GOVERNMENT OF ZAMBIA

STATUTORY INSTRUMENT No. 142 of 1996

The Banking and Financial Services Act
(Act No. 21 of 1994)

The Banking and Financial Services (Classification and Provisioning of Loans) Regulations, 1995

In EXERCISE of the powers contained in sections *fifty-eight and one hundred and twenty-four* of the Banking and Financial Services Act, 1994, and on the recommendation of the Bank of Zambia, the following Regulations are hereby made:

PART I

PRELIMINARY

1. These Regulations may be cited as the Banking and Financial Services (Classification and Provisioning of Loans) Regulations, 1996, and shall come into operation on the 1st January, 1997. Title

2. In these Regulations, unless the context otherwise requires- Interpretation

"allowance for loan losses" means a balance sheet valuation account established, through charges to the income statement, to absorb anticipated losses in respect of a bank's or a financial institution's on-balance sheet and off-balance sheet loans and commitments;

"Board" means the Board of Directors of a bank or a financial institution;

"capitalisation of interest" means-

(a) the process whereby accrued but uncollected interest is added to the unpaid principal balance at the payment date or maturity of a loan; or
(b) interest which is refinanced or rolled-over into a new loan facility;

"in the process of recovery" means that the efforts of collecting a debt are proceeding on course with the final recovery not expected to exceed one hundred and twenty days, either through-

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(a) legal action against the borrower; or
(b) collection efforts which do not involve legal action, but which, in the near future, are expected to result in the repayment of the loan, including interest or, in its restoration to current status through payment of all the principal and the interest due;

"loan" means-
(a) any direct or indirect advance of funds, whether secured or unsecured, made on the basis of any obligation of the recipient or on the recipient's behalf to repay the funds; or
(b) leasing, and all credit risks, arising from actual claims and potential claims of all kinds, overdrafts, credit substitutes or commitments to extend credit and to acquire a debt security or other right of payment of a sum of money;

"non-accrual loan" means a loan-

(a) on which interest is no longer being taken into income unless paid by the borrower in cash;
(b) which has been placed on a cash basis for the purpose of financial reporting;
(c) on which principal or interest is due and unpaid for ninety days or more; or
(d) on which interest payments equal to ninety days' interest or more have been capitalised, refinanced, or rolled-over;

"non-performing loan" has the same meaning as in the Act;

"past due loan" means a loan where payment of principal or interest in contractually past due, but which has not yet been included in non-accrual loans;

"provision for loan losses" means a charge against income which is added to the Allowance for Loan Losses Account to ensure that the account is maintained at an adequate level in order to cover all anticipated loan losses, after taking into account any write-offs or recoveries of specific loans;

"renegotiated loan" means a loan which has been refinanced, rescheduled, rolled-over, or otherwise modified on such terms and conditions as may have been agreed by the parties thereto because of the weakened financial condition of the borrower resulting in the borrower's inability to repay in accordance with the original terms of the loan;

"senior management" means the officers responsible for the administration of a bank or a financial institution;

"well secured" means securing a loan by-

(a) collateral in the form of perfected liens on, or pledges of, real or personal property;
(b) securities that have realisable value net of realisation costs which is documented in writing and available for examination and which is sufficient to repay the debt and accrued interest in full; or
(c) the guarantee of a financially responsible party, irrevocable guarantees issued by banks which are internationally rated as "first class" banks, multi-national companies, and governments where the beneficiary bank has performed the financial analysis necessary to determine that the issuer is financially sound, well-capitalised, and able to pay the guarantee on demand or upon the default of the borrower and which guarantee is properly acknowledged by the issuer through independent confirmation.

PART II

LOAN REVIEW SYSTEM AND RELATED POLICIES AND PROCEDURES

Loans policy

4. The Board shall adopt a loans policy which shall specify, at a minimum-

(a) standards for loans and extensions of credit; and
(b) the bank's or financial institution's functions of lending and approving of loans, delegation of responsibilities, and the process of reviewing the quality of loans.

Loan review system

5. (1) The Board shall establish, in writing, a loan review system which shall identify risk, assure the adequacy of the Allowance for Loan Losses Account, and properly reflect such result in its financial statements.

