Turks & Caicos Islands Financial Services Commission

Guideline for Banks on Credit Risk Assessment, Classification and Provisioning

1. Introduction

1.1 This guideline has been issued by the Turks and Caicos Islands Financial Services Commission ("the Commission"), pursuant to Section 43 of the Financial Services Commission Ordinance 16.01 (2007) ("the FSC Ordinance"), in furtherance of its responsibility to regulate and supervise licensees and monitor their compliance with relevant ordinances. Section 43(4) of the FSC Ordinance provides that the Commission may consider any failure to follow guidelines in determining whether there has been a contravention of the FSC Ordinance or any Financial Services Ordinance or the Code.

1.2 Section 31 of the FSC Ordinance further establishes a requirement for banks to develop and maintain adequate systems and controls to ensure their ongoing compliance with the requirements of, and obligations under the FSC Ordinance and other relevant ordinances.

1.3 As part of its overall mandate to supervise the activities of banks operating in and from The Islands, the Commission is responsible for monitoring banks' overall management of credit risk, including the treatment of assets which demonstrate potential for impairment or may be impaired. This guideline sets out the Commission's minimum expectations of banks in respect of the identification, measurement and monitoring of credit risk, and the establishment and maintenance of adequate provisions.

1.4 Compliance with this guideline will be considered in determining the effectiveness of credit risk management and oversight. To that end, this guidance should be read in conjunction with others issued by the Commission on credit, risk management and governance, as well as applicable accounting standards which treat with expected credit losses.

1.5 This guideline applies to all the banks operating in and/or from the TCI, including subsidiaries and branches of foreign banks which conduct banking business in and/or from the TCI.

1.6 This guideline will be subject to periodic review.

2. Background

2.1 The purpose of credit classification is to evaluate credit, categorise it based on collectability (the likelihood of recovering the debt), and to make adequate provisions based on the likelihood of collectability.

2.2 Asset quality is influenced by the robustness of management and systems implemented to control risk. Poor asset quality has over time proven to be a leading cause of bank failure and wider systemic disruption. Whether caused by poor credit decisions, economic downturn or a combination of these and other market-driven factors, asset quality deterioration poses a major threat to bank earnings and capital. Significant loss events since the 2007-08 global financial crisis have served to further underscore the importance of prudent provisioning and early recognition of impairment to limit the amount and frequency of credit losses.

2.3 The Commission requires banks to exercise prudence by adopting forward-looking provisioning and credit loss estimation methodologies, which promote early detection of problem exposures. It also expects banks to continually assess the adequacy of their provisioning levels based on the risk profile of borrowers, the bank, the jurisdiction and international conditions.

2.4 The Commission's monitoring of asset management and quality forms a critical part of its review of the health and performance of individual banks as well as the overall system, and facilitates the issuing of tailored guidance, particularly where provisioning and other supervisory requirements for banks may differ from accounting treatments.

2.5 This guideline is intended to aid in the development of prudent and well documented polices and processes for the recognition and measurement of problem assets and an effective system of internal controls over the management of those assets.

3. Scope of Application and Implementation

3.1 This guideline apply to all banks licensed under the Banking Ordinance.

3.2 The guideline apply in relation to the granting and monitoring of all facilities that carry credit risk, including loans and advances, overdraft facilities and off-balance sheet exposures as well as investments and debt securities.

3.3 Banks are required to apply the regulatory treatment for credit classification (that is, standard, special mention, substandard, doubtful and loss) and the regulatory and accounting provisioning requirements (minimum requirement and ECL stage rating) to their credit facilities.

3.4 Date of Implementation

This guideline applies from 1 January 2023.

3.5 Repeal

The following guideline is repealed, with effect from the date of application of this guideline: *Statement of Guidance: Loan Classification and Provisioning, July 2011*.

4. Interpretation

For the purpose of this guideline, the following definitions apply:

4.1 **"Concessions"** refer to special terms or conditions offered by intuitions to allow borrowers to better service their debt. Examples of such concession include, but is not limited to:

(i) extending the term of the facility;
(ii) rescheduling the dates for principal or interest payments;
(iii) granting new or additional periods of non-payment (grace period, moratorium);
(iv) 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 same or other banks in the market;

(v) capitalising arrears;

(vi) forgiving, deferring or postponing principal, interest or relevant fees;

(vii) changing an amortising loan to interest payment only;

(viii) allowing the conversion of debt to equity of the borrower;

(ix) deferring recovery/collection actions for extended periods of time;

(x) easing of covenants

4.2 **"Counterparty"** refers to a borrower (client/customer) or an individual/entity standing as a guarantor.

4.3 **"Credit classification"** is the allocation of risk of non-payment on a credit facility based on the assessment of a borrower's repayment capacity to meet their total obligations under the credit contract.

4.4 **"Credit exposure" or "credit facility"** is the amount of risk arising from the loan, advance, or extension of credit, which represents the maximum loss which may be incurred through a counterparty's failure to honour an obligation or other diminution in value at realisation due to changes in asset prices or off-balance sheet positions.

4.5 **"Credit documentation"** refers to data, information, and documents to be considered by banks for the purposes of credit-granting, in accordance with this guideline. These items include, at minimum:

(i) official identification;

(ii) proof of residence;

(iii) information on the purpose of the credit facility;

(iv) evidence of eligibility for the purposes of the credit facility;

(v) evidence of employment, including the type, sector, status (e.g., full-time, part-time, contractor, self-employed) and duration;

(vi) evidence of income or other sources of repayment (including annual bonus, commission, overtime, where applicable) covering a reasonable period, e.g., payslips, current bank account statements, and audited or professionally verified accounts (for self-employed persons);

(vii) information on financial assets and liabilities, e.g., savings account statements and loan statements indicating outstanding loan balances, audited statements or management accounts (for businesses);

(viii) information on other financial commitments, such as child maintenance, education fees and alimonies, if relevant;

(ix) information to ascertain the borrower's debt-to-income ratio;

(x) information on the ownership and value of collateral, if any (see section 19 for guidance on collateral); and

(xi) Information on guarantees, other credit risk mitigating factors and guarantors, if any.

4.6 **"Collateral"** should be taken to mean assets which are pledged as security for repayment of a credit facility, and in which a bank has a perfected security interest, so that the bank may take action to foreclose on the asset in the event of a default by the borrower.

4.7 A facility is considered **"adequately secured/ collateralised"** when it is secured by an asset of sufficient value to cover the principal debt outstanding and all accrued interest in full after factoring in the estimated cost of disposal of the asset under forced liquidation. To satisfy this condition, the following requirements must be met[1]:

(i) the bank has a legally enforceable (perfected) interest in the pledged asset that is registered with an appropriate authority;
(ii) the bank's interest is adequately ranked to ensure that there in sufficient value in the pledge asset in the event of a sale to cover the bank's exposure;
(iii) all valuations on the collateral are up-to-date and show that the value is adequate to cover interest and principal amounts under forced sale conditions;
(iv) insurance on the collateral is current and adequate, with the proceeds legally assigned to the bank;
(v) the collateral is marketable; and
(vi) the collateral value is based on current market prices, discounted by a suitable margin[2]

4.8 **"Expected credit losses (ECL)"** is the probability-weighted estimate of credit losses, that is, the present value of all cash shortfalls over a twelve-month period or the remaining life of a financial asset.

4.9 A **"specific provision"** is an allowance, usually funded through charges to income, which is established to reduce the book value of specific assets, against quantifiable future losses.

4.10 A **"general provision"** is a prudential allowance established to absorb losses which cannot yet be ascribed to specific assets or exposures.

4.11 A credit exposure is considered "**past due**" when any amount due under the contract (interest, principal, fee, or other amount) has not been paid in full at the date when it was due up to 89 days. A facility should be considered past due if the following conditions hold:

(a) in the case of a term loan or other similar exposure with fixed repayment dates:
- *(i)* payment, in full or partial, (i.e., interest, principal, fee or other amount) is up to 89 days late, irrespective of the materiality of the amount; or
- *(ii)* interest charges for up to 89 days have been capitalised, rolled over or otherwise restructured.

(b) in the case of an overdraft facility or other facility with no fixed repayment dates:
- *(i)* the approved limit has been exceeded for a period of 30 to 89 days;
- *(ii)* the facility's tenure has expired, and the balance remains outstanding for a period of fewer than 90 days; or
- *(iii)* interest charges accruing beginning 30 to 89 days have not been fully covered by deposits.

