National Bank of Rwanda
Banki Nkuru y'u Rwanda

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The Governor

Our/Ref: 2100/2018 - 03020/0010 BNR[801.1] Kigali, August 1st 2018

Managing Director/CEO

- **Bank of Kigali Ltd**
- **I&M Bank Plc**
- **COGEBANQUE Ltd**
- **Development Bank of Rwanda Ltd**
- **ECOBANK Rwanda Ltd**
- **Banque Populaire du Rwanda Ltd**
- **GT Bank Rwanda Ltd**
- **Access Bank Rwanda Ltd**
- **Equity Bank Rwanda Ltd**
- **Bank of Africa Rwanda Ltd**
- **AB Bank Ltd**
- **UNGUKA Bank Ltd**
- **Urwego Bank Ltd**
- **CBA Rwanda Ltd**
- **Zigama CSS**
- **KCB Rwanda Bank Ltd**

KIGALI

Dear Sir/Madam,

RE: IFRS 9 Implementation Guidance.

Reference is made to the new Standard, IFRS 9 (Financial Instruments), issued by the International Accounting Standard Board (IASB), which came into effect for annual periods beginning on or after 1 January 2018.

Reference is also made to the IFRS 9 impact assessment reports submitted by the Banks as well as several stakeholder discussions held with the National Bank of Rwanda.

The National Bank of Rwanda noted gaps in the implementation of the Standard which required guidance to ensure consistency across banking sector.

It is in this regard that the National Bank of Rwanda hereby issues the guidance annexed to this letter to help Banks to consistently implement IFRS 9.

Yours Sincerely,

NATIONAL BANK OF RWANDA: THE GOVERNOR
REPUBULIKA Y'U RWANDA
1 GV
UBUMWE - UMURIMO - GUKUNDA IGIHUGU

RWANGOMBWA John
Governor

Cc :
Managing Partner :
- **PWC**
- **KPMG**
- **EY**
- **Deloitte**

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Guideline on IFRS 9 – Financial Instruments Implementation and Disclosures

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CHAPTER ONE: INTRODUCTION

The Law N°17/2018 of 13/04/2018 Governing Companies operating in Rwanda in its Article 121 requires that the Financial Statements of companies must comply with International Standards. Law N° 11/2008 of 06/05/2008 establishing the Institute of Certified Public Accountants of Rwanda and determining its powers, organisation and functioning in its Article 3 further defines these standards as, International Financial Reporting Standards (IFRS) for the private sector. Further, the Law N° 47/2017 of 23/9/2017 governing the organisation of banking in its Article 46 also requires that the financial statements of a bank must comply with the International Financial Reporting Standards (IFRS).

The objective of adopting IFRS is to achieve greater **transparency** (enhanced international comparability and quality of financial information which enables investors and other market participants to make informed economic decisions), **accountability** (reduced information gap between the providers of capital and Directors/Managers) and **efficiency** (helps investors to identify opportunities and risks across the world, thus improving capital allocation. The use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs). In addition, Rwanda's adoption of IFRS meant that there was no need to reinvent the wheel in establishing different local standards.

The adoption of IFRS means that banks in Rwanda are required to comply with all subsequent revisions and amendments passed by International Accounting Standard Board (IASB) on the existing standards.

In 2014, the IASB issued a final version of IFRS 9 (Financial Instruments) to replace IAS 39 (Financial Instruments: Recognition and Measurement). The new standard, which came into effect for annual periods beginning on or after 1 January 2018, introduced a new forward looking methodology for computing credit losses "**Expected Credit Loss**" as opposed to IAS 39's "**Incurred Loss**" model.

The new standard requires banks to recognize and account for credit losses at origination of loans or investment in financial instruments and update the losses as information on the financial asset develops. The shift to expected credit loss model is a major step towards resolving the weaknesses of IAS 39 and is aligned with prudential standards. The replacement of IAS 39 by IFRS 9 was also against a backdrop of major criticism after the 2008 global financial crisis that "credit loss recognition was too little, too late".

