capital, then qualifying supplementary capital is limited to the amount of core capital.

9 Risk weights for on balance sheet items.

In determining risk weights of assets for purposes of calculating capital requirements for credit risk, weights of on-balance-sheet assets shall be assigned as indicated in the following table according to their relative risk.

Risk weight	On-balance-sheet assets
0%	**Cash**
	Claims on central government and central banks denominated in national currency and funded in that currency
	Other claims on OECD central governments and central banks

	Claims collateralized by cash of OECD central-government securities or guaranteed by OECD central governments
20%	Claims on Multilateral Development Banks (MDBs) and claims guaranteed by or collateralized by securities issued by such banks
	Claims on banks incorporated in the OECD and claims guaranteed by OECD incorporated banks.
	Claims on securities firms incorporated in the OECD subject to comparable supervisory regulatory arrangements, including in particular risk-based capital requirements and claims guaranteed by these securities firms.
	Claims on banks incorporated in countries outside the OECD with residual maturity of up to one year, claims with a residual maturity of up to one year guaranteed by banks incorporated in countries outside the OECD.
	Claims on non-domestic OECD public-sector entities, excluding central government and claims guaranteed by or collateralized by securities issued by such entities.
	Cash items in process of collection.
50%	Loans fully secured by mortgage on commercial and residential property that is or will be occupied by the borrower or that is rented.
100%	Claims on the private sector
	Claims on banks incorporated outside the OECD with a residual maturity of over one-year.
	Claims on central governments outside the OECD (unless denominated and funded in national currency)
	Claims on commercial companies owned by the public sector.

	Premises, plants and equipment and other fixed assets.
	Real estate and other investments (including non-consolidated investment participations in other companies).
	Loans less cash collateral less 50% legal mortgage.
	All other assets

10 Risk weights for off balance sheet items

In calculating risk weights of assets for purposes of capital adequacy, different types of off-balance-sheet items must be converted to a "credit equivalent" according to the values indicated in the following table. The credit equivalent is then assigned to one of the four risk weight categories as for on-balance sheet assets.

Credit Conversion Factor	**Instruments**
100%	Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).
50%	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).
20%	Short-term self-liquidating contingent items (such as documentary credits collateralized by the under-lying shipments related to particular transactions).
100%	Sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the bank.

100%	Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain draw down.
50%	Note issuance facilities and revolving underwriting facilities
50%	Other commitments (e.g. formal standby facilities and credit lines) with an original maturity of over one year.
0%	Similar commitments with an original maturity of up to one year, or which can be unconditionally cancelled at any time.

11 Derivatives.

Forwards, swaps, purchased options and similar derivative contracts are treated differently from the off-balance sheet accounts included in the previous section, because banks are not exposed to credit risk for the full face value of these contracts, but only for the potential cost of replacing the cash flow if the counterparty defaults.

In calculating the credit equivalent of forwards, swaps, purchased options and similar derivative contracts, one of the following two sets of conversion factors are to be applied to the notional principal amounts of each instrument according to the nature of the instrument and its maturity. Then, assign a credit equivalent from one of the five risk weight categories as for on-balance sheet assets.

Instruments traded on exchanges may be excluded where they are subject to daily receipt and payment of cash variation margin.

Residual maturity	Interest rate contracts	Exchange rate contracts and gold
One year or less	0.5%	2.0%
Over one year to two years	1.0%	5.0%
For each additional year	1.0%	3.0%

12. Minimum paid up capital requirement

Banks' compliance with minimum paid up capital levels will be monitored on a continuous basis by the Central Bank. The minimum paid up capital shall be determined by the Central Bank from time to time and will apply to all institutions.

Banks are expected to maintain a higher level of capital commensurate with their risk profile.

13. Responsibility to maintain adequate capital.

The Board of Directors of each institution shall be responsible for establishing and maintaining, at all times, an adequate level of capital. The capital standards herein are the minimum acceptable for institutions that are fundamentally sound, well managed, and which have no material financial or operational weaknesses. Higher capital adequacy ratios may be required for individual or all institutions based on circumstances under section 27(2) of the Banking Act 2019.

14. Capital Adequacy

When the Central Bank determines that an institution has insufficient capital to shield against the risks arising from its group relationships, pursuant to Section 27 of the Banking Act, the Central Bank shall require higher minimum capital adequacy ratios for the institution.

Members of the banking group are required to maintain the capital adequacy ratios prescribed by their respective regulators and ensure that minimum capital requirements are complied with on a solo and consolidated basis. In case of any shortfall in the capital adequacy ratio of any of the subsidiaries, the parent should maintain capital in addition to its own regulatory requirements, to cover the shortfall.

15. Report on capital adequacy.

Banks shall submit to the Central Bank not later than 10 (ten) days after the end of every month a return on Capital Adequacy in the form and format required by the vRegCoSS system or any successor system for submitting returns to the Central Bank. The Central Bank may require such other information as is necessary to evaluate compliance with this guideline and may call for adjustments to capital where necessary.

16. Capital raised externally.

Capital raised externally shall be remitted to Sierra Leone in a freely convertible currency through the Central Bank. Capital raised externally shall be channeled through the NOSTRO Accounts of the Central Bank.

Types of capital to be remitted through BSL

a) Injection of additional capital which will immediately be transferred by BSL to banks after amount is received

b) New Bank's Capital

This will be monitored by the BSL as not all capital should be used to acquire fixed assets as the residue will have to be used as working capital once the licence is issued. This can be given to banks on request.

17. Higher Minimum Capital Adequacy Ratio.

In addition to the criteria set out in section 65 of the Banking Act 2019 the Central Bank may require higher minimum capital adequacy ratios for an individual institution based on, but not limited to, any one or more of the following criteria:

1) The institution has incurred or is expected to incur losses resulting in a capital deficiency;

2) The institution has significant exposure to risk, whether credit, concentration of credit, market, interest rate, liquidity, operational, or from other sources including non-traditional activities;

3) The institution has a high or particularly severe volume of poor quality assets;

4) The institution is growing rapidly either internally or through acquisitions;

5) The institution has deficiencies in ownership or management (i.e. shareholding structure; composition or qualifications of directors or senior officers; risk management policies and procedures).

6). Market Risk

The bank's investments in all securities, including government securities, shall be assigned a risk weight of 2.5 percent for market risk. This will be in addition to the risk weights assigned towards credit risk since some capital cushion should also be provided for market risk in addition to credit risk.

A risk weight of 100 per cent shall be assigned on the open position limits for each foreign currency and on open position in gold and precious stones.

