St. Vincent and the Grenadines
International Financial Services Authority
Statement of Guidance No. 3

- Loan Classification Criteria
- Provisioning Guidelines
- Treatment of Interest on Loans
- Write off Procedures
- Restructured Loans

This guidance is made in exercise of the authority conferred on the International Financial Services Authority ("IFSA" or "the Authority") by section 30 of the International Banks Act Chapter 99 of the Revised Laws of Saint Vincent and the Grenadines, 2009 (the Act)[1].

1. Statement of objectives

To provide guidance to international banks licensed under the Act relating to the minimum standards for the administration and monitoring of and the methodology for evaluating and classifying loans and other assets held, and the applicable procedures to effect same. To set the minimum provisioning requirements that should be applied and provides guidance for the treatment of interest on loans, the treatment of restructured loans and write off of loans classified as a loss.

2. Definitions:

(i) Restructured Loans and Advances

These are credit facilities which have been refinanced, rolled over, rescheduled or otherwise changed to more favourable terms and conditions than the debt that was previously arranged for the borrower with his/her agreement because of weaknesses in the borrower's financial condition and which the Bank would not otherwise consider;

[1] These credit guidelines are based upon international prudential standards which have been adopted and used widely by international and regional regulators.

(ii) Non-Performing Loans and Other Interest Bearing Assets

(a) Principal or interest is due and continues to accrue interest[2] and has not been paid for ninety (90) days or more based on the repayment terms that were established. The same will apply if Principal and interest are outstanding;

(b) Interest payments are equal to ninety days or more have been capitalized[3], refinanced or delayed by agreement;

(c) Loans which have been placed on nonaccrual i.e. loans which have been placed on a cash basis for accounting and reporting purposes. Interest is no longer accrued on the books of the licensee and is recorded as earned income only when payments are collected from the borrower;

(d) Overdrafts and other credit facilities without pre-established repayment terms are considered non performing when deposits are insufficient to cover the interest capitalized for ninety days or more. The principal balance outstanding and not the amount of delinquent payments is used in calculating the aggregate amount of non-performing loans;

(iii) Other Assets are overdrafts and other credit facilities or any other asset that does not have pre-established repayment terms.

3. Requirements: A Classification System

Introduction:

Loan classification refers to the process used to review loans and other assets and assign same to categories based on the perceived risk and other relevant characteristics of the loans/assets.

Financial Institutions operating within St. Vincent and the Grenadines are required to conduct an annual review[4] of all its credit portfolio. This should represent at least 70% of the portfolio and should include:

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2 Accrual of interest - a term used to describe the accounting method where interest receivable has been recognized, but has not yet been received. Accrued interest occurs as the result of the difference in timing of cash flows and the measurement of these cash flows.

3 The process of adding uncollected interest to the principal balance of a loan or advance. Capitalization of interest also includes unpaid interest which is refinanced or rolled over into a new bank credit. Future interest thus accrues on this new principal.

4 Performed every financial year.

- All large credits – i.e. large relative to the institution;
- Past due loans – i.e. a loan on the Bank's books that has passed its maturity date;
- Restructured Loans and Advances – as previously defined in 2. (i) above;
- Non-Performing Loans and other Interest bearing Assets – as previously defined in 2.(ii) above;
- Other Problem Credits and Assets - excluding those stated above.

The information reviewed would include but are not limited to the following:

(a) The original amount of the loan/advance, the terms such as its duration, the interest rate, the current balance and status of the disbursements in keeping with the purpose of the loan/advance;
(b) The nature of business of the borrower, balance sheets, cash flows and other financial data both on the business and the guarantors;
(c) Where applicable an evaluation of the project being financed;
(d) The security/collateral taken, including up to date appraisals, legal assignments, insurances, etc;
(e) Track record of the borrower including the servicing of previous borrowings;
(f) If part of a group, the performance of loans/advances to other members of the group.

The financial institution, based on the criteria detailed **<u>below</u>** should assign classifications of its loans and advances following the annual review of the portfolio and apply the required provision. In addition, all recoveries, charge-offs and rescheduled loans for the period should be reported.