Notwithstanding the improvements, the implementation of IFRS 9 requires a considerable exercise of judgement, which if not guided would result in inconsistent application across the sector.

The National Bank of Rwanda (NBR) would like to see a smooth implementation of and transitioning to IFRS 9 in the Rwandan Banking sector to continue enhancing market discipline, transparency and consistency, **hence this Guidance Note, details supervisory expectations, especially in areas where banks are expected to exercise significant judgment and/or elect to use simplifications and other practical expedients permitted under the Standard.**

To this effect, this guidance note is issued to set out the NBR's expectations on the implementation of the IFRS 9. This guidance note is not intended to override IFRS 9 but endeavours to promote consistency of application, facilitate greater comparability across the banking sector and address supervisory concerns.

CHAPTER TWO: EXPECTED CREDIT LOSS (ECL)

Article 1: Overview

The National Bank of Rwanda expects banks and financial institutions to put in place policies and systems as well as governance arrangements and controls to identify instances where their exposures have suffered significant increase in credit risk.
On the application of these instructions, banks should adopt the expected credit losses (ECL) model that is introduced by IFRS 9 for the recognition of impairment losses on financial assets.
Government of Rwanda securities are considered to have low credit risk. As such banks and financial institutions need not assess their holdings of such securities or Loans/Overdrafts secured by such securities for significant increase in credit risk since its initial recognition.

IFRS 9 contains a 'three stage' approach to recognize credit impairment, which is based on the changes observed in credit quality of financial assets since initial recognition. Assets move through the three stages as credit quality changes and the stages dictate the level of impairment losses to be recognized.

'Three-stage' model ('general model') for recognition of credit impairment based on changes in credit quality since initial recognition:

Change in credit quality since initial recognition		
Recognition of expected credit losses		
12-month expected credit Losses	**Lifetime expected credit losses**	**Lifetime expected credit losses**
Interest revenue		
Effective interest on gross carrying amount	Effective interest on gross carrying amount	Effective interest on amortized cost carrying amount (that is, net of credit allowance)
Stage 1 Performing (Initial recognition)	**Stage 2** Performing (Assets with significant increase in credit risk since initial recognition)	**Stage 3** Non-performing

The new ECL model requires a significant amount of data in order to estimate the expected losses. In addition, it requires banks to make judgments about certain complex areas of accounting and other judgments related to credit risk management, which could materially affect the provision levels.

• Performing credit accounts: the instructions in stages 1 and 2 in this section will be applicable

• Non-performing credit accounts: banks will continue to apply relevant provisions of the applicable regulations. However, Banks should use provisions of IFRS 9 for stage 3 and will therefore continue to have dual reporting if IFRS 9 stage 3 impairment is lower than regulatory.

