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The Governor

Our/Ref: 2100 /2020 - 04967/0010 BNR [801.1] Kigali, June 10, 2020

Chief Executive Officer/Managing Director

- **Bank of Kigali Plc**
- **I&M Bank Plc**
- **Cogebanque Plc**
- **Development Bank of Rwanda Plc**
- **Ecobank Plc**
- **Bank Populaire du Rwanda Plc**
- **GT Bank Rwanda Plc**
- **Access Bank Rwanda Plc**
- **Equity Bank Rwanda Plc**
- **Bank of Africa Rwanda Plc**
- **AB Bank Rwanda Ltd**
- **Unguka Bank Plc**
- **Urwego Bank Plc**
- **NCBA Rwanda Plc**
- **Zigama CSS**
- **KCB Plc**

Dear Sir/Madam,

Re: Guidance on treatment of IFRS 9, Capital requirement and relief measures due to COVID 19 Pandemic by banks

The Government of Rwanda (GOR) through the Ministry of Finance and the National Bank of Rwanda (NBR) have introduced relief measures aimed at ensuring that banks continue to lend to households and businesses, thereby supporting the real economy during and post the COVID-19 pandemic.

There are also high levels of uncertainty regarding the forward-looking information relevant for estimating expected credit losses (ECLs) and applying the IFRS 9 assessment of significant increases in credit risk (SICR) arising from payment holidays and other modifications resulting from the COVID-19.

Although it is not our role to set, interpret or enforce accounting standards, the NBR has an interest in the appropriate ECL accounting through regulatory capital position to ensure the safety and soundness of banks.

This letter intends to highlight four areas as set out in the attached guideline:
(i) consistent and robust IFRS 9 accounting and the regulatory definition of default; (ii) the treatment of borrowers who breach covenants due to COVID-19; (iii) the regulatory classification and capital treatment; and (iv) the transitional arrangement of ECL due to COVID-19.

The above measures are aimed at ensuring that banks make reliable and consistent ECL estimates in determining how to treat payment holidays and similar schemes for accounting and regulatory purposes as well as provide robust and consistent market disclosures. The attached guideline has been developed in the context of the exceptional circumstances arising out of COVID-19 and will be reviewed in light of future developments.

The guideline shall take effect for 12 months effective from 1st June 2020 and will be valid until 31st May 2021. NBR will work with you to share concerns, facilitate industry solutions, and promote high-quality implementation.

Yours Sincerely,

RWANGOMBWA John
Governor

GUIDELINE ON TREATMENT OF IFRS 9, REGULATORY CAPITAL AND RELIEF MEASURES TO LIMIT THE IMPACT DUE TO COVID 19 PANDEMIC BY BANKS

A. Introduction

1. The uncertainties caused by the COVID-19 pandemic as well as the corresponding response measures (including reliefs) have given rise to substantial expected credit losses (ECL) implementation issues. At the moment, it is difficult to incorporate the specific effects of COVID-19 and relief measures on a reasonable and supportable basis. These uncertainties include the forward-looking information relevant to estimating ECLs and to applying the International Financial Reporting Standard 9 (IFRS 9-Financial Instruments) assessment of significant increases in credit risk (SICR). However, changes in economic conditions should be reflected in macroeconomic scenarios applied by banks and in their weightings.

2. This guidance is issued to banks to ensure consistent application of IFRS 9 ECL across the banking sector during this period of increased economic uncertainty due to COVID-19. It also guides banks on implementation of the prudential framework, specifically regarding loan restructure and classification as well as treatment of the relief measures by government and other public authorities; IFRS 9 financial assets particularly loans and advances staging and ECL treatment as well as regulatory adjustment due to COVID 19 to allow banks to continue supporting sectors affected by COVID-19 pandemic.

3. This guideline highlights four issues of focus that are particularly relevant to period-end reporting (The National Bank of Rwanda will continue to explore some of the other issues where possible): (i) consistent and robust IFRS 9 accounting and the regulatory definition of default; (ii) the treatment of borrowers who breach covenants due to COVID-19; and (iii) the regulatory classification and capital treatment on credit risk (iv) the transitional arrangement of ECL due to COVID-19. The objective in highlighting these issues is to encourage robust response to them, consistent from bank-to-bank and based on reasonable and supportable forward-looking information. Achieving these objectives will reduce the risk of significant under or overstatement of ECL provisions resulting in greater consistency and enhancing confidence in banks' stated capital positions.