7). Operational Risk

Basic Indicator Approach

The capital requirement under the Basic Indicator Approach, K_{BIA}, may be expressed as follows, where GI is summation of annual gross income, where positive, over the previous three years; n is the number of the previous three years for which gross income is positive; and α is 15%.

$$K_{BIA} = [\alpha \times \sum GI_{1\ldots n}] / n,$$

Gross income is defined as net interest income plus net non-interest income. This measure should:

(1) be gross of any provisions (e.g. for unpaid interest);

(2) be gross of operating expenses, including fees paid to outsourcing service providers;

(3) exclude realised profits / losses from the sale of securities; and

(4) exclude extraordinary or irregular items as well as income derived from insurance.

The equivalent risk-weighted assets for operational risk under the Basic Indicator Approach are determined by multiplying the capital requirements calculated as above by 6.67 (reciprocal of 15%, which is the prescribed minimum capital adequacy ratio).

8). Leverage Ratio and minimum requirement

The leverage ratio is calibrated to act as a credible supplementary measure to the risk-based capital requirements and is intended to achieve the following objectives:

(a) constrain the build-up of leverage in the banking sector to avoid destabilising deleveraging processes which can damage the broader financial system and the economy; and

(b) reinforce the risk-based requirements with a simple, non-risk based “backstop” measure.

8.1 Definition and minimum requirement:-

The leverage ratio is defined as the capital measure (Tier 1 capital) divided by the exposure measure (the denominator), with this ratio expressed as a percentage.

Leverage Ratio = 100 **x** *Tier 1 Capital ÷ Exposure Measure*

The exposure measure for the leverage ratio should generally follow the accounting measure of exposure. To be measured consistently with financial accounts, the exposure measure should include:

(i) All on-balance sheet items

- on-balance sheet, non-derivative exposures are *net of* specific provisions and valuation adjustments (e.g. credit valuation adjustments);
- physical or financial collateral, guarantees or credit risk mitigation purchased are *not allowed to reduce* on-balance sheet exposures; and
- netting of loans and deposits is *not allowed*.

(ii) All off-balance sheet items

- Multiply the off-balance sheet item by the prescribed Credit Conversion Factor to obtain the Credit equivalent

(iii) Derivative exposures

- Determine the Credit Equivalent by applying the prescribed conversion factors to the notional principal amounts of each instrument according to the nature of the instrument and its maturity.

(iv) Securities Financing Transactions

- transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions;
- On balance sheet amounts with no recognition of accounting netting of (cash) payables against (cash) receivables.

All banks are required to maintain a minimum leverage ratio of 4.5% at all times

18. Ratio of aggregate exposure to capital base.

The total of a bank's exposures less provisions, interest in suspense and cash collateral shall not exceed 300% of its capital base.

19. Remedial measures.

If a bank fails to comply with the provisions of Sections 27 and 28 of the Banking Act 2019 the Central Bank may levy administrative sanctions as contemplated in the Schedule of Penalties or in accordance with Section 66 and 67 of the Banking Act 2019.

III. ASSET CLASSIFICATION, INCOME RECOGNITION AND LOSS PROVISIONING

20. Purpose

These guidelines are intended to ensure that all assets are regularly evaluated using an objective internal grading system which is consistent with this guideline; and that timely and appropriate provisions are made to the provisions account in order to accurately reflect the true condition and operating results of the institutions. It is also intended to encourage institutions to develop effective work plan for problematic assets in accordance with this guideline. These guidelines are to be complied with in parallel to the IFRS accounting framework.

21. Protection of Credit Assets.

To help assure the quality of loans, banks are required to

1) Obtain and use credit reports from the Credit Reference Bureau (CRB) in making credit decisions.
2) Banks should not use expired credit report to make credit decisions.
3) Customers with credit facilities that are classified as non-performing in the credit report, should be referred to regularise those facilities, in conformity with these guidelines, before approving any new credit for them.
4) Customers whose credit facilities have been written off, should be denied credit as stated in the current Credit Write-off Policy.
5) Update the CRB on the status of credit customers every 10^{th} day of the month.
6) Banks are directed to register security interests in movable and immovable assets with the Sierra Leone Collateral Registry (Central Bank) as soon as they are created.

7) Banks are mandated to conduct search (es) at the Sierra Leone Collateral Registry (Central Bank) to ascertain the encumbrance status of collateral prior to granting a credit facility and as well as registering the collateral(s).

8) Banks are required to submit regular monthly returns on all secured transactions to the Sierra Leone Collateral Registry (Central Bank) by the 10th of the following month.

22. Credit Portfolio Reviews

Banks must review their credit portfolio at least monthly with a view to recognizing any deterioration in credit quality.

23. Adverse Classification

Consistent with the principles of IFRS 9, assessment of asset quality must be forward looking, taking into account not only current arrears, but the prospect of default at a future time. Where there is doubt or uncertainty regarding the appropriate classification of a loan, the more severe classification should be applied. Banks must use IFRS 9 principles in completing financial statements, but the Central Bank may rely on classification according to these guidelines for comparison and regulatory assessment.

1). Asset Classification Criteria

All loans must be classified into one of the following four categories using the criteria provided.

a. Current Credit Facilities

Well-documented facilities granted to financially sound customers where no weaknesses exist. All such loans are performing in accordance with their contractual terms and are assessed as fully protected by the current sound net worth and paying capacity of the borrower.

b. Watch Credit Facilities

Credit facilities or loans identified for more intense monitoring. The credit facilities are past due for less than 90 days or funding account(s) exhibit signs of insufficient/infrequent cash flow.

2). Substandard Credit Facilities

a. Credit facilities which are past due for 90 days or more but less than 180 days.

b. Credit facilities which display well defined weaknesses which could affect the ability of borrowers to repay such as inadequate cash flow to service debt, under-capitalization or insufficient working capital, absence of adequate financial information or collateral documentation, irregular payment of principal and/or interest, and inactive accounts where withdrawals exceed repayments or where repayments hardly cover interest charges.

3). Doubtful Credit Facilities

a. Credit facilities which are past due for at least 180 days but less than 360 days.

b. Credit facilities which, in addition to the weaknesses associated with sub-standard credit facilities, reflect that full repayment of the debt is not certain or that realizable collateral values will be insufficient to cover bank’s exposure.

4). Criteria of Loss Credit Facilities

a. Credit facilities which are past due for 360 days or more.

b. Credit facilities which, in addition to the weaknesses associated with doubtful credit facilities, are considered uncollectible and are of such little value that their continuation as a bankable asset is unrealistic, such as facilities that have been abandoned, facilities secured with unmarketable and unrealizable securities and facilities extended to judgment debtors with no means or foreclosable collateral to settle debts.