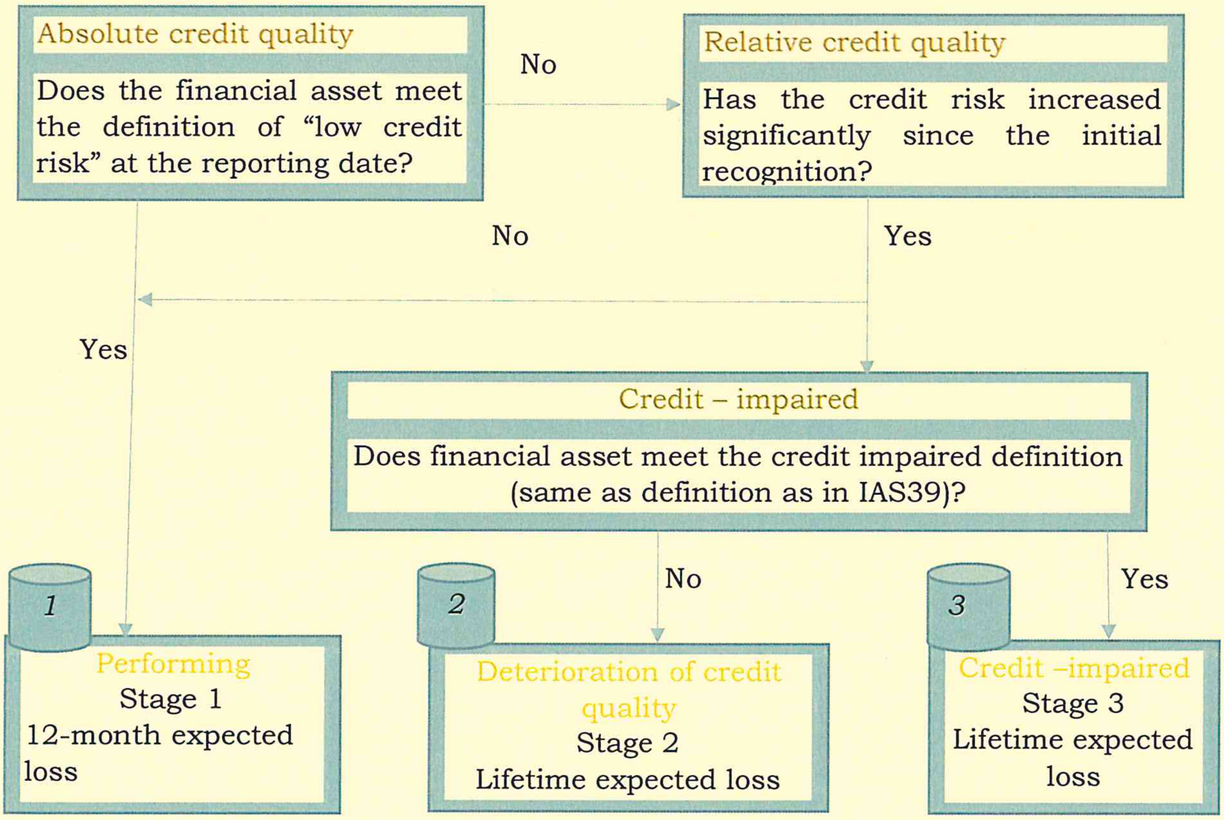
Article 2: Alignment with risk management

To ensure appropriate identification of significant increase in credit risk, banks and financial institutions should avoid applying absolute PD or credit rating threshold to all exposures in a portfolio except where exposures are of a similar credit risk at initial recognition. The use of absolute threshold is only permitted if it would appropriately capture significant increase in credit risk since initial recognition in a manner consistent with the requirements of IFRS 9.

Financial institutions should consider both counterparty and individual exposures of the obligor and connected obligors, in determining significant increase in credit risk. This would ensure that the impact of multiple exposures to the same obligor originated at different periods with different initial PDs have been taken cognizance of compliance with IFRS 9.

IFRS 9 ECL requirements are driven by the provisioning stage in which a particular credit exposure is classified. Accordingly, the first step for any ECL calculation is to determine the population of credit facilities in each of the three stages, keeping in mind the information required to make such an assessment. This process can be summarized graphically as presented below:

The first step is to determine whether any of the exposures meet the definition of low credit risk assets. It is important to isolate this population as these credit exposures will be classified in stage 1 and will always stay in that stage unless significant change occur to require movement to stage 2.



IFRS 9 ECL requirements provide that all exposures (with the exception of those with an explicit expectation of credit deterioration) will be classified in stage 1. Subsequent to initial recognition, IFRS 9 requires Financial Institution to make a relative assessment of deterioration of credit quality, i.e., an assessment of whether the quality of credit has deteriorated relative to the assessment of credit quality performed at initial recognition of the credit exposures.

Assets where there is objective evidence that they are non-performing, are to be placed in stage 3 also requiring lifetime expected loss in accordance with National Bank of Rwanda instructions.

<u>Article 3</u>: Credit commitments and financial guarantees (payment guarantees)

ECL for credit commitments and financial guarantees represent a probability-weighted estimate of the difference, over the remaining life of the financial instrument, between" **Present value of contractual cash flows if the bank becomes obliged to extend** and **Present value of cash flows the bank expects to receive**".