B. Matters to be of high consideration for banks

4. All aspect of COVID-19 pandemic issues have significant implications to banks and it is therefore important for the Board :
   I. To consider how the spread of coronavirus will affect the governance and operations of their business including risk, internal controls, financial reporting, audit and assurance and other regulatory and corporate reporting requirements.
   II. To put in place a governance framework to manage the risks and impact of the COVID-19 pandemic by:
   - Putting in place an adequate policy related to the treatment of credit relief measures of COVID-19 related restructured loans and must be able to support and demonstrate every

instance where the restructure was due to COVID-19 related factors, and ensure compliance with this guideline.

- Taking decisions about forward-looking expected credit loss (ECL) estimates in the coming days and weeks.
- Reviewing the underlying assumptions and model parameters for ECL calculations, which may no longer hold true.
- Identifying models that may no longer be reliable e.g. the use of probability of default estimates in IFRS 9 models. This could be because they are based on historical data, which have not yet incorporated future economic shocks. It could also be due to models being unable to handle high volatility data.
- Putting in place appropriate modelling scenarios and ensure senior management oversight, as well as robust IT infrastructure to provide adequate reporting.
- Put in place controls and ensure effective monitoring of management overlays, post model adjustments, scenario analysis and stress testing.
- Consider initiatives by the Government of Rwanda, the Central Bank and other interventions by Public Authorities in mitigating the impact of the pandemic.

C. IFRS 9 and forward-looking information

5. Banks are advised to develop forecasts based on reasonable and supportable information. The International Accounting Standard Board (IASB) expects ECL estimates to reflect the mitigating effect of the significant economic support and payment relief measures put in place by public authorities and the banking sector. While estimating ECL, banks may not apply the standard mechanistically and should use the flexibility inherent in IFRS 9, for example to give due weight to long-term economic trends.

6. IFRS 9 requires that the forward-looking information used in ECL estimates is both reasonable and supportable. Given the sudden onset of the virus, NBR consider that there is very little such information available currently. Clearly the markets have been trending significantly downwards and the steps being taken to contain the virus (including social distancing and business closures) could, if judged in isolation, have negative implications for borrowers' ability to pay. Those factors should, however, not be judged in isolation because governments and central banks globally have announced unprecedented interventions to minimize the impact on individuals and corporates. Preparing a detailed forecast that factors all this in fully is very challenging currently.

7. The above information is believed to have the immediate implications on the financial reporting in the following measures:
   - **Economic scenarios and probability-weights**: In addition to the challenges already mentioned, the situation is evolving rapidly and changes to consensus data are likely to lag government and central bank interventions. This seems likely to mean that, if any substantive changes are to be made to the ECL estimates at end February 2020, those changes will be driven predominantly by adjustments ('overlays'). It is essential that overlays are the subject of high-quality governance, given the unprecedented nature of the current situation and the significant uncertainties that exist.

- **Model adjustments**: In exceptional credit conditions, traditional drivers of credit risk, when considered in isolation, tend not provide a complete picture of how credit risk and losses are evolving. For example, given unprecedented levels of government-led support for borrowers, normal relationships between credit risk and economic variables may not prove a reliable guide. Events like a temporary loss of income will not necessarily have the same consequences as in the past. There has not been enough time and there is not enough information for these factors to have fed through to lenders' models. This also means greater reliance being placed on overlays and the governance around them.

8. Each bank is required to form its own view on the appropriate provision levels in order to comply with IFRS 9 taking into account: the governance process around economic scenarios, probability weights, model adjustments and overlays, Banks should consider that to make well-balanced judgments about ECL it is essential to:
   - Recognize that, although it is difficult to forecast the impact of the pandemic itself and although the amount of forward-looking information on the subject is very limited, there are clear signs that, taken in isolation, economic and credit conditions are worsening. It is, however, equally important also to take into account the significant economic support measures announced by domestic and international fiscal and monetary authorities and the measures – such as payment holidays and new lending facilities – that are being made available to assist borrowers affected by the Covid-19 outbreak to resume regular payments.
   - Reflect that the economic shock from the pandemic should be temporary, although its duration is uncertain. While it is plausible to assume that the economic consequences of the pandemic could mean that some borrowers will suffer a long-term deterioration in credit risk, many will need the support measures in the short-term but will not suffer a deterioration in their lifetime probability of default.
   - Give due weight to established long-term economic trends when preparing long-term forecasts, given the challenges of preparing detailed forecasts far into the future. The temporary nature of the pandemic means that banks will need to consider the appropriateness both of their existing forecast period and of the way in which and speed at which conditions then return to the longer-term trend. Compared to the practices we can see pre-pandemic, it seems likely that this will involve in many cases a shortening of the forecast period and a much quicker return to the long-term historical trend. This is relevant to forecasts used to estimate both probability of default and loss given default, and for both individual (that is, case-by-case) and modelled approaches.