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[1] See section 19 for detailed guidance on collateral treatment.
[2] See section 19.3.

4.12 A credit exposure is considered **"nonperforming"** when any portion of principal or interest remains due and unpaid for 90 days or more. A facility should be considered nonperforming if it has been classified as substandard, doubtful and/or loss, and any of the following conditions hold:

(a) in the case of a term loan or other similar exposure with fixed repayment dates:

(i) payments of interest and/or principal remain outstanding for 90 days or more;

(ii) interest payments equal to 90 days or more have been capitalised, refinanced, or restructured;

(iii) payments are fewer than 90 days overdue, but there are other good reasons, such as a debtor filing for bankruptcy, to doubt that payments will be made in full; or

(iv) when evidence suggests that the debtor is unlikely to honour its credit obligations without the collateral being possessed or sold by the bank, even when the exposure is not past due or has been past due for less than 90 days.

(b) in the case of an overdraft or other facility with no fixed repayment dates:

(i) the approved limit has been exceeded for a period of 90 days or more;

(ii) the facility's tenure has expired, and the balance remains outstanding for 90 days or more;

(iii) interest charges accruing for more than 90 days have not been fully covered by deposits; or

(iv) all or a portion of the debt may be considered 'hardcore'[3] but has not been converted to a structured term loan.

4.13 A credit exposure is considered "**impaired**" when evidence suggests that the debtor is unlikely to repay the full principal and/or interest, based on the contractual terms, without the collateral either being possessed or sold by the bank, even when the exposure is not past due or has been past due for less than 90 days. Impairment is synonymous and used interchangeably with nonperforming.

4.14 **"Materiality"** refers to the importance or significance of an amount, transaction or any other item of information such that its omission or misstatement can reasonably influence the judgement of a person or entity relying on the financial information of the reporting entity. For credit exposures, materiality is determined by the Board of Directors and senior management and is relative to the size and operations of the bank.

4.15 The **"net realisable value"** or **"NRV"** of an item of collateral is the amount of assessed proceeds from the disposal of the collateral after deduction of the estimated costs of disposing the asset.

4.16 **"Non-accrual facilities"** refer to credits on which interest is no longer being accrued.

4.17 For the purposes of this Guideline and the Commission's assessments, "**off-balance sheet items**" means all exposures not shown on the balance sheet, but which constitute credit risk. Such exposures include bills of collection, unused overdraft facilities, guarantees, acceptances, performance bonds,

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[3] The hardcore of an overdraft facility is the portion of the overdraft which shows little to no turnover over a period of twelve consecutive months and which is not supported by either inventory or receivables in the borrower's account.

letters of credit, documentary credits and all other off-balance sheet items deemed to constitute credit risk by the Commission, excluding derivatives.

4.18 For the purposes of this Guideline and the Commission's assessments, an exposure will be considered **"forborne"** or **"restructured"** where the original contractual terms have been modified in any way to provide concessions to a borrower experiencing difficulty in meeting their financial obligation.

4.19 A facility is considered to be **"refinanced"** or **"renegotiated"** when the original contractual terms of a performing facility has been modified to afford the borrower more attractive terms such as better interest rate, opportunities for debt consolidation or alteration in risk profile. For the avoidance of doubt, note that this definition distinguishes from restructured debt which only occurs when the debtor is experiencing financial difficulty.

5. Role of the Board of Directors and Senior Management

5.1 The Board of Directors is responsible to, *inter alia*:

(i) Develop the bank's credit risk appetite[4], in conjunction with senior management, taking cognizance of the institutional, local and global risk factors which may arise over various time horizons, and the bank's ability to manage these risks as they arise;

(ii) ensure effective implementation of credit risk management policies, procedures and controls that are adequate and tailored to the bank's risk profile and activities;

(iii) review and approve, at least annually, the bank's credit risk management strategy and related policies, procedures and controls;

(iv) ensure that the credit underwriting function is being properly managed by senior management and credit exposures are within levels consistent with prudential standards and internal limits;

(v) oversee all large exposures[5], as well as other exposures that require regulatory approval;

(vi) determine, in conjunction with senior management, the bank's materiality threshold for credit exposures and ensure that it is clearly documented in the bank's credit risk policy;

(vii) ensure periodic review of all material credit exposures which have been categorised as 'special mention' or nonperforming;

(viii) ensure policies and procedures for collateralization (including sound and prudent valuations) are approved, sufficiently robust and commensurate with the risk appetite of the bank;

(ix) provide oversight for timely identification and management of potential and actual problem credits which include reviews and approvals of all material changes to problem credit management strategies, policies, procedures and system of controls, providing recommendations and workout solutions where necessary;

(x) ensure periodic review and assessment of the reasonableness and prudence of provisioning levels;

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[4] Development of credit risk appetite should consider the aggregate level and types of risk which the bank is willing to assume to achieve its strategic objectives and business plan. These should be determined in advance and in writing, in relation to the bank's capital base, risk management and control infrastructure, as well as legal and regulatory constraints.

[5] A large exposure refers to any exposure to a single counterparty or group of related counterparties which is equal to or greater than twenty-five per cent (25 per cent) of a bank's paid-up capital. For more information, see the Commission's guideline on large exposure and credit concentration for banks.

(xi) ensure the adequacy and oversee proper implementation of write-down and write-off policies with respect to uncollectible balances; and

(xii) ensure that minutes are recorded and documented at board meeting and/or other meetings with respect to compliance with this guideline.

5.2 Senior management is responsible to, *inter alia*:

(i) implement the Board approved credit risk management strategy and appropriate policies, procedures and controls for managing credit risk;

(ii) report to the Board, at least quarterly, on the state of the credit portfolio. The report should include, at minimum, status update on new and ongoing nonperforming and impaired exposures above a determined materiality threshold, the level of provisioning held against those exposures and the impact on the bank's capital, as well as large exposures and other exposures that require regulatory approval.

(iii) communicate to all relevant staff the bank's strategy, policies and procedures for credit-granting, approving and managing credit risk, and be accountable for complying with the established policies and procedures;

(iv) ensure that this guideline is incorporated into the bank's policies and procedures;

(v) ensure that portfolio reviews on material credits are conducted at least annually;

(vi) provide quarterly reports to the Board on all credits placed on the watchlist[6];

(vii) ensure that credits are appropriately valued using forward-looking approaches, uncollectable credits are written off and expected or probable losses are adequately provided for;

(viii) establish robust policies and procedures to validate the accuracy and consistency of its ECL models and to ensure that ECL estimates are continuously reviewed and in line with the level of credit risk exposures; and

(ix) ensure that the value of assets pledged as collateral and other credit risk mitigants, are evaluated in a timely manner, considering prevailing market conditions, such as the time taken and the cost for liquidating the asset.

6. Credit-granting Criteria

6.1 Banks must operate within sound, well-defined credit-granting criteria. These criteria should include a clear indication of the bank's risk appetite and target market, and a thorough understanding of the borrower's creditworthiness, as well as the purpose and structure of the credit, and its source of repayment.

6.2 Banks must receive sufficient information to enable a comprehensive assessment of the true risk profile of the borrower. Depending on the type of credit exposure and the nature of the credit relationship to date, the factors to be considered and documented in approving credits include:

(i) the purpose of the credit and sources of repayment;

(ii) the current risk profile (including the nature and aggregate amounts of risks) and creditworthiness of the borrower or counterparty, and the collateral and its sensitivity to economic and market developments;

(iii) the borrower's repayment history and current capacity to repay, based on historical financial

[6] The watchlist comprises of all credit facilities categorized as special mention, substandard, doubtful or loss.

trends and future cash flow projections, under various scenarios;

(iv) for commercial credits, the borrower's business expertise, the status of the borrower's economic sector and the borrower's position within that sector;

(v) the proposed terms and conditions of the credit, including covenants designed to limit changes in the future risk profile of the borrower; and

(vi) where applicable, the adequacy and enforceability of collateral or guarantees under various scenarios.

