

GAZETTE NOTICE NO. 287 OF 2020

The Banking and Financial Services Act, 2017
(Act No.7 of 2017)

The Banking and Financial Services
(Classification and Provisioning of Loans) Directives, 2020

IN EXERCISE of the powers contained in section 167 of the Banking and Financial Services Act, 2017, the following Directives are made:

PART I
PRELIMINARY

Title

1. These Directives may be cited as the Banking and Financial Services (Classification and Provisioning of Loans) Directives, 2020, and shall come into operation on the date of publication of the *Gazette*.

Interpretation

2. In these Directives, unless the context otherwise requires---

“allowance for loan losses account” means a balance sheet valuation account established through charges to the income statement, to absorb anticipated losses in respect of a bank or a financial institution’s on-balance sheet and off-balance sheet exposures.

“capitalised interest” means accrued but uncollected interest which has been added to the unpaid principal balance of a loan at a payment date or at maturity. Capitalised interest also includes unpaid interest which is refinanced or rolled-over into a new loan.

“credit facility” has the meaning assigned in the Banking and Financial Services Act;

“loan or extension of credit” means:

(i) any direct or indirect advance of funds, including obligations as maker or endorser arising from discounting of commercial or business paper, 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

(ii) 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.

“credit risk” means the potential that a borrower or counterparty may fail to meet its obligations in accordance with agreed terms.

“fair value” means the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction or, in the absence of an active market, by using an appropriate valuation technique to establish what the transaction price would have been in an arm’s length transaction;

“hard-core balance” means an outstanding debit balance on an overdraft account or other credit facility without fixed repayment dates, that shows no fluctuations for a period of ninety days or more in line with the cash flow cycle of the borrower;

“homogeneous risk group” means a class of risks that have similar characteristics.

“non-performing loan” has the meaning assigned in the Banking and Financial Services Act;

“overdraft” means a short-term revolving facility which:

(i) has a pre-agreed limit that allows payments to be made where there are insufficient funds in a current account;

(ii) allows in and out payments to be made at any time; and

(iii) has no fixed repayment date, although customers are expected to ensure that the account operates in line with the cash flow cycle of the borrower.

“provision for loan losses” means a charge against income which is added to the Allowance for the 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 off or recoveries of specific loans.

“restructured loans” are credit facilities whose originally agreed terms and conditions have been modified or renegotiated.

Application

3. These Directives shall apply to all financial service providers licensed under the Banking and Financial Services Act.

PART II
CREDIT RISK MANAGEMENT

General principles for the assessment, monitoring and control of credit risk

4. (1) A financial service provider shall have policies for the assessment, monitoring and control of credit risk, that require:

(a) utmost care and diligence in the assessment of the credit risk associated with its credit facilities, not only at the time of granting the facilities but also throughout the period that the facilities remain outstanding;

(b) maintaining a database of transactions to enable proper assessment, monitoring and control of credit risk, and the preparation of reports and other timely and comprehensive documentation for management and to inform third parties or respond to requests from the Bank;

(c) the reclassification and corresponding provisioning of credit facilities as soon as the deterioration of credit risk becomes apparent; and

(d) an adequate line of communication with the board of directors.



(2) These policies shall be implemented through methods, procedures and practices, that specify, among other things, the characteristics which the financial service provider's database should comply with, including the following requirements:

- (a) depth and breadth, in that they cover all the significant risk factors;
- (b) accuracy, integrity, reliability and timely provision of up-to-date data;
- (c) consistency, such that the data is based on common sources of information and uniform definitions of the concepts used for credit risk management; and
- (d) traceability, such that the source of information can be identified.

General principles for estimating the allowance for loan losses

5. A financial service provider shall be guided by the following principles when estimating the allowance for loan losses,

(1) Governance and integration in management, which entail approval by the board of directors of the policies for estimating the allowance for loan losses and their periodic monitoring, and their continuous integration in the various credit risk management processes;

(2) Have an up-to-date knowledge of the relevant information on the credit risk assumed;

(3) The various internal control functions shall review, at least annually, the methods and procedures for estimating the allowance for loan losses, seeking at all times to ensure they are observed, and reporting on such observance to the board of directors;

(4) The review required in sub-directive (3) must also cover, the suitability of the information systems and the database used for the estimation of the allowance for loan losses;

(5) The methods and processes for monitoring and updating estimates of the allowance for loan losses must ensure, at all times, that the results obtained are attuned to the reality of the transactions, the prevailing economic climate, and the forward looking information available;

(6) Estimates must be based on adequately substantiated assumptions that are consistent over time;

(7) The methods for estimating the allowance for loan losses should be comprehensible to users and, in any event, ensure that the results obtained do not contradict the underlying economic and financial logic of the various risk factors;

(8) Ensuring consistent treatment of the different categories into which credit facilities may be classified, such that, the level of the allowance for loan losses estimated for a credit facility shall be higher than the level of the allowance for loan losses that would apply to it if it were classified in another category with lower credit risk;

(9) Establishing and documenting the periodic procedures for checking the reliability and consistency of its loan classifications and its estimates of the allowance for loan losses over the course of the various stages of the credit risk management cycle; and

(10) A detailed and up-to-date documentation on all the methods, procedures and criteria for the assessment, monitoring and control of credit risk, including those relating to estimates of the allowance for loan losses, such that a third party could understand and replicate the calculations made.