24. Classification of Renegotiated or Restructured Loans

1) A renegotiated loan in the substandard category may only be reclassified as current when all past due principal and interest is repaid in full at the time of renegotiation or there is a sustained record of performance under a realistic repayment program for a continuous period of at least three months from the date of first payment of principal/interest under the renegotiated terms or its upgrade from ‘doubtful’ category, whichever is later.

2) A renegotiated loan in the doubtful category may be reclassified as substandard only when all past due interest and principal is repaid in full at the time of renegotiation or all principal and interest payments

are made for a continuous period of six (6) months from the due date of first payment of principal/interest according to the modified repayment schedule.

3) A renegotiated loan in the loss category may be reclassified as current if all principal and interest payments are made according to the modified repayment schedule for a continuous period of 12 months from the aforesaid due date.

4) A loan in the current category which is renegotiated must be re-classified as substandard.

5) A renegotiated loan which becomes past due under the modified repayment schedule will be classified as per its past due status.

25. Reclassification of loans which are not renegotiated

Such loans once subject to adverse classification shall not be reclassified to a higher classification unless the requirements of this section are met.

1). A facility in the Substandard category should continue to be classified as Substandard unless all past due principal and interest is repaid in full, sustained record of performance under a realistic repayment program for a continuous period of at least three months from the date of first payment of principal/interest under the renegotiated terms.

2). A facility in the Doubtful category will normally continue to be classified Doubtful unless all past due Principal and interest is repaid in full and a sustained repayment is maintained for period of **three months** in which case it may upgraded to 'Substandard' classification. A loan facility which meets condition (1) above may be reclassified as 'Current' if a sustained record of satisfactory performance is maintained for a period of **six (6)** months.

3). Loss- A facility in the Loss category will normally continue to be classified Loss unless all past due interest and principal is repaid in full and a sustained repayment is maintained for period of **three months** in which case it may upgraded to '**Doubtful**' classification and sustained repayments for six months in which case it may be upgraded to "**Substandard**". A loan facility which meets condition (1) above may be reclassified as 'Current' if a sustained record of satisfactory performance is maintained for a period of **twelve (12)** months.

26. Reclassification by the Central Bank

Banks are required to classify their credit portfolios in order to reflect the true accounting values of their credit facilities. The Central Bank reserves the right to object to the classification of any credit facility and to prescribe the classification it considers appropriate for such credit facility. No account for which classification has been prescribed by the Central Bank may be upgraded by the institution without the approval of the Central Bank.

27. Non-Performing Loans

For purposes of this guideline, loans are "non-performing" when they are classified as Substandard or Doubtful or Loss.

28. Calculation of Total Non-Performing Loans

For purposes of calculating the aggregate value of non-performing loans in the loan portfolio, the entire balance outstanding of each loan, and not just the amount of delinquent payments, is to be included.

29. Non-Performing Loans Ratio

The maximum acceptable ratio of non-performing loans to gross loans (NPL ratio) is 10%.

1) Where the ratio of non-performing loans is greater than 10% but less than 20% the bank must provide an action plan to address the problem within 6 months. A special or targeted examination by the Central Bank may be conducted to determine the factors responsible for the non-performing credits.

2) Where the ratio of non-performing loans is 20% or more, the Central Bank may, in addition to the actions described in subsection 1 above, direct that

    a. The bank should recall any and all loans for which proper lending procedures were not followed;

    b. Loans to subsidiary/ related companies should be recalled;

    c. Further loans to any unhealthy subsidiary be stopped.

30. Restriction on Loan Modifications

A bank shall not -

1) Re-negotiate, roll-over or modify the terms of a credit in order to avoid an adverse classification; or

2) Advance additional funds to enable an obligor to meet current payment obligations to the bank.

3) A loan modification resulting in reduction or removal of adverse classification is presumed to be made in order to avoid the adverse classification unless the borrower has demonstrated the ability to make payments when due for a period of not less than 6 months.

31. Non-Accrual

All adversely classified assets, including assets with payments which are contractually ninety days or more past due shall be promptly placed on non-accrual status and-

1) The bank shall cease recognising the accrual of interest;
2) Uncollected interest which has previously been accrued shall be derecognised; and
3) Interest accrued shall no longer be recognised as income except when realised in cash.

32. Restoration from Non-Accrual

An asset which has been placed on non-accrual status shall be restored to accrual status only when the contractual amount of principal and interest is deemed to be fully collectible in accordance with the terms of the contract; and

1) The bank has received repayment of the past-due principal and interest, none of the principal is due and unpaid and the bank expects re-payment of the remaining contractual principal and interest as scheduled in the contract;

2) The obligor has resumed paying the full amount of the scheduled contractual principal and interest for at least six months, and all remaining contractual payments (including compensation for past-due payments) are deemed to be collectable in timely manner.

33. Acquisition of Assets

1) If a bank acquires an asset in lieu of repayment of a credit, the book value of the asset shall be the lower of the net unpaid principal balance of the credit or the estimated recoverable amount of the asset acquired.

2) If the estimated recoverable amount of the asset acquired is less than the book value of the credit the deficient amount shall be charged off through the provision for bad and doubtful debts when the asset is added to the books.

34. Loan Loss Provision for non-performing credit facilities

1) Principal repayments and applied interest that are overdue by more than 90 days should be fully provided for and recognized on cash basis only.

2) For principal repayments not yet due on non-performing credit facilities, provision should be made after netting cash or near cash realizable securities as follows: -

   a. Sub-Standard Credit Facilities: 20% of the gross loans;

   b. Doubtful Credit Facilities: 50% of the gross loans;

   c. Loss Credit Facilities: 100% of the gross loans.

35. Loss Recognition

At the time of credit classification, impairment to the value of a credit shall be recognized by reducing the book value of the credit through the provision for non-performing loan and by charging the income statement in the period in which the impairment occurs. The aggregate amount of the provision for non-performing loan must be adequate to absorb estimated losses associated with the entire credit portfolio.

36. Treatment of Security Interests

While banks can accept collateral as security for credit, due to difficulties with foreclosure and collection, at the present time the only security which should be taken into account when calculating provision for bad debts should be cash, government securities, and other readily realizable securities.

37. International Financial Reporting Standard 9 (IFRS9)

1). Regulatory Guidance on Implementation of IFRS accounting along with prudential norms on income recognition, asset classification and provisioning

(a) **Banks shall hold loan loss provisions and recognise income in their books as required under the IFRS accounting framework. In parallel and separate from the accounting framework, banks shall also maintain the asset classification, compute provisions and recognise income on assets under these prudential guidelines.** A comparison (as per the template in Appendix 2) between provisions required under these guidelines and ECL provisions made under IFRS should be disclosed by banks in the notes to their financial statements to provide a benchmark to their Boards, BSL supervisors and other stakeholders, on the adequacy of provisioning for credit losses.