6.3 In approving borrowers or counterparties for the first time, consideration should be given to the integrity and reputation of the borrower or counterparty as well as their legal capacity to assume the liability. Once credit-granting criteria have been established, it is essential for the bank to ensure that the information it receives is sufficient to make proper credit-granting decisions. This information will also serve as the basis for rating the credit under the bank's internal rating system.

6.4 In considering potential credits, banks must recognise the necessary provisions for expected losses and hold adequate capital to absorb unexpected losses. Banks should factor these considerations into credit-granting decisions and into the overall portfolio risk management process.

6.5 Banks should establish and document, in policy, exposure limits for both on and off-balance sheet activities to ensure that credit-granting activities are adequately diversified, independent of consumer demand and requires Board approval for breach of those limits.

6.6 Banks should establish and institute sound procedures to monitor and ensure that staff involved in credit-granting process comply with the bank's policies and procedures on credit-granting.

6.7 Creditworthiness Assessment

Sound lending practices are important from both a prudential and a consumer protection perspective. Failure to complete an accurate and thorough creditworthiness assessment may have negative consequences for banks and borrowers, as it might lead to increase nonperforming exposures. As a result, banks must specify in their credit risk policy, the requirements for the credit worthiness assessment of borrowers in the credit-granting process. Such requirement should include at minimum:

(i) an analysis of the factors that could influence the present and future repayment capacity of the borrower. The factors should include other debt-servicing obligations, considering their remaining duration, interest rates, outstanding amounts, and repayment behaviour;

(ii) analysis of the borrower's financial position, to include at a minimum:

- *(a)* current and the projected financial positions, including, where relevant, financial statements, capital structure, working capital, income and cash flows;
- *(b)* net operating income and profitability;
- *(c)* where relevant, the borrower's leverage level, dividend distribution, and actual and projected capital expenditure, as well as its cash conversion cycle

in relation to the facility under consideration;

(d) probability of default, based on credit scoring or internal risk rating; and

(e) exposure until maturity, in relation to potential market movements, such as exposures denominated in foreign currencies.

(iii) analysis of the borrower's business model and strategy and the capacity to manage business activities, assets or investments linked to the loan agreement;

(iv) assessment of the creditworthiness of any guarantors. The creditworthiness assessment of the guarantor should be proportionate to the size of the guarantee in relation to the loan and the type of guarantor;

(v) ensuring that collateral pledged for the purposes of risk mitigation meets the requirements for collateral set out in the bank's credit risk appetite, policies and procedures; and

(vi) where relevant, sensitivity analysis that assesses the sustainability and feasibility of the borrower's financial position and future repayment capacity under potential adverse conditions.

7. Credit Portfolio Review

7.1 At least annually, banks must review the health of their credit portfolio for the purposes of credit classification and determining the adequacy of provisioning.

7.2 Reviews should be conducted on a credit-by-credit basis. Homogeneous credit facilities below a certain materiality threshold (e.g., mortgage loans, retail loans, credit card receivables) may be pooled together with all other facilities that exhibit similar credit risk characteristics (e.g., standard, special mention).

7.3 The annual review shall cover <u>at least</u> 70 per cent of the value of all credit exposures[7], ensuring coverage of all the following:

(i) loans and advances which equal or exceed one 1.0 per cent of total loans, including aggregate loans to borrower groups;

(ii) past due accounts;

(iii) nonperforming accounts;

(iv) accounts placed on the watchlist;

(v) forborne/restructured credit facilities; and

(vi) exposures for which regulatory approval is required, such as large exposures.

7.4 The annual review shall also cover <u>at least</u> 70 per cent of the value of all off-balance sheet exposures, ensuring coverage of:

(i) commitments which equal or exceed 10 per cent of the total off-balance sheet exposures;

(ii) past due accounts; and

(iii) nonperforming accounts

7.5 The portfolio review should take account of, among other things:

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[7] Credit exposure as defined at section 4.4. This requirement does not preclude partial reliance on automated credit reviews to monitor performance on an ongoing basis (including assessment based on payment performance as a proxy for repayment capacity, for homogenous groups of small value credits) provided that banks demonstrate to the Commission's satisfaction that (i) credit monitoring systems are robust; and (ii) review includes all of the categories of credit listed under 6.2.

(i) facilities' performance against agreed terms;
(ii) borrowers' financial condition (by way of assessing financial statements and other relevant financial and non-financial information);
(iii) the adequacy of any collateral (as defined at section 4.7), including whether valuation, insurance coverage and legal assignment arrangements are all in place and up to date;
(iv) changes in the economic condition specific to the market in which the borrower operates;
(v) in the case of a group of related borrowers, the status and performance of other facilities also being serviced within the group; and
(vi) significant changes to the ownership and/or management of the company.

7.6 Banks must ensure that estimates for ECL are periodically reassessed and adjusted in accordance with changes in credit risk of the lending exposure[8].

7.7 Each bank is required to submit summary results of its credit portfolio review as at the end of each financial year in the format prescribed by the Commission in Schedule I. This summary report should be remitted to the Commission within three months following the financial year end.

8. Classification of credit exposures[9]

8.1 Under the Commission's credit classification system, exposures are required to be classified according to the following five categories: standard, special mention, substandard, doubtful, and loss. The exposures in the substandard, doubtful and loss categories are collectively regarded as "nonperforming" exposures, for which specific provisions are required. Credit facilities classified as special mention plus those that fall into the nonperforming category are watchlisted facilities.

8.2 While subject to judgment in some instances, the decision to classify an exposure should ultimately be premised on the assessment of a borrower's capacity to repay and on the degree of doubt regarding the collectability of the principal and/or interest payments. For this reason, an important indicator of collectability is the period that payments of interest and principal are overdue. However, the existence of payment arrears is only one of several factors which should be considered. Even in instances where an exposure is current or has been past due for fewer than 90 days, an adverse rating of substandard or doubtful may be justified where there is clear cause to doubt the borrower's ability to continue to service the facility in accordance with the agreed terms.

8.3 Unimpaired /Performing Credit Exposures

Facilities which are unimpaired are categorised as either standard, or where they exhibit specific weaknesses which warrant their placement on a watch list, as special mention.

(i) Standard

Credit facilities to be included in this category are those which are current and whose borrowers

[8] See section 9 for more guidance on the ECL methodology.
[9] Note that this section excludes exposures related to investments as these will be classified in accordance with IFRS 9 standard.

are up-to-date in meeting agreed commitments, such that full repayment of interest and principal is not in doubt. Facilities included in this category must meet all of the following criteria:

(a) principal and interest repayments are current and up to date or not more than twenty-nine (29) days in arrears;

(b) the original source of repayment is adequate and financial condition of the borrower has been assessed as sound;

(c) there is up-to-date evidence of adequate credit documentation to support the borrower's credit worthiness, which includes current financial statements, credit reports/analysis, valuation of collateral, assigned insurance over collateral;

(d) in the case of a secured facility, the collateral is adequate and without any impediment to possession by the bank, meeting also the criteria outlined in section 4.7.

(e) In the case of an overdraft or other facility with no fixed repayment dates:

- *(i)* the facility is operating within approved limits and in accordance with agreed terms; and.
- *(ii)* there is no evidence of a hardcore.

(ii) Special Mention

Special mention credits are those of fair quality; however, there is evidence that particular weaknesses exist that may threaten collectability. While such facilities exhibit potential for deterioration which requires management's close attention, assessed weaknesses do not yet justify a substandard classification.

This classification should be assigned to credit exposures that demonstrate at least one of the following deficiencies/conditions:

(a) payments are up to date but there is evidence that certain factors could affect the borrower's ability to service the loan as per agreement;

(b) early signs of liquidity trouble which may delay loan repayments;

(c) the condition of, or control over, the collateral is questionable, or (in the case of a secured facility) its value is inadequate to cover principal and interest outstanding;

(d) inadequate credit documentation to support borrowings or other deviation from prudent lending practices;

(e) Repayments (whether principal or interest) are in arrears, from 30 to 89 days and/or non-compliance with other terms of the agreement;

(f) deterioration or volatility in economic or market conditions which may likely affect the borrower negatively;

(g) poor performance in the industry in which the borrower operates, or slowdown in the borrower's operations that signals a potential weakness in financial strength, but which has not yet jeopardized servicing of the facility;

(h) borrower is the subject of litigation which may have a significant impact on his financial position;

(i) the subject facility is current, but the borrower or borrower group is having difficulty servicing other facilities, either from the bank concerned or, where the bank becomes aware, from other banks.