Credit review system

6. (1) The board of directors shall establish a formal credit review system which shall ensure that:

(a) credit exposures are timely and correctly classified on the basis of credit risk;

(b) there is a sound and documented loan loss provisioning methodology, which addresses credit risk assessment policies, procedures and controls for assessing credit risk, identifying problem loans and determining loan loss provisions in a timely manner;

(c) the aggregate amount of individual and collectively assessed loan loss provisions are adequate to absorb estimated credit losses in the loan portfolio;

(d) there is adequate information about the credit risk in the credit portfolio at all times;

(e) credit exposures are properly identified and timely classified and placed on non-accrual status, in accordance with these Directives;

(f) 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 levels 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 Directives;

(g) Allowances and provisions are properly reflected in the financial service provider's financial statements.

(2) Every review of overdrafts and other credit facilities without fixed repayment dates, shall be supported by an analysis for each account, showing monthly balances and a summary of movements on the account which shall include:

i. the total value of deposits and withdrawals; and

ii. accruals and repayments of interest charges.

(3) The credit review system referred to in sub-directive (1) shall be reviewed, at least once every year, and shall be submitted to the board for approval.

Loans Review committee

7. (1) A financial service provider shall have a Loans Review Committee which shall be composed of, not less than three non-executive directors.

(2) A financial service provider shall, through the Loans Review Committee, and at least on a quarterly basis, cause a review to be made of the quality and collectibility of all credit facilities in its portfolio, including any accrued and unpaid interest.

(3) The Loans Review Committee shall, immediately after reviews referred to in sub-directive (2), make a detailed written report directly to the board, and the board shall take appropriate action on the report.

(4) A financial service provider shall at all times maintain records in support of such reviews and related records and shall make the review reports available for inspection as and when requested by the Bank.

PART III

DETERMINATION AND TREATMENT OF NON-ACCURAL LOANS RELATED ACCOUNTS

Past due loans, overdrafts and credit facilities

8. (1) A loan shall be past due when any portion of principal or interest that is contractually due remains unpaid for a period of thirty days or more.

(2) An overdraft or credit facility without fixed repayment dates shall be considered past due when any of the following conditions exist:

- (a) the debt exceeds the approved limit for thirty consecutive days or more; or
- (b) the borrowing line has expired for a period of thirty days or more; or
- (c) any portion of principal or interest that is contractually due remains unpaid for thirty days or more.

Conditions for placing a loan in non-accrual status

9. (1) A loan or an overdraft shall be placed in non-accrual status when:

- (a) it is non-performing; or
- (b) deposits are insufficient to cover the interest that was capitalised for ninety consecutive days; or
- (c) the credit line has expired, or has been inactive, for ninety days or more.

(2) A financial service provider shall place a loan in non-accrual status, notwithstanding the fact that, there is collateral held against it, if:

- (a) there is reasonable doubt about the ultimate collectibility of the principal or the interest; and
- (b) a provision for loan losses has already been raised against that specific loan.

(3) Any determination that a loan is ultimately not collectible shall be supported by a current documented credit evaluation report of the borrower's financial condition which shows that:

- (a) prospects for repayment are assessed to be weak; and
- (b) historical repayment performance is unsatisfactory.

Treatment of income on non-accrual loans

10. Where a loan is placed in non-accrual status under these Directives:

- (a) a financial service provider shall cease reflecting the accrued interest in its income statement; and
- (b) all previously accrued, but unpaid interest, shall be subjected to the loan loss provisioning requirements under these Directives.

Treatment of cash payments on non-accrual loans

11. (1) Subject to the provisions of section 110 of the Banking and Financial Services Act:

- (a) where a loan is placed in non-accrual status, any cash payments received shall first be applied to reduce the principal amount due;
- (b) where the principal amount due on the loan has been fully recovered, any excess payments may be taken to the income statement, provided the amount of income recognised is limited to the amount which would have been due to the financial service provider if the loan had been current at its contractual rate; and
- (c) any further excess payments after providing for the payment in paragraph (b) shall be applied against the outstanding principal amount.

(2) Where a loan is restructured, payments shall be taken to income on the basis of the revised terms of the loan agreement.

Restoration to accrual status

12. (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 is deemed to be fully collectible in accordance with the terms of the contract and the borrower has resumed paying the full amount of the scheduled contractual principal and interest payments for at least one hundred and eighty days, and all the remaining contractual payments, including compensation for past due payments, are deemed to be collectible; or

(b) a determination that a loan is ultimately collectible is made and such determination shall be supported by a current, documented credit evaluation report of the borrower's financial condition which shows that prospects for repayment are strong.

(2) Until a loan is restored to accrual status, any cash payments received shall be treated in accordance with the provisions of Directive 11.

Restructured loans

13. (1) Where a financial service provider restructures a credit facility, such restructured facility shall be supported by documentary evidence as to the collectibility of future repayments.

(2) A restructured loan, which was in non-accrual status, shall return to performing status:

(a) when the rate of interest charged for the loan or advance is equivalent to the rate of interest that would be charged on a new loan or advance of similar merit; and

(b) when one of the following conditions is satisfied:

(i) all past due principal and interest payments are current; or

(ii) where interest has been capitalised, the principal and interest payments are made in accordance with the modified repayment terms for a period of at least one hundred and eighty days from the date of restructuring. (3) A non-accrual loan that has been restructured more than twice over its lifetime, shall remain in non-accrual status and shall be treated in accordance with the provisions of Directives 10 and 11.

(4) Where a loan is reclassified from non-accrual to accrual status, all specific provisions previously made shall be reversed.