(b) **Where ECL provisions under IFRS are lower than the regulatory provisioning required under these guidelines, banks shall appropriate the difference from their net profit or loss after tax to a separate non-distributable reserve (a 'Credit Risk Reserve')**. The balance in the 'Credit Risk Reserve' shall not be reckoned for regulatory capital or capital adequacy. Further, no withdrawals shall be permitted from this reserve without prior permission from the BSL.

2). Computation of Regulatory Capital and Regulatory Ratios

In determining 'owned funds', 'net owned funds' and 'regulatory capital', Banks shall be guided by the following :

a) Any net unrealised gains arising on fair valuation of financial instruments, including such gains arising on transition to IFRS, should not be included in 'owned funds' whereas all such net losses should be considered.

b). The unrealised gain / loss on a derivative transaction undertaken for hedging may be offset against the unrealised loss / gain recognized in the capital (either through Profit or Loss or through Other Comprehensive Income) on the corresponding underlying hedged instrument. If after such offset and netting with unrealised gains / losses on other financial instruments, there are still net unrealised gains, the same should be excluded from owned funds or regulatory capital.

c) 12 month expected credit loss (ECL) allowances for financial instruments i.e. where the credit risk has not increased significantly since initial recognition, shall be included under general provisions and loss reserves in Tier II capital within the limits specified by extant regulations. Lifetime ECL shall not be reckoned for regulatory capital (numerator) while it shall be reduced from the risk weighted assets.

IV. ASSET-LIABILITY MANAGEMENT FOR LIQUIDITY AND INTEREST RATE RISKS

Liquidity: Is the ability of an institution to fund increase in assets and meet obligations as they fall due without incurring unacceptable losses.

Interest Rate Risk: Is the risk where changes in market interest rates might adversely affect a bank's financial condition.

Contingency Funding Plan (CFP) is the compilation of policies, procedures and action plans for responding to severe disruptions to a bank's ability to fund some or all of its activities in a timely manner and at a reasonable cost.

Other terms used in this Guideline are as defined in the Banking Act.

Responsibility - The Board of Directors of each institution shall be responsible for the effective management of its liquidity including the maintenance of minimum statutory requirements. The Board shall decide the strategy, policies and procedures of the Institutions to manage liquidity risk in accordance with the liquidity risk tolerance/limits decided by it.

38. Key elements of the liquidity risk management guidelines are as under:

1). Governance of Liquidity Risk Management

Successful implementation of any risk management process has to emanate from the top management in the Bank with the demonstration of its strong commitment to integrate basic operations and strategic decision-making with risk management. The Chief Risk Officer, appointed by the Board, shall be involved in the process of identification, measurement, and mitigation of liquidity risks. Each institution shall identify its unique liquidity requirements over specific time periods and plan for appropriate funding.

2). Liquidity Risk Management Policy, Strategies and Practices

Assurance of effective liquidity management is the responsibility of the Board of Directors. To ensure a sound and robust liquidity risk management system, the Board of the Bank shall frame a liquidity risk management framework which ensures that it maintains sufficient liquidity, including a cushion of unencumbered, high quality liquid assets to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources. It shall spell out the entity-level liquidity risk tolerance; funding strategies; prudential limits; system for measuring, assessing and reporting/ reviewing liquidity; framework for stress testing; liquidity planning under alternative scenarios/formal contingent funding plan; nature and frequency of management reporting; periodical review of assumptions used in liquidity projection; etc.

In particular, the Board of the bank shall lay down policies and procedures for

a. Managing potential mismatches between liquidity requirements and asset maturities;

b. Maintaining appropriate information systems for measuring, monitoring, controlling and reporting liquidity requirements.

c. Articulating and documenting assumptions underlying cash flow projections, including funding requirements of off-balance-sheet items.

d. Management of illiquidity events, including procedures for making up liquidity shortfalls in emergency situations.

e. Provision for regular independent review of the liquidity management system

3). Risk Management Committee

The Risk Management Committee, which reports to the Board and consisting of Chief Executive Officer (CEO)/ Managing Director, Chief Risk Officer and heads of various risk verticals shall be responsible for evaluating the overall risks faced by the Institutions including liquidity risk.

4). Asset-Liability Management Committee (ALCO)

The Asset - Liability Committee (ALCO) consisting of the bank's senior management including CEO should be responsible for ensuring adherence to the limits set by the Board as well as for deciding the business strategy of the bank (on the assets and liabilities sides) in line with the bank's budget and decided risk management objectives. The Chiefs of Investment, Credit, Resource Management or Planning, Funds Management/ Treasury (forex and domestic), Economic Research may be members of the Committee. The role of the ALCO with respect to liquidity risk should include, inter alia, decision on desired maturity profile and mix of incremental assets and liabilities, sale of assets as a source of funding, the structure, responsibilities and controls for managing liquidity risk, and overseeing the liquidity positions of all branches.

The ALCO must report directly to the Board or in the case of a foreign incorporated bank, to senior management of the institution in the country;

The ALCO must facilitate, coordinate, communicate and control balance sheet planning with regards to risks inherent in managing liquidity and convergences in interest rates; and

The ALCO is responsible for ensuring that a bank's operations lies within the parameters set by its Board of Directors. However, the ALCO is not responsible for formulating the in-house liquidity risk management policy.

In determining the composition, size and various roles of the ALCO, the Board is required to consider the size of the institution, the risks inherent in the institution's operations and the organizational complexity.

5). Asset Liability Management (ALM) Support Group

The ALM Support Group consisting of the operating staff shall be responsible for analyzing, monitoring and reporting the liquidity risk profile to the ALCO. Such support groups will be constituted depending on the size and complexity of liquidity risk management in the Institutions.

In order to capture the maturity structure of the cash inflows and outflows, the Statement of Maturity Structure of Assets and Liabilities should be prepared, separately for local and for foreign assets and liabilities, as on the last day of each month and put up to ALCO/top management within the succeeding month.

The Statements of Maturity Structure may be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while a maturing asset will be a cash inflow. In each maturity bucket, the 'mismatch' is defined as the inflows minus the outflows, in that time bucket.

Tolerance levels for negative mismatches (where outflows exceed inflows) in various maturities may be fixed by the bank's top management depending on the bank's asset - liability profile, extent of stable deposit base, the nature of cash flows, etc.

While determining the likely cash inflows / outflows, banks have to make a number of assumptions according to their asset - liability profiles. For instance, banks with large branch network can (based on the stability of their deposit base as most deposits are rolled over) afford to have larger tolerance levels in mismatches in the long-term if their term deposit base is quite high.

