Bank Of Zambia

OFFICE OF THE DEPUTY GOVERNOR - OPERATIONS

BOZ/EXEC/DGO/banksup/bp

December 29, 2017

CB Circular No. : 11/2017

To : All Heads of Commercial Banks and Financial Institutions

THE IMPLEMENTATION OF THE INTERNATIONAL FINANCIAL REPORTING STANDARD 9, FINANCIAL INSTRUMENTS, BY FINANCIAL SERVICE PROVIDERS

The International Financial Reporting Standard 9, Financial Instruments (IFRS 9) takes effect on January 1, 2018 and will replace the current standard, the International Accounting Standard 39, Financial Instruments: Recognition and Measurement (IAS 39).

IFRS 9 provides a complete shift in terms of accounting for loan loss provisions by introducing an 'expected credit loss model' compared to the current 'incurred loss model' under IAS 39. The provisioning accounting under IFRS 9 will entail higher provisioning amounts compared to those computed under IAS 39. This will give rise to a difference in the provision figures computed under IAS 39 as at December 31, 2017 and the opening balance on January 1, 2018 computed under IFRS 9. In compliance with IFRS 9, this difference will require to be expensed by the financial service providers (FSPs). In order to lessen the impact on the financial condition of the FSPs, particularly on regulatory capital requirements, the Bank of Zambia (Bank) has prescribed a transition period of three years over which to amortise this difference.

Attached to this Circular is the **Bank of Zambia IFRS 9 Guidance Note No. 1,** which provides guidance to on how provisions under IFRS 9 will be treated for regulatory purposes. The Guidance Note also outlines transitional arrangements to ensure that the negative impact of the anticipated higher provisions at the time of adoption of the standard are moderated.

Given that this will constitute a fundamental change in provisioning accounting, FSPs are advised to ensure that their risk management systems are closely aligned with the requirements of the standard. Further, FSPs will be required to develop new, robust and resilient internal controls, systems, models and governance arrangements to ensure full compliance with the requirements of IFRS 9. It is the expectation of the Bank that FSPs have made the necessary preparations to allow for a smooth transition from the accounting requirements under IAS 39 to IFRS 9 to the new standard as it takes effect on January 1, 2018.

Please be guided accordingly,

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DEPUTY GOVERNOR – OPERATIONS

Cc Governor
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THE BANK OF ZAMBIA IFRS 9 GUIDANCE NOTE NO. 1

This Guidance Note provides guidance on the modalities of implementation of the International Financial Reporting Standard 9, Financial Instruments (IFRS 9) from a regulatory perspective as follows:

1. IFRS 9 Accounting Provisions and the Banking and Financial Services (Classification and Provisioning of Loans) Regulations

For determining the required provisions under the Banking and Financial Services Act, the minimum shall be the higher of:

a. Provisions stipulated by the Banking and Financial Services (Classification and Provisioning of Loans) Regulations; or

b. Accounting provisions in accordance with the requirements of IFRS 9.

Further, where the IFRS 9 accounting provisions are lower than the provisions stipulated by the Banking and Financial Services (Classification and Provisioning of Loans) Regulations, the difference between the two amounts shall be treated as appropriations of retained earnings by creating a general banking loan loss reserve on the balance sheet, and not as a charge to the income statement. Similarly, if in a subsequent reporting period, there is need to reduce the general banking loan loss reserve, such a reduction shall be added back to retained earnings and not as a credit to the current period's income statement.

2. Regulatory Treatment of the IFRS 9 Accounting Provisions

For regulatory capital purposes, the IFRS 9 accounting provisions shall be categorized as either general provisions (GP) or specific provisions (SP) as follows:

a. Financial instruments for which the FSP determine that at the reporting date there has been no significant increase in credit risk since initial recognition (i.e., Stage 1 exposures in line with the requirements of IFRS 9), the associated accounting provisions shall be treated as GP.

b. Financial instruments for which the FSP determine that at the reporting date there has been a significant increase in credit risk since initial recognition, but that they are not credit impaired (i.e., Stage 2 exposures in line with the requirements of IFRS 9), the associated accounting provisions shall be treated as GP.

c. Financial instruments for which the bank determine at the reporting date that they are credit impaired (i.e., Stage 3 exposures in line with the requirements of IFRS 9), the associated accounting provisions shall be treated as SP.

3. IFRS 9 Transitional Arrangements

A. APPROACH

Transitional arrangements have been introduced in line with the guidance given by the Basel Committee on Banking Supervision (see the document entitled 'Regulatory treatment of accounting provisions – interim approach and transitional arrangements, March 2017' on the following link for more details: https://www.bis.org/bcbs/publ/d401.htm).

The transitional arrangements are intended to ensure that the FSPs' regulatory capital does not breach the minimum requirements immediately following the implementation of IFRS 9 provisioning requirements. Under the arrangements, FSPs will be granted a three-year transition period in which to amortise, on a straight-line basis, the IFRS 9 transitional adjustment amount to be computed as in sub-section B below.

The transitional arrangements shall only apply to general provisions as defined in section 2 of this Guidance Note and shall not apply to provisions, which otherwise should have been raised, either in terms of the requirements of IAS 39 or as stipulated by the Banking and Financial Services (Classification and Provisioning of Loans) Regulations, but the FSP did not comply. Consequently, the Bank shall enter into bilateral discussions with each FSP to ensure that these arrangements are implemented as originally intended.

B. IFRS 9 TRANSITIONAL ADJUSTMENT AMOUNT

i. The IFRS 9 transitional adjustment amount (adjustment amount) will be computed using a static approach (a one-off calculation) as in the box below:

An FSP shall compare primary capital based on the opening balance sheet (i.e., January 1, 2018) using IFRS 9 with primary capital based on the closing balance sheet (i.e., December 31, 2017) using IAS 39. The decrease in qualifying primary capital (net of tax effect) shall be the adjustment amount.

ii. The adjustment amount shall be added back to primary capital under line item 21 (other adjustments) on Schedule 15 of the Prudential Returns (to be expressed in negative), as follows for each year during the three years' transition period:

Year 1	3/4 of adjustment amount
Year 2	2/4 of adjustment amount
Year 3	1/4 of adjustment amount

iii. The unamortised portion of the adjustment amount shall be risk weighted at 100% and shall be included under line item 37 (other assets) in Schedule 14 of the Prudential Returns. This amount shall also be decreased annually on a straight-line basis over a three-year period.

C. DEFERRED TAX ASSET

The deferred tax asset impact resulting from the adoption of IFRS 9 will be phased-in over a three-year period and shall be calculated as in the box below:

FSPs shall, on a static basis, calculate the difference between deferred tax assets arising from temporary differences, based on the opening balance sheet using IFRS 9 (January 1, 2018) and the closing balance of deferred tax assets using IAS 39 (December 31, 2017).

A portion of this amount (net of deferred tax liabilities), calculated in line with the schedule in sub-paragraph B(ii), shall be reduced from the line item 9 (Goodwill and other intangible assets) on Schedule 15 of the Prudential Returns.

The unamortised portion of this amount shall be risk weighted at 100% and shall be included under line item 37 (other assets) on Schedule 14 of the Prudential Returns. This amount shall also be decreased annually on a straight-line basis over a three-year period

D. DISCLOSURES

For quarterly financial statements publications effective 2018, FSPs shall be required to disclose the adjustment amount in the computation of regulatory capital.

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