Treatment of multiple credit facilities to one borrower

14. (1) Where a financial service provider has a number of credit facilities outstanding to a single borrower, and one of those facilities meets the criteria for non-accrual status, a financial service provider shall, where appropriate, place one or more of such other loans in non-accrual status upon:

(a) evaluating and documenting the financial standing of the borrower; and

(b) evaluating and documenting the performance of all other credit facilities to that borrower.

(2) Notwithstanding sub-directive (1), all loans to the same borrower shall be deemed non-accrual where the multiple loans and advances referred to are being financed from a single source of cash flows, and one of those credit facilities meets the criteria for non-accrual status.

PART IV

CLASSIFICATION OF CREDIT FACILITIES

Classification of credit facilities

15. (1) A financial service provider's credit facilities shall be classified as pass, special mention, substandard, doubtful or loss, according to the criteria outlined in sub-directives (3) to (11).

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

(a) a significant departure from the intended source of repayment develops even if the credit facility is current and supported by the underlying collateral value; or

(b) a delinquency has been cured by restructuring, refinancing, or additional advances.

(3) A loan shall be classified as "pass":

(a) if it is current and performing in accordance with its contractual terms and is expected to continue doing so; and

(b) where the financial condition and paying capacity of the borrower is sound.

(4) An overdraft or credit facility without fixed repayment date shall be classified as "pass" if:

(a) it is operating within the limit of an approved and unexpired credit line;

(b) interest charges for the period are covered by the deposits; and

(c) it is not a hard-core balance.

(5) A loan shall be classified as "special mention" where:

(a) ultimate loss is not expected, but the borrower is experiencing difficulties that may jeopardise the orderly repayment, such as, the following:

(i) there are early signs of liquidity problems, as shown, for example by delays in repayments;

(ii) there is slowdown in business activity or an adverse trend in the borrower's operations that signals a potential weakness in the financial strength of the borrower;

(iii) volatility in economic or market conditions that may affect the borrower negatively in future; or

(iv) there is poor performance in the industry in which the borrower conducts business.

or

(b) if it is in arrears as to the principal or interest for sixty days or more, but less than ninety days.

- (6) An overdraft or credit facility without fixed repayment dates shall be classified as "special mention" if:
- (a) the approved limit has been exceeded for sixty consecutive days, but less than ninety days; or
 - (b) the credit line has expired for thirty consecutive days, but less than ninety days; or
 - (c) interest charge remains outstanding for thirty consecutive days, but less than ninety days.
- (7) A loan shall—
- (a) be classified as "substandard":
 - (i) where the financial condition and paying capacity of the borrower is not sound; or
 - (ii) if it has a well-defined weakness or weaknesses that jeopardise the liquidation of the loan.
 - (b) at a minimum, be classified as "substandard" if it is in arrears as to principal or interest payment for ninety days or more, but less than one hundred and eighty days.
- (8) An overdraft or credit facility without fixed repayment dates shall be classified as "substandard" if:
- (a) the approved limit has been exceeded for ninety consecutive days, but less than one hundred and eighty consecutive days; or
 - (b) the credit line has expired for ninety consecutive days, but less than one hundred and eighty consecutive days; or
 - (c) interest charge for ninety consecutive days, but less than one hundred and eighty consecutive days, has not been covered by deposits; or
 - (d) it is a hard-core balance.
- (9) A loan shall be classified as "doubtful" if:
- (a) i. it is considered to have all the weaknesses inherent in a substandard loan;
 - ii. collection or orderly repayment in full, on the basis of currently existing facts, conditions and values, is highly questionable;
 - (b) at a minimum, it is in arrears as to principal or interest payment for a period of one hundred and eighty days or more, but less than three hundred and sixty-five days.
- (10) An overdraft or credit facility without fixed repayment dates shall be classified as "doubtful" if:
- (a) the approved limit has been exceeded for one hundred and eighty consecutive days or more, but less than three hundred and sixty-five days; or
 - (b) the credit line has expired for one hundred and eighty consecutive days or more; but less than three hundred and sixty-five days;
 - (c) interest charge for a period of one hundred and eighty consecutive days or more, but less than three hundred and sixty-five days, has not been covered by deposits; or
 - (d) it is a hard-core balance.
- (11) A loan, overdraft or credit facility without fixed repayment dates shall be classified as "loss":
- (a) at a time it is considered uncollectible or of such low value that its continuance as a bankable asset is not justified, although there may be some salvage or recovery value; or
 - (b) a loan, overdraft or credit facility without fixed repayment dates, which meets the criteria in sub-directives (9) or (10), but on which principal or interest remains in arrears, or where the credit facility has expired, for a period of three hundred and sixty-five days or more.

PART V

DETERMINATION OF THE LOAN LOSS ALLOWANCES

Determination of the amount of the loan loss allowance

16. (1) In determining the amount of loan loss allowance related to individual credit facilities and to the aggregate of the loans portfolio of a financial service provider, the factors to be considered shall include those set out in the First Schedule.

(2) Notwithstanding sub-directive (1), the Bank shall consider the following in determining the amount of the loan loss allowance related to individual credit facilities and to the aggregate of the credit portfolio of a financial service provider:

- (a) the effectiveness of the financial service provider's lending policies and collection procedures; and
- (b) the timeliness and accuracy of the financial service provider's credit review function.

Allowance for loan losses account

17. (1) A financial service provider shall at all times maintain a balance on the Allowance for Loan Losses Account that represents the best possible estimate of the probable credit related losses existing in the portfolio of on-and off-balance sheet exposures in light of the current conditions.