(j) In the case of an overdraft or other facility with no fixed repayment dates:

(i) the approved limit has been exceeded from 30 up to 89 days;
(ii) the facility's tenure has expired, and the balance remains uncleared from 30 to 89 days; or
(iii) interest charges accruing from 30 to 89 days have not been fully covered by deposits;
(iv) there is evidence of a hardcore from 30 to 89 days.

This is not an exhaustive list however – facilities which exhibit other weaknesses may be included among this category for special monitoring, provided they do not exhibit actual impairment.

8.4 Impaired/Nonperforming Credit Exposures

A facility should be adversely classified regardless of whether it is 90 days or more past due, when there is doubt as to whether the full amounts due, including principal and interest, will be repaid as agreed. Collateral and other risk mitigation arrangements must not influence the classification of an exposure as nonperforming.

(i) Substandard

Substandard facilities are those where identified and well-defined weaknesses threaten repayment in full of principal and/or interest. They are typically inadequately protected by the net worth and paying capacity of the counterparty, such that, owing to the uncertainty of repayment, the bank stands to incur some loss if the deficiencies are not corrected. Facilities in this category may demonstrate any one or more of the following criteria:

(a) more than one conditions under special mention exists;
(b) inability of the borrower to meet the contractual repayments, e.g., borrower's cash flow insufficient to service the debt as arranged;
(c) interest or principal accrued from 90 to 179 days have been capitalised or restructured. Principal and/or interest payments are in arrears from 90 to 179 days;
(d) primary source of repayment is insufficient to service debt and the bank has to look to secondary sources, such as collateral or restructuring for repayment;
(e) credit facilities fully secured by hypothecated cash and/or guaranteed by Government of the Turks and Caicos Islands and/or the Government of the United Kingdom; but is otherwise nonperforming.
(f) In the case of an overdraft or other facility with no fixed repayment dates:
  (i) the approved limit has been exceeded from 90 to 179 days;
  (ii) the facility's tenure has expired, and the balance remains uncleared from 90 to 179 days;
  (iii) interest charges accruing from 90 to 179 days and have not been fully paid or covered by deposits; or
  (iv) the facility has not been converted to a structured term loan after demonstrating 'hardcore' features from 90 to 179 days.

(ii) Doubtful

Doubtful facilities are those for which prospects for full collectability have deteriorated to such a degree that substantial loss of either principal or interest is probable but not yet definitely ascertainable in amount. In addition to any one or more of the weaknesses observed in the substandard category, facilities classified as doubtful may demonstrate any one or more of the following criteria:

(a) principal and/or interest in arrears from 180 to 364 days;

(b) interest or principal accrued from 180 to 364 days have been capitalised or restructured;

(c) collection of the debt in full is highly questionable or improbable such that there is strong likelihood of a loss, but clearly demonstrable factors[10] exist which could improve the situation.

(d) In the case of a term loan or similar exposure with fixed repayment dates, the exposure may be assigned a spilt classification when the available collateral supports only part of the exposure. In this instance, the secured portion of the facility should be classified as substandard and given a 20 per cent specific provisioning rate unless such security is in the form of cash of which no specific provisioning will be required and the classification remains substandard. The unsecured portion of the facility should be classified as doubtful and given a 50 per cent specific provisioning rate.

(e) In the case of an overdraft or other facility with no fixed repayment dates:

(i) the approved limit has been exceeded from 180 to 364 days;

(ii) the facility's tenure has expired, and the balance remains uncleared from 180 to 364 days;

(iii) interest charges accruing from 180 to 364 days have not been paid or fully covered by deposits; or

(iv) the facility has not been converted to a structured term loan after 180 to 364 days demonstrating 'hardcore' features.

(iii) Loss

Loss facilities are those which are deemed uncollectible within 12 months of being in arrears, rendering their continuance as bankable assets uncertain. In addition to exhibiting one or more criteria in the doubtful category, facilities in this category may meet one or more of the following criteria:

(a) principal and/or interest remain unpaid for at least 365 days;

(b) interest or principal accrued for at least 365 days have been capitalised or restructured;

(c) identified for write-off during the current period (based on internal policy);

(d) collection of the debt in full is unlikely or loss is certain.

(e) In the case of a term loan or similar exposure with fixed repayment dates, the exposure may be assigned a spilt classification when the available collateral supports only part of the exposure. In this instance, the secured portion of the facility should be classified as substandard and given a 20 per cent specific provisioning rate unless such security is in the form of cash of which no specific provisioning will be required and the classification remains substandard. The

[10] These may include evidence of new or improved income to support the facility, or evidence of (imminent) sale of collateral pledged as support for facility, the net realizable value (NRV) of which would be sufficient to cover the outstanding balance.

unsecured portion of the facility should be classified as loss and given a 100 per cent specific provisioning rate.

(f) In the case of an overdraft or other facility with no fixed repayment dates, the unsecured portion of the facility when:

(i) the approved limit has been exceeded for a period of at least 365 days;

(ii) the facility's tenure has expired, and the balance remains uncleared for at least 365 days;

(iii) interest charges accruing for at least 365 days have not been fully paid or covered by deposits; or

(iv) the facility has not been converted to a structured term loan after 365 days of demonstrating 'hardcore' features.

8.5 Credit cards, commitments, contingencies, and other off-balance sheet exposures that carry credit risk but excluding investment products, must also be classified based on the classification criteria set out under this section.

9. Forward-looking determination of expected credit losses (ECLs) – Application of the International Financial Reporting Standard (IFRS) 9

9.1 Historically, the incurred loss model served as the basis for accounting recognition and measurement of problem financial assets under the international standards. Hence, impairment was recognised only after a loss event occurred. The transition to the ECL framework established under the IFRS 9 standard requires banks to take a forward-looking approach when recognising impairment. This will result in earlier recognition of credit losses, as it will no longer be appropriate for banks to wait for an actual loss to occur before credit losses are recognised.

9.2 To that effect, the supervisory requirement is that all banks must apply the requirements under IFRS 9 and US GAAP (based on the adopted accounting standard) in assessing the ECL/CECL[11] for all credit exposures. Where there is a conflict in the application of these standards, this guideline must take precedence except in circumstances where the IFRS 9 standard would result in a higher provisioning requirement. Justification for the methodology employed must be provided in the audited accounts and in the regulatory reports submitted to the Commission.

9.3 Under IFRS 9, expected credit losses must be recognised for all credit facilities and the amount of credit losses recognised at each reporting date must be updated to reflect changes in the credit risk of financial instruments. Expected credit losses are required to be measured through a loss allowance, in accordance with one of two approaches:

(i) at an amount equal to the 12-month expected credit losses, that is, the expected credit losses that result from those default events on the financial instrument that are possible within 12 months after the reporting date[12]; or

(ii) at an amount equal to lifetime expected credit losses, that is, the expected credit losses that

[11] Current expected credit losses (CECL) is the methodology for estimating allowances for credit losses issued by the Financial Accounting Standards Board (FASB).

[12] Note that it is not the expected cash shortfalls over the 12-month period but the entire credit loss on an asset weighted by the probability that the loss will occur in the next 12 months.

result from all possible default events over the life of the financial instrument.

9.4 For the avoidance of doubt, banks must apply lifetime ECLs to a financial instrument if the credit risk of that instrument has increased significantly since initial recognition. For all other financial instruments, expected credit losses are measured at an amount equal to the 12-month expected credit losses.

9.5 Banks must have in place sound methodologies for assessing increases in credit risk of a counterparty. A credit facility can be considered to have significantly increased credit risk even if the following circumstances hold:
(i) the bank has not downgraded the facility's internal risk grading;
(ii) the facility is not yet past due;
(iii) the facility is not in default on technical loan covenant requirements;
(iv) the facility has a lower risk of default than the bank's other facilities;
(v) the facility has substantial collateral.

