CENTRAL BANK of BELIZE

DOMESTIC BANKS AND FINANCIAL INSTITUTIONS ACT, 2012
DBFIA Practice Direction No. 3

Loan Loss Provisions and Reserves

Authority

This Practice Direction is made in exercise of the authority conferred on the Central Bank of Belize (Central Bank) by Section 9 of the Domestic Banks and Financial Institutions Act (DBFIA), 2012 and replaces the previously issued DBFIA Practice Direction No. 3 of 2018.

Summary

This DBFIA Practice Direction prescribes procedures for the establishment and maintenance of loan loss provisions and reserves for licensed banks and financial institutions for regulatory reporting and regulatory capital computation purposes only.

Licensed banks and financial institutions are also required to establish and maintain loan loss provisions in accordance with International Financial Reporting Standards (IFRS) for financial reporting purposes, and reserves for financing reporting purposes. Procedures for establishing and maintaining such loan loss provisions and reserves for financial reporting purposes are prescribed in a separate Guidance to be issued by the Central Bank on implementing IFRS 9 – Financial Instruments.

Definitions

1. Specific Loan Loss Provisions refer to the portion of total regulatory loan loss provisions that is calculated based on loans and other assets which have been classified as non-performing: “substandard”, “doubtful”, and “loss”.

These provisions are used solely for regulatory reporting purposes and are not distinguished for financial reporting purposes. As such, these provisions do not act as a contra asset account in determining the net realizable value of loans and other assets for financial reporting purposes.

2. General Loan Loss Provisions refer to the portion of total regulatory loan loss provisions that is calculated based on loans and other assets that have not been classified as non-performing: “substandard”, “doubtful”, and “loss”.

These provisions are used solely for regulatory reporting and regulatory capital computation purposes and are not distinguished for financial reporting purposes.

3. Loan Loss Reserve is an equity account that is funded through the appropriation of retained earnings. The balance in this account must always be equal to the portion of total regulatory Loan Loss Provisions, i.e. the sum of Specific Loan Loss Provisions and General Loan Loss Provisions, that is in excess of total Loan Loss Provisions under IFRS.

4. Other assets are overdrafts and other credit facilities, or any other asset that does not have a pre-established repayment term.

REQUIREMENTS

A. Calculation of Loan Loss Provisions and Reserves for Loans and Other Assets

1. Specific Loan Loss Provisions

SPECIFIC LOAN LOSS PROVISIONS for all loans and other assets which are classified as "substandard", "doubtful" or "loss" must be calculated in the following manner:

(i) For all loans classified "substandard", specific provisions equivalent to twenty percent (20%) of such loans and other assets shall be maintained.

(ii) For all loans classified "doubtful", specific provisions equivalent to fifty percent (50%) of such loans and other assets shall be maintained.

(iii) For all loans and other assets classified "loss" which are fully unsecured, specific provisions equivalent to one hundred percent (100%) of such loans and other assets shall be maintained.

(iv) For all loans and other assets classified "loss" which are fully secured by mortgages, specific provisions equivalent to fifty percent (50%) of the outstanding loan balance shall be maintained.

2. General Loan Loss Reserves

GENERAL LOAN LOSS PROVISIONS shall be established and maintained by licensees in an amount equivalent to one percent (1%) of all loans which are not adversely classified.

B. Frequency and Reporting of Specific Loan Loss Provisions

Specific loan loss provisions must be evaluated at least on a quarterly basis concurrent with the quarterly loan classification review and reported to the Central Bank on the prescribed return.

C. Write-Off of Loans and Other Assets

1. Loans and other assets which are uncollectible and of such little value that their continued reporting as bankable assets is no longer warranted shall be written off immediately.

2. Unsecured loans classified "loss" shall be written off within twenty-four months of the loan being classified as "loss".

3. Loans classified as “loss” which are collateralized by mortgages shall be written off as follows:

(i) 60% of secured loans shall be written off by the end of year four of being classified as “loss” and the 40% will remain on the bank’s books until the collateral is sold.

(ii) If the collateral is not sold within two years of the initial write-off of 60%, the bank will be required to write off the 40% remaining on its books, by which time provisions for the 40% must be made to accommodate the write-off. Therefore banks will be allowed a total of six years to fully write-off secured non-performing loans.