(2) The Allowance for Loan Losses Account shall:

- (a) in the case of balance sheet assets, appear as deduction from the applicable asset; and
- (b) in the case of off-balance sheet exposures appear as a separate line item within other liabilities.

Requirements for individual estimation of the allowance for loan losses

18. (1) A financial service provider shall develop methods for the estimation of the allowance for loan losses relating to non-performing or special mention loans, which are subject to individual estimation.

- (2) The allowance for loan losses for the following must be estimated on an individual basis:
- (a) non-performing or special mention loans that a financial service provider considers to be significant. For this purpose, a financial service provider must have duly documented policies, procedures and practices which specify, inter alia, the absolute and relative quantitative thresholds for considering a loan to be significant. A financial service provider may consider all transactions with a borrower to be significant when the sum of all loans with that borrower exceeds this threshold; and
 - (b) non-performing or special mention loans which do not belong to a homogeneous risk group, and, therefore, for which a financial service provider cannot develop internal methods for collective estimation of the allowance for loan losses.
- (3) For the purposes of these Directives, a loan shall be considered significant, if at least, it is five percent of the financial service provider's primary capital.

Requirements for collective estimation of allowance for loan losses

19. (1) Collective estimation shall be applied to calculate the allowance for loan losses for all loans for which an individualised estimate does not have to be made. The allowance for loan losses for the following loans shall be calculated by collective estimation:

- (a) loans classified as non-performing that are not considered to be significant; and
- (b) loans classified as non-performing or under special mention because they belong to a group of credit facilities with similar risk characteristics or a homogeneous risk group.

(2) Internal methods for collective estimations must comply with the general principles set out in these Directives, and with all the specific requirements for collective estimates set out below:

- (a) a financial service provider shall have formal written procedures describing the criteria used to identify and group transactions with similar risk characteristics and the factors and parameters that, in each case, determine this estimation. The financial service provider shall periodically review how well the homogeneous risk groups used match the reality of its operations and the economic environment; and
- (b) estimates must be based on each financial service provider's historical experience of observed losses, which, if necessary, will be adjusted to take into account the prevailing economic conditions and other current circumstances known at the time of the estimate.

Additions and reductions to the allowance for loan losses account

20. (1) Any additions to, or deductions 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 Additions and reductions to the allowance for loan losses account 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, except as provided for under Directive 25 sub-directive (1).

Provision for loan losses

21. (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 exposures, and which at a minimum, meets the provisioning requirements specified in these Directives except as provided for in Directive 25 sub-directive (2).

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

(3) Where there are no provisions in respect of a loan to be written off, 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.

Allowance for loan losses for non-performing loans

22. (1) A financial service provider shall evaluate loans classified as non-performing in order to estimate the allowance for loan losses, taking into account the number of days' past-due, the recoverable amount of the effective collateral held, and the economic situation of the borrower and guarantors.

(2) The allowance for loan losses relating to non-performing loans shall be calculated by individual or collective estimation in accordance with Directives 18 and 19.

(3) When estimating the allowance for loan losses, the recoverable amount of effective collateral held shall be estimated by applying to its reference value, determined in accordance with Directives 28 and 29, the discounts needed to adequately capture the uncertainty of the estimate and consequent possible falls in value up to the time of foreclosure and sale, plus foreclosure costs, maintenance costs and costs to sell.

(4) At a minimum, the discounts to be applied to the reference value referred to in sub-directive (3) shall be as those provided in Part 1 of the Second Schedule.

(5) Where the recoverable amount of effective collateral held is greater than the outstanding amount of a credit facility, no provision for loan losses shall be required on that credit facility.

(6) Any amount of the credit facility which is not covered by the recoverable amount of the effective collateral held, shall be provided for based on the minimum percentages set out in Part 2 of the Second Schedule, based on the corresponding number of days past due.

(7) Notwithstanding sub-directive (1), a credit facility which has remained a non-performing loan for more than five years shall be fully provisioned, irrespective of the recoverable amount of the effective collateral held.

Provisioning for the loss category

23. Any loan or a portion thereof which is assigned a "loss" classification shall be fully provisioned, after taking into account the recoverable amount of effective collateral held if any, at the time the loss is identified.

Allowance for loan losses for performing loans and loans under special mention

24. (1) The allowance for loan losses for performing loans shall be estimated collectively, and those for performing loans under the special mention category, shall be estimated individually or collectively, in accordance with Directives 18 and 19.

(2) The estimation of the allowance for loan losses for performing loans and performing loans under special mention shall be based on the recoverable amount of the effective collateral held as set out in these Directives, and management shall determine the discounts which are needed to adequately capture the uncertainty of the estimate and consequent possible falls in value of the collateral held, up to the time of foreclosure and sale, foreclosure costs, maintenance costs and costs to sell.

(3) The amount of the credit facility which is not covered by the recoverable amount of the effective collateral held, shall be provided for as set out in Part 3 of the Second Schedule.

Provisions for loan losses under accounting standards

25. (1) If the provision for loan losses computed in line with the accounting standards that are officially recognised by the Zambia Institute of Chartered Accountants are lower than the minimum provision for loan losses required under these Directives, the difference shall be treated as appropriations of retained earnings, by creating a non-distributable regulatory loan loss reserve, and not charged as an expense to the income statement. Similarly, any credits resulting from the reduction of such amounts shall result in an increase in retained earnings, and shall not be included in the determination of profit or loss for the period.