In respect of mismatches in cash flows for the 1-30 days bucket, it should be the endeavour of the bank's management to keep the negative mismatch at the minimum levels, not exceeding 20% of the cash outflows in this time bucket.

6). Liquidity risk monitoring tools

Institutions shall adopt liquidity risk monitoring tools/metrics in order to capture strains in liquidity position, if any. Such monitoring tools shall cover a) concentration of funding by counterparty/ instrument/ currency, b) availability of unencumbered near cash assets that can be used as collateral for raising funds; and, c) certain early warning market-based indicators, such as, book-to-equity ratio, coupon on debts raised, breaches and regulatory penalties for breaches in regulatory liquidity requirements. The Board of Institutions shall put in place necessary internal monitoring mechanism in this regard.

7). Adoption of "stock" approach to liquidity

In addition to the measurement of structural and dynamic liquidity, Institutions are also mandated to monitor liquidity risk based on a "stock" approach to liquidity. The monitoring shall be by way of predefined internal limits as decided by the Board for various critical ratios pertaining to liquidity risk. Indicative liquidity ratios are Cash and balances with BSL to total local deposits, total liquid assets to total local deposits, short-term liability to total assets; short-term liability to long-term assets; commercial papers to total assets; non-convertible debentures (original maturity less than one year) to total assets; short-term liabilities to total liabilities; long-term assets to total assets; etc.

8). Extension of liquidity risk management principles

In addition to the liquidity risk management principles underlining extant prescriptions on key elements of ALM guidelines, it has been decided to extend relevant principles to cover other aspects of monitoring and measurement of liquidity risk, viz., off-balance sheet and contingent liabilities, stress testing, intra-group fund transfers, diversification of funding, collateral position management, and contingency funding plan.

9). Liquidity risk Tolerance

An Bank shall have a sound process for identifying, measuring, monitoring and controlling liquidity risk. It should clearly articulate a liquidity risk tolerance that is appropriate for its business strategy and its role in the financial system. Senior management should develop the strategy to manage liquidity risk in accordance with such risk tolerance and ensure that the Bank maintains sufficient liquidity.

10). Liquidity Costs, Benefits and Risks in the Internal Pricing

Institutions should endeavour to develop a process to quantify liquidity costs and benefits so that the same may be incorporated in the internal product pricing, performance measurement and new product approval process for all material business lines, products and activities.

11). Off-balance Sheet Exposures and Contingent Liabilities

The process of identifying, measuring, monitoring and controlling liquidity risk should include a robust framework for comprehensively projecting cash flows arising from assets, liabilities and off-balance sheet items over an appropriate set of time horizons. The management of liquidity risks relating to certain off-balance sheet exposures on account of special purpose vehicles, financial derivatives, and, guarantees and commitments may be given particular importance due to the difficulties that many Institutions have in assessing the related liquidity risks that could materialize in times of stress.

12). Funding Strategy - Diversified Funding

An Institutions shall establish a funding strategy that provides effective diversification in the sources and tenor of funding. It should maintain an ongoing presence in its chosen funding markets and strong relationships with fund providers to promote effective diversification of funding sources. An Institutions should regularly gauge its capacity to raise funds quickly from each source. There should not be over-reliance on a single source of funding. Funding strategy should also take into account the qualitative dimension of the concentrated behavior of deposit withdrawal in typical market conditions and over-reliance on other funding sources arising out of unique business model.

13). Public disclosure

An Institution shall publicly disclose information on a quarterly basis on the official website of the company and in the annual financial statement as notes to account that enables market participants to make an informed judgment about the soundness of its liquidity risk management framework and liquidity position.

14). Management Information System (MIS)

An Institution shall have a reliable MIS designed to provide timely and forward-looking information on the liquidity position of the Institution and the Group to the Board and ALCO, both under normal and stress situations. It should capture all sources of liquidity risk, including contingent risks and those arising from new activities, and have the ability to furnish more granular and time-sensitive information during stress events.

15). Currency Risk

Exchange rate volatility imparts a new dimension to the risk profile of an Institution's balance sheets having foreign assets or liabilities. The Board of Institution should recognize the liquidity risk arising out of such exposures and develop suitable preparedness for managing the risk.

39. Measuring and Monitoring Net Funding Requirements:

An institution should have a process of assessing cash inflows against its outflows to identify the potential for any shortfall. This should incorporate funding requirements for off-balance sheet items. Assumptions made in making cash flow projections should be clear and documented. They should be subject to frequent reviews to determine the validity of underlying factors. Less frequent, but more in-depth reviews should be carried out to re-examine and refine institution's liquidity policies and practices in the light of its experience and developments in its business and economic environments.

40. Contingency Planning

Contingency plans to handle liquidity crises should be put in place. The strategy should include procedures for making up liquidity shortfalls in emergency situations. Each institution should develop a back-up liquidity strategy for circumstances in which its normal approach to funding operations is disrupted.

The plan should be commensurate with a bank's complexity, risk profile, scope of operations and role in the financial systems in which the bank operates. It should articulate available potential contingency funding sources and the amount of funds an institution estimates can be derived from these sources; clear escalation/prioritization procedures detailing when and how each of the actions can and should be activated; and the lead time needed to tap additional funds from each of the contingency sources.

CFPs should be reviewed and tested regularly to ensure their effectiveness and operational feasibility and should be consistent with institution's business continuity plans.

41. Liquidity Stress Tests

An institution should conduct stress tests on a regular basis for a variety of short-term and protracted institution-specific and market-wide stress scenarios (individually and in combination) to identify sources of potential liquidity strain and to ensure that current exposures remain in accordance with a bank's established liquidity requirement. An institution should use stress test outcomes to adjust its liquidity management strategies, policies, and positions and to develop effective contingency plans.

42. Foreign Currency Liquidity Management

Each institution should have a measurement, monitoring and control system for its liquidity positions in major currencies traded; both in terms of aggregate foreign currency needs and for each currency individually.

43. Internal Controls for Liquidity Management

An institution should have an adequate system of internal controls over its liquidity management process. There should be regular, independent reviews and evaluations of the effectiveness of the system.

The internal control system for liquidity should be integrated with the overall system of internal control and it should promote effective and efficient operations, reliable financial and regulatory reporting, and compliance with applicable laws, regulatory requirements and institution's own policies.

44. Minimum Required Liquidity Reserve Ratio.

Institutions shall at all times maintain a minimum amount of liquid assets equal to the aggregate of 40% of demand deposits and 20% of time and savings deposits. For purposes of this calculation the following liquid assets are admissible for computation of the liquidity requirement:

1) Cash;
2) Balance held with the Central Bank;
3) Government Securities with a maturity period of 365 days or less;
4) Inland bills of exchange and promissory notes which are eligible for rediscount at the Central Bank, subject to such limitations in amount as the Central Bank may determine;
5) Any other asset as may be prescribed by the Central Bank from time to time.