9.6 In determining whether a facility has significant increases in credit risk, banks must consider reasonable and supportable information that is available, without undue cost or effort. This includes information about historic events, current conditions, and forecasts. Such assessment may include evaluating, inter alia:
(i) facilities with common credit weaknesses, such as those that will be affected due to the type of exposure, borrower characteristics or local environmental, economic or political circumstances;
(ii) credit spreads, terms or collateral requirements for existing and newly originated facilities;
(iii) changes in market indicators, the economy or other financial conditions;
(iv) in the case of businesses, declines in operating results;
(v) declines in credit quality of related party exposures;
(vi) significant changes in a facility's collateral value or economic conditions specific to a facility's geographic area or market sector;
(vii) delinquency information.

9.7 When measuring ECLs, banks are expected to classify exposures as follows:
(i) Stage 1/Performing Exposures - those that have no significant increase in credit risk since initial recognition. For these exposures, 12-month ECLs are recognised.
(ii) Stage 2/Underperforming Exposures - those that have exhibited significant increase in credit risk since initial recognition but do not yet show objective evidence of credit-impairment. For these exposures, lifetime ECLs are recognised. Objective evidence of credit-impairment is defined as one or more events that have occurred and have an impact on the expected future cash flows of the financial instrument. It includes observable data that has come to the attention of the bank about the following events:
(a) the borrower has experienced significant financial difficulty in honouring their obligations;
(b) there is a breach of contract such as a default or delinquency in interest or principal payments;
(c) the bank, whether for economic or contractual reasons relating to the borrower's

financial difficulty, granted the borrower a concession that would not otherwise be considered;

(d) it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;

(e) there are adverse changes in the macroeconomic environment that may affect the market in which the borrower operates;

(f) the disappearance of an active market for that financial asset because of technological, economic or financial downturn.

(iii) Stage 3/Nonperforming or Credit-Impaired Exposures – these exposures are those where credit risk has significantly increased and there is objective evidence of impairment. In this instance, lifetime ECLs are recognised.

9.8 Banks should evaluate their existing methodology, policies and procedures and, where necessary, make the relevant amendments to ensure that the full spectrum of information that may impact the assessment and measurement of ECLs is collected and analysed.

9.9 Banks must clearly document, in policy, ECL assessment and measurement methods (such as a loss rate method, probability of default (PD)/loss-given-default (LGD) method, or any other method) to be applied to each exposure or portfolio.

9.10 Inputs, data, and assumptions used for calculating ECLs (such as historical loss rates and economic forecasts) must be reviewed and updated, as necessary. If there are changes in inputs and assumptions that affect the measurement of ECLs, the rationale should be well documented.

9.11 Banks must ensure that key parameters used in the measurement of ECLs (such as loss and migration rates, loss events and default) are clearly defined in policy.

9.12 Banks must ensure that when measuring ECLs, their procedures include the use of updated valuations of collateral and other credit risk mitigants, cash flow estimates based on assessments of borrower-specific factors, current and future macro-economic conditions, and forward-looking information that affects the expected collectability of the bank's exposure. Additionally, banks must ensure that un-collectability is recognised in the appropriate period through allowances for write-offs.

9.13 It is important that banks conduct validations of their ECL models and document the methodology used for such validations. The scope of the ECL model validation should include an assessment of the model inputs, model design and model output/performance. These validations involve ensuring that the models are suitable for their proposed usage at both the beginning stage and on an ongoing basis. Banks must also ensure that their model validation is performed independently of the model development process and is conducted by staff with the requisite expertise.

10. Requirements for Provisioning

10.1 Banks must maintain provisions that are adequate to absorb estimated credit losses associated with their credit portfolio. The adequacy of specific and general provisions should be reviewed in preparation of annual and quarterly reports or more frequently, if warranted, to ensure that the aggregate amount of provisions is consistent with current information about the collectability of the credit portfolio.

10.2 Banks should ensure that the framework and methodology for establishing provisions, whether determined on a portfolio basis or individually, are robust.

10.3 Banks should maintain adequate records to support their determination of expected losses and provisions and make such records available to the Commission for inspection on request.

10.4 Banks must provide the Commission with full access to information concerning the amount of provisions held against each classification of credit in relevant detail, within such period as may be agreed by the Commission.

10.5 The Commission in exercising its discretion may intervene where, in its opinion, the level of provisions estimated by the bank may be inadequate or the bank is being insufficiently prudent in its approach to its own provisioning policies.

10.6 For the purposes of this Guideline, the Commission may, by notice in writing, direct the bank to vary the level of provisions to a level which is more consistent with the bank's risk profile, should the Commission determine that a licensee is insufficiently prudent in its approach to its own provisioning policies, or is significantly at variance with best practice provisioning policies.

10.7 Banks must make a minimum provision for each credit classification category at least quarterly based on a review of the bank's credit portfolio. An increase in nonperforming assets should result in an increase in provisions. Furthermore, bank assessed loss provisions must be adequate to absorb estimated credit losses.

10.8 Banks will not be required to set aside provisions in the following instances, even where such exposures are classified as nonperforming:

(i) facilities, or portions thereof, including interest, which are adequately secured by cash, which is perfected in favour of the bank, and are in the process of collection; and

(ii) facilities, or portions thereof, supported by unconditional and irrevocable guarantees from the Government of the Turks and Caicos Islands and/or the Government of the United Kingdom.

10.9 **General Provisions**

Under the previous guidance, the Commission required all banks to maintain minimum general provisions equivalent to at least 1 per cent of the portion of the portfolio not reviewed. Under the accounting standard, general provisions are not applicable as ECLs must be recognised on all facilities from inception. However, for the purpose of this guideline, general provisions should be calculated as the higher of 0.5 per cent of the total credit portfolio of loans and advances (including off-balance sheet exposures that carry credit risk) and the calculation of Stage 1 loss allowance under the accounting standard. This general provision could be recognised as a capital item on the balance sheet, and therefore a reduction of asset is not required in the reporting to the Commission on the prudential returns. Notwithstanding, banks should also be guided by the paragraph in section 10.5. Banks are required to submit the summary results for the calculations of general provisions in the format prescribed in Schedule IV.

10.10 Specific Provisions

Under the regulatory method, banks shall calculate and report specific provisions at the minimum levels on the outstanding balance of credit facilities within each of the classification categories outlined in section 8. For the accounting method, banks must calculate and report specific provisions for exposures that have been designated as stage 2 and 3 or nonperforming exposures where a loss event has occurred, and the bank recognises these exposures as lifetime ECLs. Banks are required to calculate specific provisions under both the regulatory and accounting methods (stages 2 and 3) and book the higher of the two calculations as specific provisions. The table below prescribes the specific provisions that are to be applied to classified credits.

Credit Classification	Prudential Minimum Provisions Required
Standard	0%
Special Mention	0%
Substandard	20%
Doubtful	50%
Loss	100%

11. Write-Offs

11.1 Credit exposures should be written off and/or partially written off/down in a timely manner when they are no longer deemed collectable by the bank.

11.2 Credit exposures extended for the acquisition of residential or commercial properties, and which are adequately secured by collateral, the portion of credit exposure which has been deemed uncollectible shall be written off within 12 months of being classified as “loss”.

11.3 All other exposures that are not adequately secured by collateral shall be written off within 6 months of being classified as “loss’.

11.4 Facilities written off should be transferred to a memorandum account and be monitored for collection.

12. Treatment of Interest on Impaired/Nonperforming credit facilities

12.1 Reliable measurement of credit risk and prudent recognition of income derived from credit exposures are fundamental for sound credit risk management practices of banks. For this reason, as a rule, interest earned on credit facilities should be brought into the profit only where its collectability is not in doubt. Where there is uncertainty about whether income is in fact collectable, these interest amounts should be excluded from the profit and loss account, to avoid overstating of profit and ultimately capital. Hence, reversal of entries may be necessary at times.

12.2 With particular respect to accrual of interest on exposures:

(i) under IFRS 9, interest income is accrued using the effective interest rate applied to the gross carrying amount for credit facilities in stages 1 and 2 and on the net carrying amount for exposures in stage 3;

(ii) all 'nonperforming' assets are to be placed on a non-accrual basis. Any interest earned but not yet received should not be recognised as income;

(iii) all interest accrued from the date a facility becomes nonperforming shall be reversed unless such exposures are adequately secured and there is demonstrable assurance of full collection of outstanding principal and interest amounts within 90 days. It bears emphasis that exposures for which partial payments have been received but which are cumulatively 90 days or more in arrears shall also have their interest reversed;

(iv) interest should not be accrued on overdrafts or similar facilities above their approved limit or when credits to the account are insufficient to cover interest accruals for at least a 90-day period;

(v) interest may be accrued on loans to, or guaranteed by, approved governments[13] up to the approved limit of the guarantee or the value of the collateral, as the case may be;

(vi) all previously accrued but uncollected interest that has been previously accrued and recognised as income should be reversed against income in the accounting period in which the credit is classified, back to the first day of default;[14]

(vii) interest earned on a facility which has been classified as nonperforming should be recognised, as and when the interest is collected, i.e., on a cash basis.