(2) Where the provisions for loan losses computed in line with the accounting standards that are officially recognised by the Zambia Institute of Chartered Accountants are higher than the minimum required under these Directives, such provisions for loan losses shall be considered as the required minimum under these Directives.

(3) For capital adequacy purposes, the regulatory loan loss reserve referred to under sub-directive (1) shall not be included as part of regulatory capital, whereas any excess of the accounting provisions under sub-directive (2) shall be treated as a general loan loss reserve.

Additional provisions required by the Bank

26. Where the Bank has determined that the classification and provisioning practices applied by a financial service provider are inadequate, the Bank may:

- (a) direct the financial service provider to categorise the credit facilities into the appropriate classification categories; and
- (b) require the financial service provider to raise a specified amount as a provision for loan losses.

PART VI

THE TREATMENT OF COLLATERAL IN THE COMPUTATION OF THE ALLOWANCE FOR LOAN LOSSES

Effectiveness of collateral

27. (1) A financial service provider shall have methods to enable it to analyse the effectiveness of the collateral and determine the discounts necessary to estimate the recoverable amount of effective collateral held, for the purposes of calculating the allowance for loan losses under these Directives.

(2) The recoverable amount of effective collateral held shall be estimated from the applicable reference value specified in Directive 28 sub-directive (7), after subtracting the adjustments needed to reflect adequately the uncertainty of the estimate and how it affects the potential fall in value up to the time of foreclosure and sale, plus foreclosure costs, maintenance costs and costs to sell. When estimating the recoverable amount of effective collateral held, a financial service provider's ability to realise the collateral, once foreclosed, must be taken into account.

(3) For the purposes of these Directives, collateral must meet the criteria laid down in Directives 28 and 29, in order to be considered effective. The analysis of the effectiveness of collateral shall take into account, among others, the time needed to realise it and the financial service provider's ability to do so. This analysis must be more rigorous in the case of collateral for performing loans under special mention and non-performing loans, for which there is a greater likelihood that their foreclosure may become the main means of recovering the credit facility.

(4) Any collateral, whose effectiveness depends substantially upon the credit quality of the borrower or of any group to which the borrower may belong, shall not be admissible as effective collateral, as an adverse correlation exist for the financial service provider between the effectiveness of the collateral and the credit quality of the borrower, such as in the following cases:

- (a) when shares or other negotiable securities in the borrower, or in any group to which it may belong, are encumbered by a security interest.
- (b) when the value of the collateral is highly conditional upon the continued operation of the party giving the guarantee.
- (c) in the case of cross guarantees, in which the guarantor in one transaction is, in turn, guaranteed by the borrower in another transaction.

- (5) For the purposes of these Directives, the following types of collateral may be considered effective:
- (a) real estate mortgages, provided they are the first mortgage and duly perfected and registered in favour of a financial service provider;
 - (b) financial instruments, such as, cash deposits and debt securities or equity instruments, provided that they are issued by creditworthy entities and a perfected security interest in favour of the financial service provider is created therein, pursuant to the Movable Property (Security Interest) Act, 2016;
 - (c) other perfected security interests, including second and subsequent mortgages on immovable property or on agricultural charges provided that the financial service provider can demonstrate the effectiveness of such collateral; and
 - (d) other movable property, whether tangible or intangible, provided that a perfected security interest is created in favour of the financial service provider under the Movable Property (Security Interest) Act, 2016.
- (6) For the purposes of sub-directive 5, only the collateral types as provided for in the Third Schedule shall be eligible.

General collateral valuation policies and procedures

28. (1) A financial service provider shall have formal board approved policies on the valuation of collateral which shall comply with the criteria established in these Directives, and shall include the following:

- (a) procedures, to be applied with a defined frequency, to verify the existence of signs of any significant decline in value and to update the value of collateral of real estate mortgages, provided they are the first mortgage and duly perfected and registered in favour of a financial service provider;
- (b) the criteria for determining that a significant decline in value has taken place. These shall include quantitative thresholds for each type of collateral, established based on the financial service provider's experience and bearing in mind relevant factors such as market price trends or the opinion of independent appraisers; and
- (c) the criteria for selecting appraisers.

(2) A financial service provider shall have a database with all the relevant information on properties and other collateral for its credit facilities and on the links between collateral and specific credit facilities.

(3) A financial service provider shall keep a register with all valuations, including full individual appraisals, of effective collateral and of real estate assets foreclosed or received in payment of debt, in which it records, in chronological order, all requested or commissioned appraisals and the appraisals and valuations carried out as a result of such requests or commissions, so as to ensure that all appraisals and valuations made are included in the financial service provider's database.

(4) A financial service provider shall apply sound criteria for the selection and contracting of appraisers that are aimed at assuring the independence of the appraisers and the quality of the appraisals.

(5) A financial service provider shall regularly review the application of the policies and procedures for the appraisal of collateral.

(6) The database of collateral and their appraisals shall be subjected to an independent audit on their consistency and quality, at least once, every three years.

(7) At the time of granting a credit facility, a financial service provider shall determine the reference value of the collateral received, and subsequently update this value at minimum frequencies set under these Directives, and applying the procedures established by the financial service provider. These reference valuations of collateral shall serve as the starting point for estimating its recoverable amount, as provided in Directive 27 sub-directive (2). In any event, financial service provider must observe the following criteria, depending on the type of collateral:

- (a) for the appraisal of real-estate collateral, the reference value shall be, the lower of the property's market value and its forced sale value, and the criteria in Directive 29 shall be observed;
- (b) financial instruments taken as collateral shall be appraised at least on a quarterly basis, for which purpose the reference value to be used shall be their fair value; and
- (c) the reference valuation of other collateral shall be carried out by an independent appraiser, and the appraised value shall be updated at least once every year.