An estimate of ECL on credit commitments should be consistent with expectations of drawdowns on that credit commitment. The bank should consider the expected portion of the credit commitment that will be drawn down within 12 months of the reporting date when estimating 12-month ECL, and the expected portion of the credit commitment that will be drawn down over the expected life of the credit commitment when estimating lifetime ECL.

ECL on financial guarantee contracts, or on credit commitments for which the effective interest rate cannot be determined, are discounted by applying the rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows. In this case, risks should be adequately addressed by adjusting the discount instead of adjusting the cash flows.

Banks should recognize ECL in the statement of financial position as an allowance for credit losses for credit commitments and financial guarantee contracts. To build expectations of drawdowns on credit commitments and cash shortfalls for the asset subject to financial guarantees, National Bank of Rwanda requires banks to use the credit conversion factors established by Basel III and National Bank of Rwanda Instructions in this regard. The banks will be required to compute the historical conversion rates. This Credit Conversion Factors (CCFs) shall be compared against Basel III and the National Bank of Rwanda Instructions. The bank shall apply the higher CCF which should be applied only to the unutilized portion of the facility.

<u>Article 4</u>*:* The approach to prepare the ECL model

Once the financial assets have been categorized into relevant provisioning stages, banks are required to calculate 12-month expected losses for stage1 and lifetime expected losses for stages 2 and 3.

National Bank of Rwanda requires that banks use the following general model to measure the provision for ECL for assets in stage 1& 2 and stage 3 as follows:

- Stage 1 : Probability of default (PD) x Loss given default (LGD) x Exposure at default (EAD) x Discount factor (12 months)
- Stage 2 : Probability of default (PD) x Loss given default (LGD) x Exposure at default (EAD) x Discount factor (Lifetime)
- Stage 3: EAD lifetime X LGD lifetime

<u>Article 5</u>: Probability of default *("PD")*

The IFRS 9 ECL emphasis on recording losses that are expected contrary to those that have already incurred, and it is generally required that PD information used when measuring impairment should be forward-looking. In measuring ECL for 12-month and lifetime of an exposure, a bank should consider all reasonably available information, especially forward-looking information about macroeconomic factors that have an impact on the PD of an exposure.
Banks may derive the lifetime PDs from models, which are already in place at banks. However, banks should ensure that the information produced by such models is fit for the purpose of IFRS 9 ECL measurement.

The purpose of this document is not to determine how banks will calculate PDs as all banks will have their own credit risk estimation models and techniques. However, as outlined above the key requirement is that these models and techniques should be capable of providing forward-looking information.

The likelihood of PDs does not necessarily increase in the form of linear relationship with time, and therefore National Bank of Rwanda requires banks to provide information about changes in PDs across different time periods.
National Bank of Rwanda requires banks to estimate PDs prudently taking into account all the relevant information that can be gathered.
Banks should ensure that the PDs that will be used for the purposes of applying the IFRS 9 ECL model, will be those that provide an estimate over the next 12 months and lifetime of the credit exposure and is forward-looking in nature.

National Bank of Rwanda requires banks to report the PD levels that are likely to be achieved (including the process used, which will derive the PDs) for all of their credit exposures in accordance with the requirements of IFRS 9 and the guidance provided in this document.

Based on the information provided by banks, National Bank of Rwanda will review the PD levels and may provide, from time to time, any additional guidance or minimum limits on PD levels for specific portfolios or assets as it sees fit and in compliance with IFRS 9.

In addition to the criteria provided in paragraph B5.5.17 of the Standard, banks and financial institutions are also required to consider other qualitative factors in assessing significant increase in credit risk including, but not limited to:

(a) Credit scoring of the obligor by any of the licensed private credit bureaux;
(b) Deterioration of collaterals pledged as security for the credit exposures;
(c) Deterioration of the guarantor's credit quality;
(d) Expectation of restructuring due to financial difficulties;
(e) Evidence that full repayment of interest and principal is unlikely in the future, regardless of the number of days past due;
(f) Deterioration in credit worthiness of the borrower such as changes in business location without notification, failure to keep promises and poor management of collateral; and
(g) Consider macroeconomic indices and sector/industry/geographical idiosyncrasies.