12.3 Further to 12.2 above, interest reversed on nonperforming exposures should be reflected in a memorandum account.

12.4 It should be noted that reversal of income on any exposure should not prevent the bank from seeking to recover the full loss amount from the borrower. Evidence of recovery attempts should be clearly documented.

13. Restoration of Credit Facilities to Unimpaired/Performing Status

13.1 A facility is only fit for restoration to unimpaired status and regular income accrual when:

(i) all arrears of principal and interest pertaining to that facility have been cleared in full and has consistently been performing for a minimum of 12 months; and

(ii) there is demonstrable evidence that the counterparty's financial situation has improved so that full repayment of the exposure is likely, according to the original, or, where applicable, modified conditions.

13.2 In the case of an overdraft facility, restoration to performing status can occur when the account resumes operating within agreed limits for a minimum period of 90 days and all interest arrears have

[13] In this context, 'approved Governments' refer to the TCI or UK government and/or governments specially approved by the Commission.

[14] The amount reversed must therefore include all recorded but uncollected interest in the year-to-date and prior periods.

been cleared.

13.3 The process of restoring a nonaccrual facility to accrual status should be supported by a current, well documented evaluation of the borrower's financial condition and credit worthiness, incorporating all relevant and available information which would affect prospects for repayment.

13.4 It bears emphasis that a mere rescheduling of repayment terms does not justify reclassifying an impaired facility as unimpaired.

13.5 The following situation will not lead to a reclassification of an impaired facility to unimpaired:
(i) a partial write-off of an existing nonperforming exposure; or
(ii) extension of forbearance measures to an exposure that is already nonperforming, subject to the exit criteria identified in section 14.8.

14. Treatment of Forborne and Refinanced Exposures

14.1 Banks may offer forbearance, in the form of concessions, to debtors who are experiencing or are about to experience difficulties in meeting their financial obligations. It is therefore important that banks establish and clearly document the criteria under which it will extend forbearance to a customer that is having problems servicing their debt, as well as the type of assistance it is willing to offer.

14.2 In considering whether to extend forbearance to a customer, a bank must first establish the criteria to assess whether a customer is experiencing financial difficulties. Circumstances that indicate financial difficulties may include, *inter alia*:
(i) a customer is currently past due on any of its material exposures;
(ii) a customer is not currently past due, but it is probable that the customer will be past due on any of its material exposures in the foreseeable future without the forbearance, for example, when there has been a pattern of delinquency in the payments of the material exposure;
(iii) a customer's outstanding securities have been delisted, or are in the process of being delisted, or are under threat of being delisted from an exchange due to non-compliance with the listing requirements or for financial reasons;
(iv) based on actual performance, estimates and projections that encompass the customer's current capabilities, the bank's forecasts that the customer's available cash flows will be insufficient to service all of its exposures (principal and interest) in accordance with the contractual terms of the existing agreement for the foreseeable future;
(v) there is evidence that the customer is already having difficulty servicing current obligations;
(vi) the customer's exposures are already categorised as nonperforming i.e., substandard or would be classified as such without the forbearance; and
(vii) the customer cannot obtain funding from other financial banks at an effective interest rate equal to the current market interest rate for similar exposures for a 'non-troubled' customer.

14.3 Concessions may only be granted when the following conditions hold:
(i) the existing financial position of the borrower(s) clearly demonstrates the capacity to service the debt under the new terms of the contract and there is little or no doubt as to the full collection of

both principal and interest; and/or

(ii) the loan-to-value ratio is reduced, or the facility becomes adequately secured.

14.4 Where the modified term includes capitalisation of interest, the bank should ensure that the collateral value is adequate to cover the total balance under the forborne exposure and the interest capitalised should be treated as deferred income and transferred to the profit and loss account only when it has been realised.

14.5 Banks may grant forbearance on performing exposures. Any forborne exposure which subsequently becomes overdue for the payment of principal and/or interest, in full or in part, for 90 days or more, according to the terms of the agreement, should be classified as nonperforming and should remain as nonperforming until the borrower pays all overdue amounts in full.

14.6 Forbearance that is applied to a nonperforming exposure should remain nonperforming until they meet both criteria for exit from the forborne category outlined in section 14.8. When the original exposure would have been categorised as nonperforming had the forbearance not been granted, the new exposure should be classified as nonperforming.

14.7 Commercial and real estate facilities may only be restructured and restored to performing status twice within a five-year period.

14.8 A forborne exposure will be identified as such and cannot be reclassified upwards unless it meets both of the following exit criteria:

(i) when all the payments (principal and interest) have been made in full and in a timely manner, consistent with the new contractual terms, for at least one year; and

(ii) the bank has demonstrable evidence that the counterparty has resolved its financial difficulty.

14.9 Where concessionary terms are granted for reasons other than the financial difficulties of the borrower and the concessionary terms are equivalent to a new debt with similar credit risk characteristics, then the exposure shall not be considered forborne but a refinanced exposure.

14.10 Exposures shall only be refinanced when the existing position of the borrower demonstrates a capacity to service the debt under the new terms of the contract.

14.11 Interest on refinanced facilities should not be lower than the bank's average cost of capital.

15. Treatment of Moratoria/Forbearance in instances of Disasters

15.1 Banks may grant payment moratoria, which are a form of concession that offer temporary relief to customers affected by disasters and other catastrophes.

15.2 Banks should be guided by the following when designing and implementing disaster related payment moratorium programmes:

(i) To benefit from the treatment outlined in this guideline, the concession must be a bank-initiated moratoria schemes for all customers or a predefined class of customers. This guidance does not

apply to customer requested moratoria or to loans granted after the programme came into effect (excluding the use of existing credit lines or renewal of revolving loans).

(ii) A payment moratorium should only be applied to a credit facility where the facility was classified as Standard or Special Mention (i.e., performing and/or in arrears for up to 89 days) at the initial period of the moratorium. In cases where a bank may wish to grant payment moratoria to nonperforming facilities (i.e., Substandard, Doubtful or Loss) or restructured facilities with up-to-date payments of interest and principal amounts but remain classified as nonperforming per section 14.8, these accounts must be explicitly reported to the Commission along with the rationale for granting the moratorium.

(iii) Facilities that are at least 10 per cent of the loan portfolio or Tier 1 capital, whichever is least, that are being considered for a payment moratorium will require prior approval from the Commission.

(iv) Facilities under a qualifying moratorium programme should not be automatically recognised to have undergone a significant increase in credit risk unless there is reasonable and supportable information/evidence to establish further increase in a borrower's default risk. Therefore, these facilities should retain their loan classification status at the initial period of the moratorium. Banks are encouraged to be proactive in assessing changes in borrowers' credit risk.

(v) Where banks have determined an exposure to have undergone significant increase in credit risk, the necessary loan classification adjustments and provision are to be made in accordance with section 8 and section 10 of this Guideline, respectively.

(vi) Procedures to measure ECL must be robust and timely and reflect the mitigating effect of governmental economic support measures, economic conditions affecting borrowers cash flows and forward-looking factors affecting their repayment capacity.

(vii) At each reporting date banks are to report, in the prescribed form, on all accounts benefiting from a moratorium program.

16. Treatment of Investment and Debt Securities

16.1 Equity investments and debt securities including bonds, certificates of deposit, floating rate notes and commercial paper that carry credit risk should be included in the bank's credit classification exercise. These instruments shall be classified based on the credit soundness of the issuer or, where appropriate, the guarantor.

16.2 When classifying and measuring ECL for investments, banks are required to do so based on the following:

(i) Performing Assets – for those that have not had a significant increase in credit risk since initial recognition. Recognise 12-month ECL.

(ii) Underperforming Assets – where credit risk has increased significantly since initial recognition. Recognise lifetime ECL.