(8) Notwithstanding the provisions in sub-directive (7), if a significant decline in the reference value of assets received as collateral is observed, a financial service provider shall update these appraisals in order to reflect this decline, without waiting for the established updating period to elapse. Stricter procedures shall be applied to update appraised values in the case of credit facilities whose remaining amount of exposure may exceed the value of the collateral following the loss of value of the latter.

Procedures and minimum frequencies of appraisal of real-estate collateral

29. (1) For the purposes of these Directives, a financial service provider shall use the following procedures for the determination of the reference value of real estate in Zambia used as collateral for credit facilities:

- (a) complete individual appraisals carried out by service of the independent and approved appraisal providers, who are registered members Valuation Surveyors Registration Board.
- (b) for the purposes of sub-directive (1) and paragraph (a), an approved appraisal service provider shall be deemed to be independent if it is not a related party of a financial service provider.

(2) A financial service provider shall have full individual appraisals at the time of granting the credit facility. For this purpose, previous appraisals of at least three years old at the time of granting the credit facility shall be considered as valid.

- (3) (a) For transactions classified as performing loans secured by real estate collateral, the financial service provider must verify the existence of signs of significant falls in their reference values with a minimum frequency of three years.
- (b) The verification of the existence of signs of significant falls in the value of real estate collateral, must be properly documented, and may be carried out by the financial service provider, taking into account all the relevant factors.
- (c) If the verification exercise evidences a significant fall in the reference value, it must be updated by an approved independent appraisal service provider. If there is evidence of a significant rise in collateral value, the financial service provider may take this rise into account in the estimation of the allowances for loan losses provided that the reference value is updated by an approved independent appraisal service provider.

(4) In the case of performing loans under special mention, the verification of the presence of signs of significant declines in collateral reference values and the updating of these valuations shall be carried out in accordance with sub-directive (3) and paragraph (a).

(5) The collateral reference valuation must be updated at the time the credit facility is classified as non-performing and at least every three years, while it continues to be classified as such. In any event, the appraisal service provider must be changed after two sequential valuations.

PART VII

EXAMINER REVIEW AND REPORTING REQUIREMENTS

EXAMINER REVIEW

30. A financial service provider shall maintain and provide records in support of the 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. In line with the requirements of these Directives, at a minimum the following information shall be maintained:

- (a) formal policies, procedures and methods for determining loan loss estimates;
- (b) the methodology and descriptions of underlying assumptions used to calculate the Allowance for Loan Losses;
- (c) a description of the process used to validate the Allowance for Loan Losses methodology;
- (d) the loan agreement and repayment schedule for individual credit facilities;
- (e) arrears/aged loans analysis with appropriate time buckets for past due loan instalments;
- (f) the cash flow projections, timings, amounts and assumptions, that formed the basis of the credit Examiner Review analysis and repayment of the loan, and an analysis of factors affecting the projections;
- (g) current management accounts and audited financial statements of the borrowers;
- (h) valuation of collateral which is in line with the provisions of these Directives;
- (i) a description of the internal controls that are in place to consistently determine the Allowance for Loan Losses in accordance with these Directives, the financial service provider's stated policies and procedures, management's best judgement and relevant supervisory guidance;
- (j) reports, correspondence and minutes of board and management meetings; and
- (k) evaluation and rationale for the estimates about the credit quality of individual credit facilities and the credit portfolio that were used to determine the loan loss estimate.

Reporting requirements

31. A financial service provider shall, within a period prescribed by the Bank, submit:

- (a) a balance sheet which reflects the Allowance for Loan Losses Account in an amount which is adequate to absorb potential losses within the financial service provider'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 past due and non-performing loans in the form set out in the Fourth (A and B) and Fifth Schedules;
- (d) details of the changes in the Allowance for Loan Losses Account in the form set out in the Sixth Schedule; and
- (e) such other information in the format and within the timeframe as may be requested by the Bank.

Transitional arrangements

32. (1) A financial service provider which does not meet all the requirements of Part VI at the coming into force of these Directives shall not include in the computation of the allowance for loan losses, the recoverable amount of effective value of collateral held, unless express approval has been obtained from the Bank of Zambia. (2) As part of the transitional arrangements, upon receiving a request from the financial service provider, for approval under sub-directive (1), the Bank of Zambia shall undertake procedures to satisfy itself that all the requirements of Part VI of these Directives have been met. This transitional arrangement shall not be for a period of more than two years from the time of coming into force of these Directives. (3) In the case of real estate collateral, previous appraisals of at least three years shall be considered valid for the purposes of determining the recoverable amount of the effective value of collateral during the transitional period.

Directive to correct deficiencies

33. (1) Where the Bank, after conducting an examination of the financial service provider's loan review system, finds that a financial service provider has deficiencies, which has led to misclassifications and consequently not adequately providing for the loan loss provision as required under these Directives, the Bank shall direct the financial service provider to correct such deficiencies.

(2) Notwithstanding sub-directive (1), the Bank may direct the financial service provider to correct any other credit administration and underwriting deficiencies.