45. Loans to Deposits Ratio.

All Institutions shall maintain a loan to deposit ratio of not more than 80%.

46. Local Assets Ratio.

The ratio of local assets to total local liabilities shall not be less than 75%.

47. Local Liquid Assets Ratio.

The ratio of local liquid assets to total liquid assets shall not be less than 60%. For the purpose of this ratio, the composition of liquid assets shall be as follows:

1) Cash – Foreign and local
2) Balances with the Central Bank
3) Claims on other Institutions
4) NOSTRO balances
5) Placement in foreign Institutions
6) Government securities with 365 days to maturity or less.

48. Minimum Cash Reserve Ratio

Institutions shall maintain at all times cash reserve of not less than twelve percent (12%) of total (local) deposits. Cash reserve shall be cash (local) in till, vaults, and current account with the Central Bank.

49. Illiquidity.

A bank may be considered illiquid if:

a. The bank suffers clearing operation deficits for 5 consecutive days i.e. there was adverse clearing settlement position without adequate cover to the extent that recourse had to be made to the clearing collateral;

b. The bank is unable to pay maturing obligations.

1). Response to Illiquidity

Where a bank is deemed illiquid, the Central Bank shall direct the bank to comply with the provisions of Section 32(6)-(10) of the Baking Act 2019.

50. Managing Interest Rate Risk

The changes in interest rates affect institutions significantly. The immediate impact of changes in interest rates is on bank's earnings by changing its Net Interest Income (NII). A long-term impact of changing interest rates is on the bank's Market Value of Equity (MVE) or Net Worth as the economic value of bank's assets, liabilities and off-balance sheet positions get affected due to variation in market interest rates. The interest rate risk when viewed from these two perspectives is known as 'earnings perspective' and 'economic value' perspective, respectively. The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM).

There are many analytical techniques for measurement and management of Interest Rate Risk. To begin with, the traditional Gap analysis is considered as a suitable method to measure the Interest Rate Risk. Other more modern techniques for Interest Rate Risk measurement such as Duration Gap Analysis, Simulation and Value at Risk at the appropriate time when institutions acquire sufficient expertise and sophistication in acquiring and handling the necessary MIS.

The Gap or Mismatch risk can be measured by calculating Gaps over different time intervals as at a given date. Gap analysis measures mismatches between rate sensitive liabilities and rate sensitive assets (including off-balance sheet positions). An asset or liability is normally classified as rate sensitive if:

i) within the time interval under consideration, there is a cash flow;

ii) the interest rate resets/reprices contractually during the interval;

iii) BSL changes the interest rates in cases where interest rates are administered; and

iv) it is contractually pre-payable or withdrawable before the stated maturities.

The Gap Report should be generated by grouping rate sensitive liabilities, assets and off-balance sheet positions into time buckets according to residual maturity or next repricing period, whichever is earlier. All investments, advances, deposits, borrowings, purchased funds, etc. that mature/reprice within a specified timeframe are interest rate sensitive. Similarly, any principal repayment of loan is also rate sensitive if the bank expects to receive it within the time horizon. This includes final principal payment and interim instalments. Certain assets and liabilities receive/pay rates that vary with a reference rate. These assets and liabilities are repriced at pre-determined intervals

and are rate sensitive at the time of repricing. While the interest rates on term deposits are fixed during their currency, the advances portfolio of the banking system may include fixed rate or floating rate loans. The interest rates on advances could be repriced on any number of occasions, corresponding to the terms of the advances.

The Gaps may be identified in the following time buckets:

i) 1-30 days

ii) 31 days and up to 3 months

iii) Over 3 months and up to 6 months

iv) Over 6 months and up to 12 months

v) Over 1 year and up to 5 years

vi) Over 5 years

The various items of interest rate sensitive assets and liabilities and off-balance sheet items may be classified as explained in Appendix 1A and the reporting format for these items is given in Appendix 1B.

The Gap is the difference between Rate Sensitive Assets (RSA) and Rate SensitiveLiabilities (RSL) for each time bucket. The positive Gap indicates that the bank has more RSAs than RSLs in the time bucket whereas the negative Gap indicates that it has more RSLs. The Gap reports indicate whether the institution is in a position to benefit from rising interest rates by having a positive Gap (RSA > RSL) or whether it is in a position to benefit from declining interest rates by having a negative Gap (RSL > RSA). The Gap can, therefore, be used as a measure of interest rate sensitivity.

Each bank should set prudential limits on individual Gaps with the approval of theBoard. The Institutions may work out Earnings at Risk (EaR) or Net Interest Margin (NIM) based on their views on interest rate movements and fix a prudent level with the approval of the Board.

V. RESTRICTIONS ON LENDING

51. Single Borrower Limits

An institution shall not grant to any person or permit to be outstanding any advance, credit facility or give any financial guarantee or incur any other liability on behalf of any person, so that the total value of the advances, credit facilities, financial guarantees and other liabilities in respect of that person at any time exceeds 25% of the bank’s net own funds for secured exposures and 10% for unsecured exposures.

1). Transactions between financial institutions.

Subject to the approval of the Central Bank, the lending limit for transactions between licensed financial institutions shall not exceed 30% of the net own funds of either party to the transaction, whichever is lesser.

2). Aggregation of facilities.

The term “person” includes that person and his affiliates. For this reason, facilities for the person and the affiliates shall be aggregated and the 25% and 10% of the net own funds rule shall apply to the aggregate amount.

3). Facilities To Insiders

An institution shall not grant or permit to be granted:

a. Any advance or credit facility against the security of its own shares.

b. Any advance or credit facility in excess of two percent of the institution's capital base to any firm or company or group of firms or companies in which any of that institution's directors or other officials is interested as a partner or guarantor or is one of the principal shareholders; and in the case of any unsecured loan or credit facility any amount which in the aggregate exceeds two thirds of one percent of the institution's capital base.

c. Any unsecured advances in respect of any of its employees or their associates.

However, facilities granted to staff members within schemes approved by the board, and are serviced by salary through a check-off system are allowed.

4). Unsecured credit

An institution shall not make any advances, loan or credit facilities, which are unsecured, or advances, loans or credit facilities, which are not fully secured to:

a. Any person of whom or of which any of its officers has an interest as an agent, director, manager or shareholder.

b. Any person of whom or of which any of its officers is a guarantor.

5). Guarantees.

For purposes of this section, where facilities to insiders are secured by guarantees, these guarantees must be supported by tangible or other securities with proven market value that are duly charged and registered in favor of the institution.