(2) The loan review system referred to in sub-regulation (1) shall, at a minimum, ensure that-

(a) the loan portfolio and lending function of a bank or a financial institution conforms to the loans policy referred to in regulation 4;
(b) the executive management and the Board are at all

times adequately informed about portfolio risk;

(c) all loans are regularly evaluated using an objective grading system which is consistent with these Regulations;

(d) loans which have, or are likely to have, a problem are properly identified, classified and placed on non-accrual status, in accordance with these Regulations;

(e) timely, appropriate provisions and write-offs of identified losses are made to the Allowance for Loan Losses Account, so as to maintain the account at a level which will-

(i) accurately reflect the fair and realisable value of the loans in the balance sheet; and

(ii) meet the overall minimum provisioning levels specified in these Regulations;

(f) allowances and provisions are properly reflected in the bank's or the financial institution's financial statements.

(3) The loan review system referred to in sub-regulation (1) shall be reassessed on a regular basis in the light of current circumstances and shall be submitted to the Board at least once a year, for review and approval.

Loans Review Committee

6. (1) There shall be a Loans Review Committee in every bank or financial institution which shall consist of not less than three members.

(2) The Chief Executive Officer of the bank or the financial institution shall be a member of the Loans Review Committee referred to in sub-regulation (1).

(3) The members of the Loans Review Committee referred to in sub-regulation (1) shall be appointed by the Board from amongst the members of the Board.

(4) A bank or a financial institution shall, through the Loans Review Committee and at least once every calendar quarter, review the quality and collectability of all loans in its loan portfolio, including any accrued and unpaid interest.

(5) The Loans Review Committee shall, immediately after the review referred to in sub-regulation (4), make a detailed report of such review directly to the Board, which shall take appropriate action on the report.

(6) A bank or a financial institution shall at all times maintain reasonable records in support of the evaluations and related entries of those records and shall make the records available for inspection as and when requested by the Bank of Zambia.

PART III

DETERMINATION AND TREATMENT OF NON-ACCRUAL LOANS AND RELATED ACCOUNTS

Transfer to non-accrual status

7. (1) A bank or a financial institution shall place a loan in non-accrual status if-

(a) there is reasonable doubt about the ultimate collectability of the principal or the interest;
(b) a specific provision has already been established on the loan;
(c) except in the case of a restructured loan, the loan has been partially or entirely written off; or
(d) the principal or the interest has been in default for a period of ninety days or more, or the account has been inactive for ninety days and deposits are insufficient to cover the interest capitalised during the period.

Treatment of income on non-accrual loans

8. Where a loan is placed in non-accrual status under these Regulations-

(a) all previously accrued but uncollected interest taken into income shall be reversed, at the latest, by the end of the quarter in which the loan was placed in non-accrual status;
(b) interest which has accrued during a current quarter shall be reversed against the income of that quarter; and
(c) interest accrued in periods other than the current quarter shall be charged to the Allowance for Loan Losses Account.

Treatment of cash payments on non-accrual loans

9. (1) Where a loan is placed in non-accrual status, any cash payments received shall first be applied to reduce the amount of the principal outstanding and due.

(2) Where the principal outstanding of the loan which is due has been fully recovered, any further excess payments may be taken into income, provided the amount of income recognised is limited to the amount which would have been due to the bank or the financial institution if the loan had been current at its contractual rate.

(3) Any further excess payments referred to in sub-regulation (1)

shall be applied against any additional balance outstanding on the loan.

(4) Where a renegotiated or a restructured loan exists, payments shall be taken into income on the basis of the revised terms of the loan agreement.

(5) Any determination by senior management or the Board that a loan is ultimately collectable shall be supported by-

(a) a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment; and

(b) a consideration of the borrower's historical repayment performance.

Restoration to accrual status

10. (1) A non-accrual loan shall only be restored to accrual status when-

(a) all payments of the principal and interest become fully current and senior management has determined that there is no reasonable doubt the ultimate collectability of the principal or the interest of the loan; or

(b) when the loan otherwise becomes well-secured and is in the process of recovery.