(3) a financial service provider that fails to adhere to any provision of these Directives shall be guilty of an offence and liable, for every day the contravention continues, to a fine assessed by the Bank of Zambia not exceeding one hundred thousand penalty units or, on conviction, and every director, and any person concerned in the management of the financial service provider shall be personally liable to the same fine, or upon conviction, to imprisonment for a term not exceeding two years, or both.

(4) The penalties referred to in sub-directive (3) shall be without prejudice to any other punitive measures which may be applied against the financial service provider or any of its directors, officers or employees and which have been provided for in the Banking and Financial Services Act.

FIRST SCHEDULE

(Directive 16)

BANK OF ZAMBIA

FACTORS TO BE CONSIDERED IN THE DETERMINATION OF THE AMOUNT OF THE ALLOWANCE FOR LOAN LOSSES

The factors to be considered in determining the amount of the allowance for loan losses shall include observable data that comes to the attention of the financial service provider's management, such as, the following:

- (a) Significant financial difficulty of the borrower;
- (b) a breach of contract, such as a default or delinquency in interest or principal payments;
- (c) a lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- (d) it becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- (e) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans since the initial recognition, although the decrease cannot yet be identified with the loans in the group, including:
 - (i) adverse changes in the payment status of borrowers in the group (e.g. an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or
 - (ii) national or local economic conditions that correlate with defaults on the loans in the group (e.g. an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in commodity prices for loans to commodity producers, or adverse changes in industry conditions that affect the borrowers in the group).

SECOND SCHEDULE

(Directives 22 (4) and 22 (6))

BANK OF ZAMBIA

PART I

PERCENTAGE DISCOUNTS TO BE APPLIED TO THE REFERENCE VALUE

		Percent Discount on reference value
Type of Collateral	Group One Collateral	0
	Group Two Collateral	20
	Group Three Collateral	50
	Group Four Collateral	60

PART 2

MINIMUM PROVISIONING RATES APPLICABLE TO THE AMOUNT OF THE CREDIT FACILITY NOT COVERED BY THE AMOUNT RECOVERABLE FROM THE EFFECTIVE COLLATERAL HELD

Number of days past due	90 days and over, but less than 120 days.	120 days and over, but less than 180 days.	180 days and over, but less than 270 days.	270 days and over, but less than 365 days.	365 days and over.
Minimum provisioning rates on the amount of the credit facility not covered by the recoverable amount of the effective collateral held (Percent)	20	50	70	90	100

PART 3

THE MINIMUM PROVISIONING RATES FOR THE ALLOWANCE FOR LOAN LOSSES FOR PERFORMING LOANS AND LOANS UNDER SPECIAL MENTION

The minimum provisioning rates (percent)	Credit risk classification	
	Performing loans	Loans under special mention
	At bank discretion	2.00

THIRD SCHEDULE
(Directive 27 (6))

BANK OF ZAMBIA

PART 1

ELIGIBLE COLLATERALS

Group One Collateral

- Cash
- Segregated deposit in the lending financial service provider
- Debt security issued by the Government of the Republic of Zambia or the Bank of Zambia
- Debt security issued by a government or a central bank of a member country of the Organisation of Economic Cooperation and Development ("OECD")
- Debt security issued by a government of a country with a current "consensus country risk classification" of 1 or 2, as published by the OECD for Export Credit Agencies participating in its "Arrangement on Guidelines for Officially Supported Export Credits."

Group Two Collateral

- Gold bullion and other precious metals
- Debt security issued by an international bank or corporate with an external credit assessment of AAA to EBB- (or its equivalent qualifying for investment grade) issued by an external credit assessment institution approved by the Bank of Zambia
- The amount of an eligible guarantee issued by: (1) The Government of the Republic of Zambia or the Bank of Zambia; (2) A government or a central bank of a member country of the Organisation of Economic Cooperation and Development ("OECD"); (3) A government or a central bank of a country 1, with a current "consensus country risk classification" of 1 or 2, as published by the OECD for Export Credit Agencies participating in its "Arrangement on Guidelines for Officially Supported Export Credits;" (4) An international bank or corporate with an external credit assessment of AAA to BBB- (or its equivalent qualifying for investment grade) issued by an external credit assessment institution approved by the Bank of Zambia
- Confirmed Export Letters of Credit issued by an international bank with an external credit assessment of AAA to BBB- (or its equivalent qualifying for investment grade) issued by an external credit assessment institution approved by the Bank of Zambia

Group Three Collateral

- Debt security or guarantee issued by a bank licensed by the Bank of Zambia
- Immoveable property
- Mortgage Debenture
- Agricultural charges
- Private company debt security issued on a stock exchange recognised by the Bank of Zambia
- Share certificates quoted at a stock exchange recognised by the Bank of Zambia
- security interests on pool of assets, such as inventories, or on account receivables
- Confirmed Export Letters of Credit issued by a bank licensed by the Bank of Zambia

Group Four Collateral

- other movable property, whether tangible or intangible, provided that a perfected security interest is created in favour of the bank or financial institution under the Movable Property (Security Interest) Act, 2016

PART 2

APPROVED EXTERNAL CREDIT ASSESSMENT INSTITUTIONS

<i>Rating Agency</i>	<i>Minimum Ratings</i>
Moody's Investor Services	Baa
Standard and Poor's Corporation	BBB-
Fitch Investor Services Inc.	BBB-
Global Credit Rating Company	BBB-/ A3

FOURTH SCHEDULE (A)

*(Directive 31)***BANK OF ZAMBIA**

CLASSIFICATION OF LOANS AND PROVISIONS

Name of institution:

As at (day/month/year):

(in K' 000)	Total gross balances	Total of Specific and General Provisions	Net balances	Interest held in Suspense (memoranda account)	Value of security held
(I) PASS					
Total aggregate amount					
(II) SPECIAL MENTION					
Total aggregate amount					
(III) SUBSTANDARD					
(a) List names of accounts (all accounts that are 5% or more primary capital)					
(b) Others (total aggregate amount)					
Sub-total (II) (a + b)					
(IV) DOUBTFUL					
(a) List names of accounts (all accounts that are 5% or more of primary capital)					
(b) Others (total aggregate amount)					
Sub-total (III) (a + b)					

(V) LOSS					
(a) List names of accounts (all accounts that are 5% or more primary capital)					
(b) Others (total aggregate amount)					
<i>Sub-total (IV) (a + b)</i>					
TOTAL (I) to (IV)					

NOTES:

- (a) The entire outstanding balance for the categories of substandard, doubtful and loss (not just the sum of delinquent payments) must be shown in the column "Total Gross Balances".
- (b) The total of the "Total Gross Balances" column must agree with the "Gross Loans and Advances" account balance appearing in a financial service provider's balance sheet in a format prescribed by the Bank of Zambia.
- (c) The total of the "Net Balances" column must agree with the net of the "Gross Loans and Advances" account balance and the "Allowance for Loan Losses" account balance in a financial service provider's balance sheet in a format prescribed by the Bank of Zambia.
- (d) The column for Interest Held in Suspense is a memoranda account only.

FOURTH SCHEDULE (B)

(Directive 31)

BANK OF ZAMBIA

CLASSIFICATION OF PRIVATE DEBT SECURITIES AND PROVISIONS

Name of institution:

As at (day/month/year):

(in K' 000)	Total gross balances	Total of Specific and General Provisions	Net balances	Interest held in Suspense (memoranda account)	Value of security held	
(I) CURRENT AND SPECIAL MENTION						
(a) Government securities, commercial paper, corporate bonds, etc. (list all).						
(b) Placements and all other interest bearing notes (list all).						
<i>Sub-total (I) (a + b)</i>						
(II) SUBSTANDARD						
(a) Commercial paper, corporate bonds, etc. (list all).						
(b) Placements and all other interest bearing notes (list all).						
<i>Sub-total (II) (a + b)</i>						
(III) DOUBTFUL						
(a) Commercial paper, corporate bonds, etc. (list all).						

(b) Placements and all other interest bearing notes (list all).						
<i>Sub-total (III) (a + b)</i>						
(IV) LOSS						
(a) Commercial paper, corporate bonds, etc. (list all).						
(b) Placements and all other interest bearing notes (list all).						
<i>Sub-total (IV) (a + b)</i>						
TOTAL (I) to (IV)						

NOTE:

- (e) The entire outstanding balance for the categories of substandard, doubtful and loss (not just the sum of delinquent payments) must be shown in the column "Total Gross Balances".
- (f) The total of the "Net Balances" column must agree with the "Other Securities" account balance appearing in a financial service provider's balance sheet in a format prescribed by the Bank of Zambia.

FIFTH SCHEDULE
(Directive 31)

BANK OF ZAMBIA

PAST DUE AND NON-PERFORMANCE LOANS

Name of institution:

As at (day/month/year):

(in K` thousands)

	Currency	Past Due 60 to 89 days	Past Due 90 to 180 days	Past Due 180 to 364 days	Past Due 365 day and over (and all classified as loss)	Totals of columns 1 to 4	Total of rows K and USD	Percentage of totals
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Agriculture, forestry, fishing and hunting	K							
	USD							
2. Mining and Quarrying	K							
	USD							
3. Manufacturing	K							
	USD							
4. Electricity, gas, water and energy	K							
	USD							
5. Construction	K							
	USD							
6. Wholesale and retail trade	K							
	USD							
7. Restaurants and hotels	K							
	USD							

8. Transport, storage and communications	K							
	USD							
9. Financial services	K							
	USD							
10. Community, social and personal services	K							
	USD							
11. Real estate	K							
	USD							
12. Personal loans	K							
	USD							
13. Credit cards	K							
	USD							
14. Other sectors	K							
	USD							
TOTAL GROSS BALANCES	K							
	USD							
Less Allowance for losses on above	K							
	USD							
TOTAL NET BALANCES	K							
	USD							

NOTE:

(g) The totals for the columns "Past Due 60 to 89 days", "Past Due 90 to 180 days", "Past Due 180 to 364 days" and "Past Due 365 days and over" must agree with the totals for Special Mention, "Substandard", "Doubtful" and "Loss" on the Fourth Schedule (A).

SIXTH SCHEDULE
(Directive 31)

BANK OF ZAMBIA

CHANGES IN THE ALLOWANCE FOR LOAN LOSSES ACCOUNT

Name of institution:

As at (day/month/year):

<i>(in K' 000)</i>	<i>Specific</i>	<i>General</i>	<i>Total</i>
1. Balance at beginning of period			
2. Less recoveries (gross) [note 1]			
3. Less write-offs			
4. Add current period provisions for loan losses(gross)			
5. Adjustment for exchange differences (Add-Losses; Subtract- Gains)			
6. Any other adjustment (provide an explanation)			
7. Balance at end of period			

NOTE 1: Where only a specific provision has been raised. In case of a previously written off debt but now recovered, the recovered amount shall be credited to the Provision for Loan Losses Account in the Income Statement.