(iii) Nonperforming Assets – where the asset is credit impaired. Recognise lifetime ECL.

16.3 When measuring ECL for investments, a summary of the review must be submitted annually to the Commission in the prescribed format outline in Schedule II.

16.4 As part of its credit risk assessment process, banks must have comprehensive procedures and adequate information systems in place to monitor the quality of their investments. These include, but are not limited to, due diligence to determine the trends and financial performance of investments, information on changes in the external credit rating of investment instruments, use of models to determine any volatility in the instruments and on-going monitoring of the issuer(s) and related party/groups, where applicable.

16.5 Credit risk classification of investments and debt securities must be reassessed and updated regularly based on factors such, as but not limited to, industry outlook, business growth rates, consumer sentiments, changes in economic forecasts (such as interest rates, unemployment rates and commodity prices), weaknesses in underwriting identified after initial recognition, or departure from the listed primary source of repayment.

16.6 Credit risk classifications should be reviewed at least annually, more frequently where necessary, to reasonably ensure classifications of investments are accurate and current. Credit risk classifications for individually assessed investments that are deemed higher-risk or credit-impaired should be reviewed more frequently than annually.

16.7 All ECL estimates must be updated on a timely basis to reflect changes in credit risk classifications for either group or individual investments.

17. Treatment of Off-balance Sheet Exposures[15]

17.1 Off-balance sheet exposures that carry similar credit risk to that of loans and overdraft facilities should be classified and provided for when it becomes probable that the bank is unlikely to receive timely payment of the full amounts outstanding.

17.2 Off-balance sheet exposures should be assessed from inception in terms of financial performance, willingness and /or ability to repay, collateral protection and all inherent risks.

17.3 Banks must review at least annually, all large off-balance sheet commitments which equal or exceed 10 per cent of total off-balance sheet exposures. The review must also take account of the requirements as outlined under section 7.4.

17.4 Off-balance sheet exposures should be classified in accordance with section 8. Should evidence arise of deterioration of the counterparty's credit worthiness which would threaten timely repayment of any potential drawdown, associated interest or fees, the amount of the entire commitment (both drawn and undrawn amounts) should be adversely classified for irrevocable commitments. In respect of revocable commitments, Bank must adversely classify the drawn portion and the undrawn portion should be classified at best as special mention.

17.5 Off-balance sheet exposures must be assessed with a view to determining the extent of expected credit losses as well as any legal risk that may arise in the contractual obligations of the parties involved.

[15] Note that in this section, the treatment of off-balance sheet exposures does not apply to fiduciary services or funds managed alike.

17.6 Adequate provisions must therefore be made for any loss (credit or legal) that may arise from off-balance sheet exposures. Banks are required to make specific provisions where there is clear evidence of weaknesses in the facility and general provisions for potential losses that might arise. The details are contained in Schedule I.

17.7 The following factors are to be taken into consideration in recognising contingent losses on off-balance sheet exposures:

(i) whether the bank is irrevocably committed to advance additional funds under the credit agreement;
(ii) date the liability was incurred;
(iii) expiry date;
(iv) security pledge;
(v) performance of other facilities being used by the customer; and
(vi) perceived risk.

18. Multiple Exposure to a Single Borrower

18.1 Where one or more of a group of exposures (whether to a single borrower or to a group of related borrowers) has/have been classified as nonperforming, the other facilities held or guaranteed by that borrower or borrower group should be classified at best as special mention and specially monitored, in light of the known financial difficulties. Adverse classification may not be warranted provided there is clear evidence that:

(i) there is no financial interdependence between the related persons[16], cross-collateralization of the facilities, or cross-guarantee arrangements; or
(ii) where there are cross-collateralization arrangements in place, the net realizable value of such collateral (after appropriate discount) is sufficient to ensure collectability of all principal and interest on both impaired and performing facilities.

19. Treatment of Collateral

19.1 Credit collateralisation is an important part of sound and effective credit risk management by banks. Banks should assess any pledged collateral that is used for the purposes of risk mitigation against the requirements for collateral set out in the bank's credit risk appetite, policies and procedures, including the valuation and ownership, and check all relevant documentation.

19.2 Banks must also ensure that any assets pledged as collateral meet the requirements set out in section 4.7.

19.3 While not an exhaustive list, the Commission will generally consider the underlying assets/property as suitable support for lending arrangements, provided there is evidence that these have been properly assigned to the order of the subject bank:

(i) Financial assets comprising:
  (a) cash and deposits that have been legally hypothecated to the bank;
  (b) equity investments[17] and bond instruments measured at fair value and where the bank

[16] For definition on related person, see the Commission's guidelines on large exposure and credit risk concentration.
[17] Equity investment is defined as purchased shares of a company that allows the investor to benefit from a capital gain when the share price rise in value and/or entitles the investor to a stream of dividend payments.

has a legal lien on the instrument and its proceeds, whether it be dividends, coupon payments or other yields;

(c) marketable securities, as defined by the Commission[18]; and

(d) life insurance policies assigned to the bank and for which there is supporting evidence of this assignment. The value of the life insurance is determined by its net cash surrender value.

(ii) Non-financial assets comprising:

(a) Motor vehicles, provided that all of the following are satisfied:

(i) there is proof of ownership or right of pledge by the borrower or guarantor;

(ii) the bank has a legally registered first lien over such chattel;

(iii) the vehicle is covered under an in-force, comprehensive insurance policy, proceeds of which have been legally assigned to the bank; and

(iv) the estimated net realizable value of such motor vehicle is sufficient to cover outstanding principal, interest and other applicable charges after discounting based on the following table:

Age of vehicle (V)	Net Realizable Value of Motor Vehicle
Fewer than 18 months old	100% of the value
More than 18 and fewer than 36 months old	85% of the value
More than 36 and fewer than 48 months old	60% of the value
More than 48 and fewer than 60 months old	45% of the value
More than 60 and fewer than 84 months old	30% of the value
More than 84 months old	0% of the value

(b) Real estate, provided all of the following are satisfied:

(i) there is proof of ownership or right of pledge by the borrower or guarantor;

(ii) the bank has a legally registered charge over such real estate;

(iii) the property, unless it is unimproved land only, is insured for sufficient value to fully cover the exposure and assigned to the bank; and

(iv) the estimated net realizable value of such real estate is sufficient to cover outstanding principal, interest and other applicable charges after discounting based on the following table:

Age of real estate valuation (V)	Net Realizable Value of real estate	
	Commercial Real Estate	Residential Real Estate
Fewer than 24 months old	100% of value	100% of value

[18] Consistent with the Commission's liquidity guidelines, a security is considered marketable if it is traded on large, deep and active repo or liquid markets with assured rapid settlement on delivery versus payment basis.

More than 24 and fewer than 36 months old	80% of value	90% of value
More than 36 and fewer than 60 months old	70% of value	80% of value
More than 60 months old	50% of value	50% of value

(c) Plant, property (other than real estate) or equipment, provided all the following are satisfied:

(i) there is proof of ownership or right of pledge by the borrower or guarantor;
(ii) the bank has a legally registered first lien over such chattel;
(iii) the asset is covered under an in-force, comprehensive insurance policy, proceeds of which have been legally assigned to the bank; and
(iv) the estimated net realizable value (NRV) of such asset is sufficient to cover outstanding principal, interest and other applicable charges after discounting based on the following table:

Age of valuation (V)	**Net Realizable Value of Plant, Property and Equipment**
Fewer than 12 months old	100% of the value
More than 12 and fewer than 24 months old	75% of the value
More than 24 and fewer than 36 months old	50% of the value
More than 36 months old	0% of the value

(d) Guarantees or irrevocable undertakings issued by the Government of the Turks and Caicos Islands, the Government of the United Kingdom or other government approved by the Commission.

(e) Guarantees or irrevocable undertakings from companies and/or individuals backed by pledged assets from among the list at (a) through (g) immediately above.

19.4 Banks may be guided by the minimum factors applied by the Commission to discount motor vehicle, real estate, plant, other property or equipment pledged as collateral. However, the Commission may permit banks to apply their own systems and methodologies in conjunction with historical loss experience to determine the level of discounts to apply internally. Banks will need to formally write to the Commission seeking approval to apply their internal systems. Banks will also need to demonstrate that their internal systems are robust and that satisfactory levels of prudence have been applied under these methodologies.