4. Write-offs shall be made against the Loan Loss Provision established under IFRS. If the amount of the loan to be charged off exceeds the balance of the Loan Loss Provision established under IFRS, additional provisions shall be established to cover the shortfall through charges to income.

5. Recoveries on loans and other assets previously written off shall be recorded in the financial period during which such recovery occurs.

D. Relationship to Other DBFIA Practice Directions

This DBFIA Practice Direction should be read in conjunction with the companion DBFIA Practice Directions on Classification of Loans and Other Assets and Treatment of Interest on Loans and Other Interest-Bearing Assets.

27 July 2020

APPENDIX I

Amendments to the Domestic Banks and Financial Institutions Act Practice Direction No. 3 – Loan Loss Provisions and Reserves

To provide a clear distinction between expected credit loss provisioning for financial reporting purposes and regulatory provisioning for regulatory reporting and capital adequacy computation purposes, the Domestic Banks and Financial Institutions Act (DBFIA) Practice Direction No. 3 – Loan Loss Provisions and Reserves has been amended. The following highlights the amendment made to the document.

1. The Summary section was restated as follows:

"This DBFIA Practice Direction prescribes procedures for the establishment and maintenance of loan loss provisions and reserves for licensed banks and financial institutions for regulatory reporting and regulatory capital computation purposes only.

Licensed banks and financial institutions are also required to establish and maintain loan loss provisions in accordance with International Financial Reporting Standards (IFRS) for financial reporting purposes, and reserves for financing reporting purposes. Procedures for establishing and maintaining such loan loss provisions and reserves for financial reporting purposes are prescribed in a separate Guidance to be issued by the Central Bank on implementing IFRS 9 – Financial Instruments."

2. The definition of Specific Loan Loss Provisions was redefined as follows:

"Specific Loan Loss Provisions refer to the portion of total regulatory loan loss provisions that is calculated based on loans and other assets which have been classified as non-performing: "substandard", "doubtful", and "loss".

These provisions are used solely for regulatory reporting purposes and are not distinguished for financial reporting purposes. As such, these provisions do not act as a contra asset account in determining the net realizable value of loans and other assets for financial reporting purposes."

3. The definition of General Loans Loss Provisions was redefined as follows:

"General Loan Loss Provisions refer to the portion of total regulatory loan loss provisions that is calculated based on loans and other assets that have not been classified as non-performing: "substandard", "doubtful", and "loss".

These provisions are used solely for regulatory reporting and regulatory capital computation purposes and are not distinguished for financial reporting purposes."

4. The following definition of Loan Loss Reserve was introduced:

"Loan Loss Reserve is an equity account that is funded through the appropriation of retained earnings. The balance in this account must always be equal to the portion of total regulatory Loan Loss Provisions, i.e. the sum of Specific Loan Loss Provisions and General Loan Loss Provisions, that is in excess of total Loan Loss Provisions under IFRS."

5. **The Section on "Calculation of Loan Loss Provisions and Reserves for Loans and Other Assets: Specific Loan Loss Provisions" was amended as follows:**

   a. *The following statement was replaced:*

   "SPECIFIC LOAN LOSS PROVISIONS shall be established and maintained by licensees for all loans and other assets which are classified as "substandard", "doubtful" or "loss" in the following manner"

   With the following statement:

   "SPECIFIC LOAN LOSS PROVISIONS for all loans and other assets which are classified as "substandard", "doubtful" or "loss" must be calculated in the following manner"

   b. *The below statement was deleted:*

   "These reserves shall be built as specified under "Definitions"."

6. **The Section on "Calculation of Loan Loss Provisions and Reserves for Loans and Other Assets: General Loan Loss Provisions" was amended as follows:**

   a. *The following statement was replaced:*

   "GENERAL LOAN LOSS PROVISIONS shall be established and maintained by licensees in an amount equivalent to one percent (1%) of all loans which are not adversely classified."

   With the following statement:

   "GENERAL LOAN LOSS PROVISIONS shall be equivalent to one percent (1%) of all loans which are not adversely classified."

   b. *The below statement was deleted:*

   "These reserves shall be built as specified under "Definitions"."

7. **Number 4 under the Section on "Write-Off of Loans and Other Assets" was restated as follows:**

   "Write-offs shall be made against the Loan Loss Provision established under IFRS. If the amount of the loan to be charged off exceeds the balance of the Loan Loss Provision established under IFRS, additional provisions shall be established to cover the shortfall through charges to income."

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