The NBR expects that financial assets which are more than 30 days past due or have been granted forbearance should be considered to have significantly increased in credit risk.
However, the NBR expect banks not to rely solely on the 30 days past due presumption, but to incorporate reasonable and supportable forward-looking information. The 30 days past due presumption can only be applied if the forward looking information is not available without undue cost or effort.
Where the 30 days past due presumption is rebutted on the basis that there has not been a significant increase in credit risk, the bank shall accompany the assertion by

documented, reasonable and supportable information that a more lagging criterion is appropriate. The NBR, however, expects that this would only be used in limited circumstances.

- **Macroeconomic Factors**

In order to derive forward-looking PD information, banks are required to overlay specific macroeconomic information to the PD information.
Banks will be required to perform their own analysis to assess the impact of such macroeconomic factors on their credit exposures and determine forward-looking PD information to be used for ECL calculations. However, National Bank of Rwanda does not expect significant discrepancies across the banking sector when calculating the effect of macroeconomic factors on PD. However, it is highly subjective and complex and will require banks to develop models that can be used to convert macroeconomic factors into forward-looking PD indicators. National Bank of Rwanda expects that banks will invest in such infrastructure to ensure expected risk in an exposure is appropriately captured and recorded.

- **Retail and Personal Credit**

National Bank of Rwanda expects banks to provide information about the internal credit risk rating systems for retail lending and the techniques used to estimate 12 month and lifetime PDs.
Banks can be guided by the credit assessment provided by the Credit Reference Bureau (CRB) for personal facilities. Banks can estimate PD and ECL at the level of each portfolio of retail facilities that has identical credit risk characteristics (such as portfolio of salary loans for Rwandan and another for non- Rwandan, or salaries of the government and non-government sectors, etc.).

Historical data time frame in PDs modelling

For the purpose of historical trend in credit risk, Banks that have been in operation for 3 years or more as at 31st December 2017 should use a minimum of 3 years historical data from 2017 backward and banks that are in operations for a period of less than 3 years should use data for years they have been in operations. NBR also requires that the PD information be maintained in a three year rolling basis going forward.

Article 6: Loss Given Default (LGD)

LGD is the percentage that determines the amount of loss that will arise if the borrower was to default. This is calculated by looking at the collateral and other resources available to the bank that can be used to recover the asset in case of default. However, the value of the collateral should consider the various factors as noted below:

LGD is calculated as follows: $$\frac{\textbf{EAD – Expected recovery}}{\textbf{EAD}}$$

The amount of expected recovery is calculated based on the present value of the amounts expected to be received from foreclosure of collateral less cost of recovery, and based on the estimated future value of the collateral and other reliable resources according to documented experience of the bank.

The following table summarizes the derivation of these assumptions:

Assumption	Description
Forward collateral projection	• Banks should determine the value of the collateral at expected time of foreclosure of the collateral.
Government collaterals	• Collaterals extended by the Ministry of Finance are fully deducted without reduction with any haircuts.
Haircut	• Banks should apply reduction to the value of the collateral due to forced/ distressed foreclosure. The haircut applied should be based on the banks past experience and the credit rating of the guarantor (PD), provided haircut percentages of in-kind guarantees are not less than those relative to haircuts applied to guarantees of provisions calculated under National Bank of Rwanda's Instructions to Banks.
Cost of recovery	• The costs incurred to possess and sell the collateral, e.g. legal fees, agent fees, etc. should be deducted when measuring the amounts recoverable.
Time to recovery	• Banks should be guided by their past experiences as to the time required between default and recovery of collateral.
Interest rate	• The discount rate used should be the original effective interest rate (EIR) of the instrument

National Bank of Rwanda expects that banks can leverage their existing credit risk systems and techniques to be able to provide such information for the ECL calculation. However, since ECL is a forward-looking estimate, banks will be required to ensure that accurate forward-looking collateral information can be provided for the purpose of calculating ECL under IFRS 9.