The process of continual review and classification enables financial institutions to monitor the quality of their asset portfolio and where necessary take remedial action to counter further deterioration in the credit quality of the portfolios.

<u>Loan Classification Criteria:</u>

There are five categories to be used to classify loans and other assets as follows:

- (a) Pass
- (b) Special mention
- (c) Substandard
- (d) Doubtful
- (e) Loss

(a) Pass (<u>All</u> of the following):

- Loan repayments current or not more than 30 days in arrears;
- Financial condition of the borrower is sound;
- Adequate credit documentation to support borrowings;
- Collateral for loan is unimpaired;

- Loans which are fully secured by cash or investment grade government securities;
- Overdrafts operating within the approved limits and showing good fluctuations.

(b) Special Mention (Any one or more of the following):

- Currently up to date but objective evidence suggests that certain factors could in the future affect the borrower's ability to service the loan properly or impair the collateral;
- Inadequate credit documentation to support borrowings or other deviation from prudent lending practices;
- Loan repayments in arrears, for between 30 – 90 days and/or non-compliance with other terms of the loan;
- Collateral not fully in place or loan up-to-date but inadequately secured;
- Overdraft exceeds the approved limit for short periods[5];
- Loans that could deteriorate because of market conditions affecting the sector;
- Rescheduled or refinanced loans that are up-to-date and adequately secured, for a minimum of 1 year after scheduling.

(c) Substandard (Any one or more of the following):

- Well defined credit weakness e.g. borrowers cash flow insufficient to service the debt as arranged, several renewals with capitalization or interest;
- Loans at least 90 days and more in arrears (non-performing loans);
- Primary source of repayment insufficient to service debt and bank has to look at secondary sources, such as collateral or refinancing, for repayment;
- Adequately secured[6] overdraft, continuously in excess of the approved limit;
- Adequately secured overdraft, with a hardcore[7] and fluctuations which do not conform to the business cycle;
- Portion of doubtful debt that is fully secured;
- Non-performing loans fully secured by Government or Government securities or cash.

(d) Doubtful (*All the weaknesses of substandard plus any one or more of the following*):

- Loans at least 180 days in arrears, unless fully secured;
- Collection of the debt in full, highly probable;
- Possibility of loss, but some factors exist which could improve the situation;

[5] This will be based on specifics of the financial institution and the overdraft facility but the period should be within one year.

[6] Adequately secured means that the security pledged is sufficient to protect the financial institution from loss of principal and interest following disposal in a forced sale situation.

[7] Overdraft with a hardcore is that level of the overdraft borrowing that it does not fall below.

- Overdraft continuously in excess of limit, minimum activity in the account and security insufficient to cover outstandings.

(e) Loss (*Any one or more of the following*):

- Loans considered uncollectible;
- Loans at least 365 days in arrears unless fully secured;
- Loans which may have some recovery value but it is neither practical nor desirable to defer write-off.

4. <u>Provisioning Guidelines</u>

Generally accepted accounting practices require that loans be recognized as impaired and the necessary provisions be made thereto if collection on all amounts due is unlikely and or other weaknesses are observed in the loan, according to the contractual terms of the loan agreement. Loan loss provisioning is thus a method used to recognize a reduction in the book value of loans.

A specific provision for loan losses should be given for all classified credit, using the percentages provided below. This represents a minimum provision assigned to each of the loan classification categories, following the annual review of the loan portfolio. The following minimum levels of provisions are provided for use for St. Vincent and the Grenadines international banks: --

Classification	**Level of Provision**
Pass	0%
Special Mention	0%
Substandard *(Loans and advances fully secured by Government securities or by cash)*	0%
Substandard (Other)	10%
Doubtful	50%
Loss	100%

Unclassified Credit – In addition a 1% general provision should be provided for the percentage of the portfolio not reviewed to cover losses that are known to exist but cant be directly addressed to individual loans.

<u>Reporting of Classification and Provisioning</u>

(1) As mentioned previously, loan classification reviews should be conducted by the licensees at least annually based on the financial year.