(2) For the purposes of paragraph (a) of sub-regulation (1), a bank or financial institution shall have received repayment of all the principal and the interest in arrears, unless the loan has been formally restructured and qualifies for accrual status.

(3) Until a loan is restored to accrual status, any cash payments received shall be treated in accordance with the provisions of regulation 9.

Renegotiated loans

11. (1) A renegotiated loan shall return to performing status-

(a) When the rate charged for the loan is equivalent to the rate that would be charged on a new fully performing loan of similar merit; and

(b) where all payments are fully current and senior credit management has determined, based on available and documented information, that there is no reasonable doubt about ultimate collectability of the principal or the interest.

(2) Where a loan is reclassified from non-current to performing status, all existing specific provisions shall be extinguished prior to that reclassification.

Treatment of multiple loans to one borrower

12. Where a bank or a financial institution has a number of loans outstanding to a single borrower, and one of those loans meets the criteria from non-accrual status, the bank or the financial institution shall evaluate all other loans to that borrower and if the bank or the financial institution considers it appropriate, place one or more of such other loans in non-accrual status.

Allowance for Loan Losses Account

13. (1) A bank or a financial institution shall maintain at all times a balance, in the Allowance for Loan Losses Account, that is the best possible estimate of probable loan related losses existing in the portfolio of on-and off-balance sheet items in the light of current conditions.

(2) The Allowance for Loan Losses Account shall-

(a) in the case of balance sheet assets, except for acceptances, appear as deduction from the applicable asset; and

(b) in the case of acceptances and off-balance sheet items such as guarantees or letters of credit, appear as a separate item with other liabilities.

Additions and reductions to the Allowance for Loan Losses Account

14. (1) Any additions to, or reductions from, the Allowance for Loan Losses Account shall be made through charges or credits to the Provision for Loan Losses Account in the income statement, and all loan write-offs or recoveries shall be charged or credited directly to the Allowance for Loan Losses Account.

(2) A loan loss or recovery shall not be charged or credited directly to "retained earnings" or to any other capital related account.

Provision for loan losses

15. (1) The amount of the provision for loan losses that is charged to the income statement shall be the amount that is required to establish a balance in the Allowance for Loan Losses Account which management considers adequate to absorb all credit related losses in its portfolio of on-and off-balance sheet items and which, at a minimum, meets the provisioning requirements specified in these Regulations.

(2) All loans that are written off shall be charged directly to the Allowance for Loan Losses Account.

(3) Where no provisions are established, a provision shall be made in an amount sufficient to cover the loan amount that is to be written off, and shall be written off against the Allowance for Loan Losses Account.

PART IV

DETERMINATION OF AMOUNT OF POTENTIAL LOSS AND CLASSIFICATION OF LOANS

Determination of amount of potential loss

16. (1) In determining the amount of potential loss related to individual loans and to the aggregate of the loans portfolio of a bank or a financial institution, the following factors shall be considered:

(a) the historical loan loss experience;
(b) the current economic conditions;
(c) the delinquency trends;
(d) the effectiveness of the bank's or financial institution's lending policies and collection procedures; and
(e) the timeliness and accuracy of the bank's or financial institution's loan review function.

Classification of loans

17. (1) Subject to regulation (2), all loans of a bank or a financial institution shall be classified by the bank or the financial institution in one of the categories outlined in sub-regulations (3) to (6).

(2) Notwithstanding sub-regulation (1), an adverse classification may be warranted and appropriate where-

(a) a significant departure from the intended source of repayment develops even if a loan is current and supported by underlying collateral value; or
(b) where repayment terms originally were too liberal or a delinquency has been cured by modifications, refinancing, or additional advances.

(3) A loan shall be classified in the "pass" category if it is-

(a) considered current and performing in accordance with its contractual terms and expected to continue doing so; and
(b) fully protected by the current sound worth and paying capacity of the borrower or of the collateral pledged.

(4) A loan shall-

(a) be classified "standard" if it-

(i) is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged; or
(ii) has well-defined weaknesses that may

jeopardize the orderly repayment of the debt.

(b) at a minimum, be classified "substandard" if it is in arrears as to the principal or interest for ninety days or more, but less than one hundred and twenty days.