52. Advances For Purchase/Improvement/Alteration Of Land.

A bank is restricted from making advances or loans for the purchase, improvement or alteration of land so that the aggregate is in excess of 25% of the amount of its total deposit liabilities.

53. Lending In Foreign Currency.

Banks shall only extend credit facilities denominated in the local currency.

54. Exposure limit on consolidated basis

As per the prudential measure aimed at better risk management and avoidance of concentration of credit risks, the institutions in a banking group should, in addition to adherence to prudential limits on solo basis, also adhere to Single & Group borrower exposure limits on a consolidated basis.

If an institution with subsidiaries exceeds the single borrower limits and restrictions on facilities to insiders on a consolidated basis, the Central Bank shall, in recognition of the risks and pursuant to Section 27b of the Banking Act, prescribe such higher capital adequacy requirements for the institution as may be required to ensure compliance with the prudential requirements.

55. Large Exposure

As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the financial institutions in a banking group should, in addition to adherence to prudential limits on solo basis, also adhere to Single and Group borrower exposure limits on a consolidated basis.

VI. FOREIGN EXCHANGE

56. Limits on Open Positions in Foreign Currencies.

Every licensed institution shall fix, with approval of its Board, exposure limits on its open position the following maximum limits on its open positions in foreign currencies, precious metals and precious stones, and these exposure limits shall not exceed the following prudential ceilings:

1) Net open position in a single foreign currency, or in precious metals or in precious stones, shall not exceed 15% of the institution’s capital base.
2) Aggregate net open position of all foreign currencies shall not exceed 25% of the institution’s capital base.

57. Maintenance of Supporting Documentation.

Each bank shall maintain records which are sufficient to determine at all times its single currency and overall foreign exchange risk exposures. Each bank shall also maintain a daily record showing close-of-business foreign exchange risk exposures (both single and aggregate currencies) and a reconciliation of opening-to-closing positions.

1). Foreign Exchange Return.

Every licensed institution shall submit to the Central Bank not later than the tenth day after the end of every month a return on the institution's foreign currency position indicating its -

a. Net spot long position;

b. Net spot short position;

c. Net forward long position;

d. Net forward short position; and

e. Net open position.

58. Correction of Excess Foreign Exchange Risk Exposures

Each bank shall take every reasonable action to immediately correct any and all foreign exchange risk exposures which exceed the limits set forth in this guideline and in its board-adopted policy. Failure to correct any non-complying risk exposure within five (5) working days may result in imposition of a penalty as prescribed in the Schedule of Penalties issued by the Central Bank.

59. Market Manipulation

Any of the following activities, when carried out for the purpose of influencing the foreign exchange market and furthering currency speculation, are to be avoided.

1) Carrying out two or more concurrent or succeeding foreign exchange deals or transactions that have, or are likely to have, the effect of altering or maintaining the ruling exchange rate with the intention of influencing the decision of others to either participate in a deal or otherwise.

2) Conveying a false or misleading impression of active forex trading through any of the available communication channels.

3) Carrying out forex deals that do not involve an exchange of consideration or making fictitious deals that influence the ruling exchange rate or forex flows.

4) Any other conduct that unduly influences the ruling exchange rate or forex flows.

60. Calculation of Currency Risk Exposures.

All institutions should evaluate their net open positions each day, individually for each foreign currency held and for all foreign currencies in the aggregate.

61. Net Spot Position.

The difference between foreign currency assets and liabilities in a particular currency should be exactly as it appears on the balance sheet.

62. Net Forward Position.

The net forward position in a particular foreign currency represents all amounts to be received less all amounts to be paid in the future in that a particular currency as a result of foreign exchange transactions which have already taken place. All amounts to be received less all amounts to be paid in the future as a result of transactions in currency forwards, currency futures, and also the principal on currency swaps, which are recorded as off-balance sheet items, must be measured and included in the net forward position.

These transactions would include:

1) Spot transactions which are not yet settled.

2) Forward foreign exchange transactions.

3) Documentary credits, guarantees and similar commitments denominated in foreign currencies which are certain to be called upon and are likely to be irrevocable. In case of guarantees, this will arise after notice has been received by the bank.

4) Currency futures and swaps.

63. Calculation of Net Open Position

Banking institutions will adopt the “shorthand method” for calculating the overall net foreign exchange risk exposure or overall net open position. This will be computed as follows;

1) Calculate the net open position in each currency

2) Calculate the net open position in precious metals and precious stones

3) Convert the net positions in each currency, precious stones and precious metals into Leones

4) Arrive at the sum of all net short positions

5) Arrive at the sum of all net long positions

6) The overall net open position is the higher of (4) and (5)

VII PUBLICATION OF FINANCIAL STATEMENTS AND OTHER DISCLOSURES

64. Audited Financial Statements and Other Disclosures.

Not later than three months after the expiry of each calendar year, every bank shall, in respect of all business transacted by it, prepare balance sheets, profit and loss account, and cash flow statements as of the last working day of that year in a form consistent with IFRS accounting standards. The Management Letter of the institution shall also be submitted not later than 31st March following the financial year. Once completed, the financial statements and management letter shall be submitted latest end of March following end of a financial year to the Central Bank for review and a “No Objection” prior for publication on websites and newspapers as indicated in the Banking Act 2019.

1). Valuation Norms of Financial Assets

The valuation, classification, provisioning and income recognition in respect of investments of banks for financial instruments including government securities, shall follow the valuation frameworks as accepted and consistent with International Financial Reporting Frameworks. Banks must also adopt valuation techniques which use inputs (level, 1, 2, 3 inputs) within models adopted that are consistent with those recognized by Internationally Accepted Accounting Standards. (IFRS 13.72, IFRS 13.93, IFRS 9.5.1.1)

2). Risk Exposures for Publicly Disclosed Financial Statements

Banks shall disclose risk exposures relating to credit, liquidity, market, capital and interest rate. These disclosures shall be consistent with internationally Accepted Accounting Standards, (IFRS 7.31, 7.33; IAS 1.134)

3). Sensitivity to Market Risk

Banks shall measure interest rate risk and foreign currency risk using suitable accounting, statistical, simulation and scenario analyses. The current form and detail within the regulatory reporting template "BSD 6" lays the foundation of the minimum requirements for reporting. Gap or maturity analysis for interest sensitive assets and liabilities, exposures to market risk of the trading portfolios and non-trading portfolios, and foreign currency risk of the non-trading portfolios, amongst others, shall be comprehensively reported.

4). Auditor's report.

Not later than three months after the expiry of each calendar year, every bank shall submit to the Central Bank a copy of its audited balance sheet, profit and loss account and cash flow statement together with the auditor's report and the long form audit report.

5). Attestation.