This will be influenced by a number of factors such as the nature of collateral, availability of forward-looking information about the value of the collateral and ability to sell, etc. However, National Bank of Rwanda requires banks to gather all relevant and supportable information to enable them to arrive at accurate information about value of the collateral at a future point in time.

Collateral Realization period

Once a default event has occurred, on average 2 Years for all collaterals realization should at least be considered for the purpose of LDG computation purposes with exception of cash collateral.

Article 7: Exposure at Default ("EAD")

EAD represents the amount of potential exposure that is at risk. Generally, calculating EAD will be a straightforward task when measuring ECL. However, since ECL is a forward-looking measure, EAD input will be forward-looking as well based on the time period when the default is likely to occur. Therefore, it includes all outstanding in and off balance sheet exposures after adjustment with contractual cash flows to reflect the exposure expected when default occurs. In addition, EADs will also include any prepayments the bank expects, in accordance with documentary evidence and historical experience, to be made before the due date.

National Bank of Rwanda requires banks to at **least use two scenarios when estimating ECL**. This typically includes various scenarios of LGD loss rate, e.g. execute mortgage on the collateral or restructure of facility, or refrain from taking any action. However, banks are free to use up to five scenarios. National Bank of Rwanda requires these scenarios to be applied at an overall PD level to simplify the implementation effort.

Article 8: Review of impairment methodology

1. The methodology for the expected credit loss calculation should be reviewed regularly so that differences between loss estimates and actual losses are minimized (back testing/stress tests). The back tests should prove that existing impairment methodology is adequate by showing that difference between actual and estimated losses is statistically insignificant. The methodology shall entail proper definition for statistically insignificant differences. The review should take place at least on an annual basis. When new ECL estimation methods are introduced, the rationale should be documented and the credit loss results in case of the new and old methodology should be provided for the first year of the update.

2. Financial Institutions (FIs) shall maintain proper documentation of impairment review results and related changes to key estimates and judgments. Validation results shall be reported to board of directors and senior management.

3. FIs should review and revise their existing trigger events to ensure that a trigger identifies stage 2 and stage 3 losses as early as possible. This should result in the earliest possible recognition of losses within the IFRS framework.

Article 9: Accounting judgment

In this section, National Bank of Rwanda provides its views on some of the complex areas where IFRS 9 requires the executive management and the board of directors of a bank to exercise significant management judgment. In order to guide banks in making those judgments and to achieve highest degree of consistency of application across the banking industry in Rwanda, National Bank of Rwanda has provided its views with which banks are required to comply as a minimum standard. However, banks should not consider these requirements as exhaustive. Banks are required to identify and consider other complex areas where exercise of management judgment is required and ensure that any key decisions made are well documented, reviewed by their auditors and approved by the board of director.

National Bank of Rwanda expects that banks and their auditors will work to ensure consistent application of IFRS 9 requirements on key areas of accounting and practical judgment arising in the implementation of IFRS 9. In this regard, National

Bank of Rwanda's requirement is that all audit firms through the National Bank of Rwanda or the Institute of Certified Public Accountants of Rwanda will hold joint periodic meetings, as required, whereby they will discuss key issues arising in the implementation of IFRS 9 or any other relevant standards; strive to achieve consensus of views; and report to National Bank of Rwanda the agreed upon results and proposals. This will provide National Bank of Rwanda the comfort that all issues are resolved using views that are consistently applied across the financial services sector and are carefully considered.

1. **Measuring significant deterioration**

IFRS 9 requires that credit exposures in stage 1 (where only a 12-month ECL is required) should transition to stage 2 (where lifetime expected losses are required), when a significant deterioration takes place in the credit quality of the exposure. The standard provides guidance as to what measures can be used to assess deterioration in credit quality or the magnitude of deterioration that would be considered as significant.
IFRS 9 also requires banks to use forward-looking information when assessing the occurrence of significant deterioration in the credit quality of any exposure. Banks should also use information on defaults to conduct such assessment. IFRS 9 assumes deterioration of credit quality of any financial asset substantially when payment of instalments is past due for more than 30 days, unless the bank has reasonable and backed up information to use longer periods of delay, which will not exceed 60 days in all cases.