19.5 Banks must ensure that they have a clear legal claim to collateral used to secure a facility in the case of default.

19.6 Banks must ensure that collateral used to secure a facility is not pledged as security for other facilities or that the collateral is of sufficient value to allow for a second pledge and the term and conditions of the first pledge does not prohibit further liens on the collateral.

19.7 The loan classification exercise outlined in sections 8 shall not depend on the amount or quality of collateral pledged.

19.8 When assessing a borrower's credit worthiness, banks should put emphasis on the borrower's realistic and sustainable future income and future cash flows and not on the available collateral.

19.9 Rules for valuing non-financial assets[19] pledged as collateral

(i) When a credit facility is collateralised by non-financial assets, banks should ensure that the valuation of the collateral is carried out accurately at the point of underwriting the loan.

(ii) Banks must have clear and documented internal policies and procedures for the valuation of collateral. The policies and procedures should specify the valuation approaches to be used by the valuer, where needed. Banks should ensure that these approaches are prudent and proportionate to the type and value of the collateral in relation to the credit agreements and are in line with the credit risk policies of the bank.

(iii) Banks should ensure that the valuation of collateral held against material credits is assessed by an internal or external/independent valuer using full site visits taking account of the interior and exterior of the physical asset.

(iv) Banks using external/independent valuers should establish a panel (list) of accepted valuers having the relevant technical skills and experience in valuation and who are independent from the credit decision process.

(v) Banks should ensure that the valuers provide an impartial, clear, and transparent valuation. Each valuation should have a final report providing the necessary information, in particular:

- *(a)* the purpose of the valuation (whether for the purposes of loan application, renewal or contractual adjustments, or in the case of structural changes (real estate);
- *(b)* the reference value of the asset;
- *(c)* the approach, methodology and key parameters and assumptions that have been used to assess the value;
- *(d)* a description of the asset, including its current use or multiple uses if applicable, and the property type and quality, including age and state of preservation;
- *(e)* a description of the location of the asset, the local market conditions and the marketability; and
- *(f)* any known circumstances that may affect the value in the short term, including drawing attention to and commenting on any issues affecting the degree of certainty or uncertainty.

(vi) It is the responsibility of the banks to critically review the valuation received from the valuer, in particular, focusing on aspects such as comprehensibility (whether the approaches and assumptions are clear and transparent), the prudence of assumptions and the clear and reasonable identification of comparable assets used as a value benchmark.

(vii) Collateral (other than real estate) held against all material credits that are classified as

[19] This refers to motor vehicle and property, plant and equipment including real estate.

nonperforming must be subject to internal valuations at least annually.

(viii) Real estate collaterals held against all material credits must be subject to internal valuations at least once every five years. However, and independent valuation must be conducted within three months by a qualified valuer in the following circumstances:

(a) where significant changes in the real estate market are detected;

(b) where the property value may have declined materially relative to general market prices; and

(c) if the credit exposure is in default.

20. External Auditors

20.1 Each bank should require its external auditor to submit a statement to the Commission at the conclusion of each financial audit exercise attesting to:

(i) the adequacy of systems and processes applied in asset quality monitoring, identification and management of problem assets, estimation of expected credit losses and determination of the prudential provisioning levels;

(ii) that provisioning levels are not less than the minimum which would be calculated under the Commission's prudential methodology.

20.2 Where provisions required by the Commission for credit losses (whether under this Guideline or otherwise) exceed those amounts prescribed by accounting standards, external auditors should ensure that those excess amounts are reported in the audited financial statements as a 'Regulatory Credit Loss Reserve' account, annotated to indicate these reserves have been established in satisfaction of regulatory requirements. Notwithstanding this general requirement, the Commission may require banks to assign portions or all of any excess as specific provisions.

Revised February 2023

Schedule I - Credit Portfolio Review Summary for Loans, Advances, Overdrafts and Off-balance Sheet Facilities

Name of Bank ___________________________________

As at_______________________________________

A.	**Category**	**Standard**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**	**Total**
B.	**Percentage (%) Provisioning**	0%	0%	20%	50%	100%	
C.	**1. Total Loans, Advances and Overdraft Facilities [1(a) + 1(b)]**						
	(a) Value of Loans Reviewed						
	(b) Value of Loans Not Reviewed						
	(c) Number of Accounts						
	(d) Number of Accounts Reviewed						
D.	**1. Total Value of Reviewed Accounts (before section 10.8 exclusions)**						
	Less:						
	(a) Total value of classified credits fully secured by cash and in the process of collection						
	(b) Total value of (the portions of) facilities supported by unconditional and irrevocable guarantees from the Government of the TCI and/or Government of the UK						
	2. Total Value of Reviewed Accounts [after netting (a) and (b) above]						
E.	**1. Total Number of Nonperforming Facilities**						
	(a) Value of Substandard Facilities						
	(b) Value of Doubtful Facilities						
	(c) Value of Loss Facilities						
	2. Total Value of Nonperforming Facilities [1(a) + 1(b) + 1(c)]						
F.	**1. Total Off-balance Sheet Facilities[20] [(a) + (b)]**						
	(a) Value of items reviewed						
	(b) Value of items not reviewed						
	(c) Total number of accounts						
	(d) Total number of accounts reviewed						
G.	**1. Total Required Specific Provisions**						

[20] These should only include facilities that carry credit risk.

	2. Loans, Advances and Overdraft Facilities [G2(a) + G2(b)]						
	(a) Specific provisions under RM[21] [% at Row B x {E1(a) + E1(b) + E1(c)}]						
	(b) Specific provisions under AM[22] [Exposures designated as stages 2 and 3]						
	3. Off-balance Sheet Facilities [G3(a) + G3(b)]						
	(a) Specific provisions under RM [% at Row B x {F1(a)}]						
	(b) Specific provisions under AM [Exposures designated as stage 2 and 3]						
H.	**Booked Provisions for Losses**						
I.	**Excess/(Deficiency) [G1 – H]**						

Item	**Total number of accounts**	**Total Principal**	**Total Interest**
Recoveries for the year			
Write-offs			
Renegotiated facilities			
Restructured facilities			
Facilities with moratoria programmes arising from disasters/catastrophes			

Schedule II – Accounting Standards Review of Loans, Advances, Overdrafts and Off-balance Sheet Facilities

As at____

No.	**Facility**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
1	Value of Accounts Reviewed				
2	Value of Accounts Not Reviewed				
3	Number of Accounts Reviewed				
4	Number of Accounts Not Reviewed				
5	IFRS/USGAAP Required ECL				
6	Booked/Recognised ECL Allowance				
7	Excess/(Deficiency) [Item 5-Item 6]				

[21] RM – regulatory method
[22] AM – accounting method

Schedule III - Accounting Standards Review of Investments and Debt Securities

As at____

No.	Investments & Debt Securities[23]	Stage 1	Stage 2	Stage 3	Total
1	Value of Accounts Reviewed				
2	Value of Accounts Not Reviewed				
3	Number of Accounts Reviewed				
4	Number of Accounts Not Reviewed				
5	IFRS/USGAAP Required ECL				
6	Booked/Recognised ECL Allowance				
7	Excess/(Deficiency) [Item 5-Item 6]				

Schedule IV - Accounting Standards Review of Other Credit Risk Facilities

As at____

No.	Other Facilities	Stage 1	Stage 2	Stage 3	Total
1	Value of Accounts Reviewed				
2	Value of Accounts Not Reviewed				
3	Number of Accounts Reviewed				
4	Number of Accounts Not Reviewed				
5	IFRS/USGAAP Required ECL				
6	Booked/Recognised ECL Allowance				
7	Excess/(Deficiency) [Item 5-Item 6]				

[23] These should only include investment and debt securities that carry credit risk.

Schedule V – Calculation of General Provisions

As at_______________________________________

No.	Credit Risk Facilities	Gross Outstanding Balance	0.5% of Outstanding Balance	Stage 1 ECL	Higher of the Regulatory and Accounting Method
1	Loans, Advances and Overdrafts				
2	Off-balance Sheet Exposures				
3	Other Credit Exposures[24]				
4	**Total**				

[24] As directed by the Commission and/or have been determined by the bank due to economic conditions/uncertainties.