Financial statements submitted pursuant to this section shall be under the joint signatures of three members of the Board of Directors, including the chief executive officer and the chairman of the Board.

65. Leones.

All amounts reported shall be in National Currency with currency conversion rates used disclosed in notes to the financial statements.

VIII IMPLEMENTATION OF SPECIFIC REQUIREMENTS

66. Abandoned Properties

Properties considered abandoned under section 121 of the Banking Act 2019 shall be transferred to the Central Bank.

67. Display of License and Rate Board

1). Display of License

A bank shall display at all times at its head office and all its branches, a copy of its banking licence, for the information of the public.

2). Display of Rate Board

A bank shall display at all times at its head office and all its branches, a copy of its rate board, for the information of the public. Failure to do so will attract administrative penalty in accordance with Section 3 of the Banking Act.

68. Conclusion

The Revised Prudential Guidelines aim to address various aspects of banks' operations, such as risk management, and loan loss provisioning. Furthermore, these guidelines also aim to address the peculiarities of different loan types and financing to different sectors of the economy. However, licensed banks should regard these prudential guidelines as minimum requirements and are therefore advised to implement more stringent policies and practices to enhance mitigation of risks.

69. Amendment of These Guidelines.

The Central Bank may at any time amend, delete, vary, add or change any provision of this Guideline and such amendment, deletion, variation, addition or change shall become effective from the date of notification to the institutions by the Central Bank. Such notification may be effected through a circular, directive, notice, letter or other means communicating the intention of the Central Bank to the institutions generally.

70. Survival.

Upon revision or replacement of any statute under the authority of which these guidelines are issued, all provisions of these guidelines not inconsistent with said revision or replacement shall remain in force until modified or replaced by the Central Bank.

71. Effective Date.

The Guidelines shall become effective on the date of their publication in the *Gazzette.*

APPENDIX IA

Interest Rate Sensitivity

Heads of Accounts	Rate sensitivity and time bucket
Liabilities	
1. Capital, Reserves and Surplus	Non-sensitive
2. Current Deposits	Non-sensitive.
3. Savings Bank Deposits	Sensitive to the extent of interest paying (core) portion. This may be included in over 3-6 months bucket. The non-interest paying portion may be shown in non-sensitive bucket. Where banks can estimate the future behaviour/sensitivity of current/savings bank deposits to changes in market variables, the sensitivity so estimated could be shown under appropriate time buckets.
4. Term Deposits and Certificates of Deposit	Sensitive and reprices on maturity. The amounts should be distributed to different buckets on the basis of remaining term to maturity. However, in case of floating rate term deposits, the amounts may be shown under the time bucket when deposits contractually become due for repricing.
5. Borrowings – Fixed	Sensitive and reprices on maturity. The amounts should be distributed to different buckets on the basis of remaining maturity.
6. Borrowings – Floating	Sensitive and reprices when interest rate is reset.The amounts should be distributed to the appropriate bucket which refers to the repricing date.
7. Borrowings – Zero Coupon	Sensitive and reprices on maturity. The amounts should be distributed to the respective maturity buckets.
8. Borrowings from BSL	Upto 1 month bucket.
9. Refinances from other agencies.	(a) Fixed rate : As per respective maturity.

(b) Floating rate : Reprices when interest rate is reset.

10. Other Liabilities and Provisions

i) Bills Payable	i) Non-sensitive.
ii) Inter-office Adjustment	ii) Non-sensitive.
iii) Provisions	iii) Non-sensitive.
iv) Others	iv) Non-sensitive

11. Repos / Bills Re-discounted, Swaps (Buy / Sell) etc. Reprices only on maturity and should be distributed to the respective maturity buckets.

Assets

1. Cash	Non - sensitive.
2. Balances with BSL	Interest earning portion, if any, may be shown in over 3 - 6months bucket. The balance amount is non-sensitive.
3. Balances with other Banks	
i) Current Account ii) Money at Call and Short Notice, Term Deposits and other placements	i) Non-sensitive. ii) Sensitive on maturity. The amounts should bedistributed to the respective maturity buckets.
4. Investments (Performing).	
i) Fixed Rate / Zero Coupon	i) Sensitive on maturity.
ii) Floating Rate	ii) Sensitive at the next repricing date
5. Shares/Units of Mutual Funds	Non-sensitive.
6. Advances (Performing)	
(i) Bills Purchased and Discounted	(i) Sensitive on maturity.
(ii) Overdrafts (including TODs) / Loans repayable on demand and Term Loans	(ii) Sensitive only when variable rate/risk premium is changed. The bank should foresee the direction of interest rate movements of funding options and capture the amounts in the respective maturity buckets which coincides with the time taken by bank to effect changes in variable rates inresponse to changes in market interest rates.

7. NPLs and NPIs (Advances and Investments) *

(i) Sub-Standard	(i) Over 3-5 years bucket.
(ii) Doubtful and Loss	(ii) Over 5 years bucket.
8. Fixed Assets	Non-sensitive.
9. Other Assets.	
(i) Inter-office Adjustment	(i) Non-sensitive.
(ii) Leased Assets	(ii) Sensitive on cash flows. The amounts should be distributed to the respective maturity buckets corresponding to the cash flow dates.
(iii) Others	(iii) Non-sensitive.
10. Reverse Repos, Swaps (Sell/Buy) and Bills Rediscounted	Sensitive on maturity.
11. Other products (Interest Rate)	
(i) Swaps	(i) Sensitive and should be distributed underdifferent buckets with reference to maturity.
(ii) Other Derivatives	(ii) Should be suitably classified as and whenintroduced.

***Amounts to be shown net of provisions and interest suspense**

APPENDIX 2
Template for Disclosure of loan provisions under IFRS vs provisions under BSL norms

Asset Classification as per BSL Norms	**Asset classification as per IFRS**	**Gross Carrying Amount as per IFRS**	**Loss Allowances (Provisions) as required under IFRS**	**Net Carrying Amount**	**Provisions required asper BSL norms**	**Difference between IFRS provisions and provisions as per BSL norms**
(1)	**(2)**	**(3)**	**(4)**	**(5)=(3)-(4)**	**(6)**	**(7) = (4)-(6)**
Performing Assets						
Standard	Stage 1					
	Stage 2					
Subtotal						
Non-Performing Loans (NPLs)						
Substandard	Stage 3					
Doubtful	Stage 3					
Loss	Stage 3					
Subtotal for NPL						
Other items such as guarantees, loan commitments, etc. which are in the scope of IFRS norms but not covered under BSL norms	Stage 1					
	Stage 2					
	Stage 3					
Subtotal						
Total	**Stage 1**					
	Stage 2					
	Stage 3					
	Total					