National Bank of Rwanda requires banks to report how the significant deterioration in credit quality is determined. In all cases, National Bank of Rwanda requires to consider the below changes in credit quality grades as a minimum cause to determine any significant change in PD unless there is delay in payment of due instalments.

2. **Backward transition**

2. 1. Stage 3 to stage 2

Under IFRS 9 requirements, credit exposures can also transition from higher credit risk categories to lower credit risk categories, i.e., from stage 3 to stage 2 ('backward transition'). Banks should comply with the instructions stated.

2.2. Stage 2 to stage 1

Credit exposures may transition back from stage 2 to stage 1 when the credit quality of the credit facility shows sign of significant improvement in lifetime PD. Set out below are considerations to be used in determining whether an exposure should transition back from stage 2 to stage 1:

- Up-to-date with payments: All outstanding payments on the credit facility are made on time and no payments are in arrears.
- Probation period: The PD has remained below the threshold that is considered a 'significant increase' for a minimum period of 12 month.

National Bank of Rwanda requires banks to provide before the end of each quarter details about all the exposures that were transferred and exposures that they intend to transfer from stage 2 to stage 1, and the value of change in credit loss provision and its impact on the statement of profit or loss. In this regard banks should provide all necessary information that was considered in arriving at the decision to backward transition the exposure from stage 2 to 1 including any policy prepared by the bank.

3. Requirements of presentation and disclosure

IFRS 9 requires retrospective application with certain exceptions as stated in the standard. Retrospective application assumes that the standard is applied as if the requirements of the new standard have been applied on a permanent basis. However, IFRS 9 contains a number of diversions from retrospective complete application. National Bank of Rwanda expects banks to take into account the transitional disclosure requirements as set forth in IFRS 9 upon the preparation of the first IFRS 9-compliant financial statements. In addition, banks should ensure they are compliant with the requirements of disclosure relative to the use of financial instruments in accordance with the requirements provided for in IFRS 9 and IFRS 7.

National Bank of Rwanda requires the following:
ECL Provision is presented, including the relevant movement, as a separate item in the statement of income. The bank should recognize ECL in the statement of financial position as an allowance for credit losses for off-financial position obligations. For financial assets that are measured at FVOCI, provision of ECL will not be presented separately in the statement of financial position. However, the bank should disclose the allowance for credit losses in the notes to the financial statements. For financial assets carried at amortized cost and lease receivables, IFRS 9 does not describe how the ECL is presented in the financial statements, and does not mandatorily state the presentation of impairment loss separately in the statement of financial position. Banks are required to present the ECL provision, net of related financial assets, unless notes to the standard state otherwise. The disclosures required under IFRS 9 and IFRS 7 standard will be enough to present ECL of financial assets within the Stage 1 and Stage 2, and the provision for impairment of financial assets in Stage (3).

Article 10: Governance requirements

To ensure a successful, well thought through and managed transition from IAS 39 to IFRS 9, banks are required to put in place a robust governance structure that is aligned to the Guidance on credit risks and accounting for expected credit losses' issued by Basel Committee on Banking Supervision. Banks are required to comply in this regard with the following requirements as a minimum:

- **IFRS 9 project steering committee**

Each Bank is required to form an IFRS 9 project steering committee to manage the implementation process.

- **Board of Directors**

National Bank of Rwanda requires the Board of Directors, either through a sub-committee constituted for this purpose, or assign one of its committees, to play an active role in the decision making of the implementation process of IFRS 9.