(5) A loan shall-

(a) be classified "doubtful" loan if-

(i) it is considered to have all the weaknesses inherent in a substandard loan; and

(ii) collection or orderly repayment in full, on the basis of currently existing facts, conditions and values, is highly questionable.

(b) at a minimum, be classified "doubtful" if it is in arrears as to principal or interest for one hundred and twenty days or more, but less than one hundred and eighty days.

Minimum provisioning requirements

18. (1) The loan classification set out in the First Schedule shall apply to the corresponding minimum percentages set out in that Schedule.

(2) Any loan or portion of a loan which is fully secured by cash, by a segregated deposit in the lending bank, or by a security issued by the Government of Zambia shall be exempt from the provisioning requirements referred to in sub-regulation (1).

(3) Any loan or portion of a loan which is assigned a "Loss" classification shall be fully provisioned at the time the loss is identified.

(4) The Bank of Zambia may, under exceptional circumstances, with its prior written approval and under such terms and conditions as it may consider necessary, vary a provisioning level for a period not exceeding one year.

Examiner review

19. (1) A bank or a financial institution shall maintain reasonable records in support of its evaluation of potential loan losses and of the entries made to ensure that an adequate provisioning level is maintained in the Allowance for Loan Losses Account.

(2) The records and entries referred to in sub-regulation (1) shall be made available to the Bank of Zambia for review in order to enable it to assess management's estimation procedures, the reliability of the

information on which estimates are based, and the adequacy of the Allowance for Loan Losses Account.

20. A bank or a financial institution shall, within ten days after the last day of every month, or such other reporting period as may be determined by the Bank of Zambia, submit to the Bank of Zambia- Reporting requirements

(a) a balance sheet which reflects the Allowance for Loan Losses Account in an amount which is adequate to absorb potential losses within the bank's or the financial institution's on-and-off-balance sheet exposures;
(b) an income statement which reflects the provision for loan losses which is necessary to maintain the Allowance for Loan Losses Account at an adequate level;
(c) details of the classification of its loan portfolio in the Form set out in the Second Schedule; and
(d) such other information, report or detailed information as may be requested by the Bank of Zambia in the format and within such time as the Bank of Zambia may request.

FIRST SCHEDULE
(Regulation 18)

BANK OF ZAMBIA

MINIMUM PROVISIONING PERCENTAGES APPLYING TO LOAN CLASSIFICATION

Loan Classification	*Provisioning Percentage*
Pass	At bank discretion
Substandard	Twenty per centum (90-119 days)
Doubtful	Fifty per centum (120-179 days)
Loss	One hundred per centum (180 days +)

SECOND SCHEDULE
(Regulation 20)

BANK OF ZAMBIA

CLASSIFICATION OF LOANS AND PROVISIONS

Name of institution:…………………………………………………………………….
As at: (month/year):…………………………………………………………………….
(in K'000)

	Total Gross Balances	Total of Specific and General Provisions	Net Balances
(I) PASS Number of accounts ___________	___________	___________	___________
(II) SUBSTANDARD			
(a) List names of accounts (K10m and above) - - - -			
(b) Others (number of accounts below K10m)	___________	___________	___________
Sub-total (II) (a + b)	___________	___________	___________
(III) DOUBTFUL			
(a) List names of accounts (K10m and above) - - - - -			
(b) Others (number of accounts below K10m)	___________	___________	___________
Sub-total (III) (a + b)	___________	___________	___________

(V) LOSS (a) List names of accounts (K10m and above) - - - -			
(b) Others (number of accounts below K10m)	____________	____________	____________
Sub-total (IV) (a + b)	____________	____________	____________
TOTAL (I) to (IV)	____________	____________	____________

NOTES: The total of the "Total Gross Balances" column must agree with the Loans account balance appearing in a bank's or financial institution's balance sheet.

The total of the "Net Balances" column must agree with the net of the Loans account balance less the Allowance for the Loan Losses Account in a bank or financial institution's balance sheet.

LUSAKA
30th August, 1996
[MOF.101/16/95]

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Minister of Finance and
Economic Development