(2) A list of all classified facilities should be reported by each licensee to the Authority on the attached Bank Return, **<u>Annual (Financial Year) Classification of Loans and Advances.</u>**

5. Treatment of Interest on Loans

Loans and other interest bearing assets on which principal and interest payments are being made according to the scheduled terms, may be reported on an accrual basis in the absence of facts and circumstances suggesting otherwise.

Interest should not be accrued on loans classified as non-performing unless such loans are adequately secured and full collection is expected within three months. Neither should interest be accrued on overdrafts when the approved limit has been reached and/or when credits to the account are insufficient to cover interest accruals for at least a three-month period.

Interest on loans collateralized by Government securities or by cash, would continue to accrue interest up to the limit of the guarantee or up to the market value of the collateral.

Whenever a loan or other interest-bearing asset is placed on non-accrual status, all accrued and unpaid interest is to be reversed from income. Subsequent payments or collections received by the licensee shall be applied first to principal and then to loan interest due even if a balloon[8] loan.

A non-accrual loan may be restored to accrual status only when all arrears of principal and interest have been paid or when it otherwise becomes well secured and is in the process of collection. In addition, payment performance should be sustained for a reasonable time after the loan repayments have been brought up to date. In the case of overdrafts, accrual status is restored when the account is operating within the limit and all interest arrears have been cleared or when it otherwise becomes well secured and is in the process of collection.

Accrued, uncollected interest should be reflected in an 'interest in suspense' account on the balance sheet.

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[8] A long term loan that has one large payment, the balloon payment which is due upon maturity; interest payments are made over the life of the loan.

Capitalization of Interest

(1) Capitalization of interest shall be permitted only when the borrower has the ability to repay the loan or other obligation in the normal course of business. A decision to capitalize interest on a particular loan or other interest-bearing asset for accounting purposes must be based primarily upon the credit-worthiness of the borrower, including an evaluation of a variety of credit-related factors.

For overdrafts and other credit facilities without pre-established repayment terms where interest is typically capitalized to the account, deposits to the account during the interest period shall be sufficient to cover interest for that period.

(2) The capitalization of interest on loans or other adversely classified assets is not permitted.

(3) Interest which has been inappropriately capitalized shall be reversed immediately.

(4) Loans shall not be granted solely for the purpose of paying outstanding interest.

Write off Procedures

Loans must be written off to a memorandum account, three months after being classified as a loss.

6. Treatment of Restructured Loans

Loans should only be refinanced under the following conditions:

- The borrower has the ability to service the loan on time and in full under the revised terms and conditions.
- Loans classified doubtful or loss (for less than 3 months) should not be renegotiated unless an upfront cash payment is made or there is an improvement in the security taken.
- Commercial loans should not be renegotiated more than twice over the life of the original loan and mortgage and personal loans not more than twice in a five year period.
- Renegotiated loans should not be reclassified upward for at least one year following the new arrangements.
- Restructured non performing loans should not be classified as Pass for a minimum of six months following modification of the credit agreement.
- The security for renegotiated loans inclusive of capitalized interest should cover the full amount of the renegotiated loan.

St. Vincent and the Grenadines
International Financial Services Authority
International Banks Act Chapter 99, of the Revised Laws of Saint Vincent and the Grenadines, 2009

ANNUAL (FINANCIAL YEAR) CLASSIFICATION OF LOAN ADVANCES[9]

NAME OF BANK: ____

YEAR ENDING ________________

USD$000's

CLASSIFICATION	NO. OF ACCOUNTS	AMOUNT STANDING	LOAN LOSS PROVISION $
Pass			
Special Mention			
Substandard			
Doubtful			
Loss			
TOTAL			

ITEM	NO. OF ACCOUNTS	AMOUNT $
Recoveries		
Charge-offs		
Rescheduled Loans		

General Loan Loss Provisions

Specific Loan Loss Provision

***TOTAL**

These items should coincide with items 13, 5, 5.1-5.3 (a) and (b) on the Form IBS/1 for the corresponding reporting period and be at least equal to the provision made in the audited financial statements.

[9] To be submitted three (3) months after the end of the financial year