Article 11: Leveraging existing infrastructure

The Shape of ECL Model for the application of IFRS 9 requirements relating to calculation of ECL, requires banks to collect significant data, particularly in relation to lifetime PD at credit facility origination and at the impairment assessment date. This would require banks to have models for the calculation of PDs. Additionally; banks are required to calculate losses on an expected basis. This requires banks to calculate 12-month and lifetime forward-looking PDs, which can be achieved by adjusting lifetime PDs by applying the effect of macroeconomic factors. Accordingly, models will be required to convert lifetime PDs into forward-looking PDs. This presents significant challenges in development of the models and collection of data.

National Bank of Rwanda considers it appropriate that banks may use some of their existing PD infrastructure to assist in the application of IFRS 9 ECL model. However, there may be basic conceptual differences in the existing PD infrastructure relative to the requirements of IFRS 9, which would need to be addressed before such infrastructure is used for IFRS 9 purposes. Below is some of the common differences between PD requirements under IFRS 9 and any existing PD models, which would need to be addressed before being used in the application of IFRS 9.

Time horizon: Generally, existing PD models would provide 12-month PD estimates. However, under IFRS 9, banks would also require lifetime PD information. Accordingly, banks would be expected to make adjustments to any existing PD models to ensure that they are able to provide life time as well as 12 months PD estimates.

- **Definition of 12 month PD:**

Generally, losses calculated under a regulatory model would cover 12-month ECL, which are generally considered to be “the expected cash shortfalls that could occur in the next 12-months”. However, IFRS 9 definition of 12-month PD is the “portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date". Accordingly, where an existing PD models is used to calculate 12 month expected losses (i.e., for stage 1), banks should ensure that the definitions of 12 month ECL are aligned to IFRS 9 definition.

- **Point-in-Time (PIT) and Through-the-cycle (TTC):**

Generally existing PD models would calculate PDs using 'through the cycle' measures, which are neutral to changes in conditions over the economic cycle covering the lifetime of the exposure. Under IFRS 9, probability of default should be 'point in time'.

The probability is estimated in current economic conditions and changes as the bank moves through the economic cycle. For the calculation of ECL under IFRS 9, PIT PDs are then adjusted to reflect impact of macroeconomic factors to arrive at forward-looking PDs. Accordingly, National Bank of Rwanda instructs banks that such differences should necessarily be adjusted before using any existing PD models for IFRS 9 application.

CHAPTER THREE: Effective date and transition rules

Article 13: Effective date

The full implementation of IFRS 9 is effective for financial reporting periods starting on or after 1st January 2018.

Article 14: Transition rules From IAS 39 to IFRS 9

Financial Institutions shall apply IFRS 9 retrospectively, in accordance with the transition requirements and guidance contained in IFRS 9. This means that 2018 comparative numbers, i.e., balance sheet numbers as at 31 December 2017, will be restated to reflect the effect of implementing IFRS 9. However, it shall not be applied to items that have already been derecognized at the date of initial application, i.e., 1 January 2018. Accordingly, the differences arising on initial application of IFRS 9 shall be adjusted though the opening retained earnings of the reporting period of initial application at 1 January 2018 without restating the comparative figures for 2017.

The transition from IAS 39 to IFRS 9 is likely to result into an increase in impairment for credit losses resulting into reduced profitability for banks and financial institutions. This increase in impairment loss may ultimately result into significant reduction of capital. The National Bank of Rwanda is aware of this potential “shock” on capital. Accordingly, it has deemed necessary to introduce a transitional arrangement to avoid “capital shock”. The objective being to smooth out the impact on capital resulting from the introduction of Expected Credit Loss (ECL) accounting.

In the first adoption, when IFRS 9 impairment is greater than National Bank of Rwanda provision, for the purpose of computing Core Capital, banks and financial institutions may spread the excess impairment equally over no more than four (4) years.

CHAPTER FOUR: FINAL PROVISIONS

Article 15: Repealing provision

Any prior provisions of guidelines contrary to these guidelines are hereby repealed

Article 16: Commencement

These guidelines shall come into force on the date of its signature

Done at Kigali..2../.08./2018

RWANGOMBWA John
Governor

NATIONAL BANK OF RWANDA: THE GOVERNOR