D. Treatment of support measures (loan restructuring and moratorium) related to COVID-19

9. Borrowers affected by COVID-19 pandemic can request for a restructuring. If they so qualify, banks shall be required to assess the potential unlikeliness to pay, of borrowers subject to any form of restructuring, in accordance with the policies and practices that they usually apply to such assessments. The responsibility of evaluating and deciding appropriate restructuring and payment deferral or extension of payment deferral of credit facilities during this pandemic lies with the bank.

10. The bank must determine whether that loan was up- to- date[1] as at end February 2020 and through its assessment process determine whether the loan is expected to remain in an up-to-date status subsequent to the relief period, all other factors remaining constant. These restructured loans will be classified as COVID-19 related restructures.

11. A bank is allowed to make a maximum of four (4) restructurings for credit facility during the implementation of this guideline, irrespective of the number of times it has been restructured in the past if the said restructuring is a response to the COVID pandemic.

12. There is no need to classify the exposure as defaulted. This type of restructuring should not be considered as a distressed restructuring provided that it is a general measure to a set of customers sharing the same criteria; on the contrary, it has to be considered a suitable measure to give relief to these borrowers, which are temporarily not able to service their loan obligations due to COVID-19 disruptions.

13. It is also pertinent to note that a moratorium /payment deferral or extension of payment deferral given to borrowers in a response to the COVID pandemic is treated as a relief measure allowable under this section of the guideline.

14. However, if there is an adverse change in other actual or expected circumstances during or after the relief period which circumstances are not expected to be temporary in nature over and above the relief provided (e.g. a mortgage debtor is retrenched or an SME or corporate enters business rescue or suffers losses that put into question its ability to repay the outstanding balance), such circumstances are indicators of distress, warranting the loan to be treated as overdue/non-performing at the time those circumstances are assessed to have changed.

15. Those loans that are not reasonably expected to remain in good standing or those loans that despite the relief measures, still exhibit signs of distress, must be treated in terms of the existing requirements respectively specified in Regulation N°12/2017 of 23/11/2017 on credit classification and provisioning.

16. NBR will not require automatic reclassification when general measures are being offered to all customers of the bank or to its customers in a specific economic sector impacted by COVID-19. However, NBR requires banks to report specific measures offered to help a specific borrower who is experiencing or likely to experience temporary financial difficulties with their repayment obligations.

E. Treatment of default for loans subject to restructure or payment moratoriums initiated in response to the Covid-19 pandemic

17. NBR expectation is that eligibility for, and use of, the BNR's policy on the extension of payment holidays should not automatically, other things being equal, trigger:

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[1] Refers to an overdraft or a credit facility with non-fixed /fixed repayment dates; when the approved limit has been exceeded/ principal or interest is due and unpaid for less than thirty (30) days.

- a default under Directive on treatment of Credit Risk[2] ; and
- the loans involved being moved into Stage 2 or Stage 3 for the purposes of calculating ECL.

18. The above expectation extends to similar government-endorsed response and schemes (Economic Recovery Fund), and similar measures by banks, to respond to the adverse economic impact of the virus, including those for small and medium-sized enterprises.

Prudential identification of default

19. Banks are reminded to apply sound risk management practices regarding the identification of defaults. Banks should continue to assess borrowers for other indicators of unlikeliness to pay, taking into consideration the underlying cause of any financial difficulty and whether it is likely to be temporary as a result of COVID-19 or longer term.

20. NBR does not consider the use of a COVID-19 related restructure or payment holiday by a borrower to trigger the counting of days past due or generate arrears under Directive on treatment of Credit Risk. NBR also does not consider the use of such a payment holiday to result automatically in the borrower being considered unlikely to pay under the above Directive.

21. The prudential identification of default includes a number of mitigating factors to ensure that classification of default is done under true circumstances where economic losses are likely to be taken.

22. In terms of the past due criteria, defaults do not have to happen until 90 days past due on credit obligation (with rebuttable presumption) and in context of paragraph 11 above. The assessment of unlikeliness to pay should be based on whether the borrower is unlikely be able to repay the rescheduled payments, and thus providing sufficient time to restructure the loans where necessary. This is particularly relevant in light of the moratoria being activated because of the COVID-19 pandemic.

Identifying whether a significant increase in credit risk (SICR) has occurred for IFRS 9

23. Under IFRS 9, loans are required to be moved from Stage 1 to Stage 2 if and only if they have been the subject of a SICR. A SICR occurs when there has been a significant increase in the risk of a default occurring over the expected life of a financial instrument.

24. To date payment holidays granted in response to financial difficulty have generally been regarded as a reliable proxy for identifying whether a SICR has occurred. NBR considers that in the case of government-endorsed payment holidays (and similar schemes), the position is different and it should not be assumed that those borrowers that are granted a payment holiday have suffered a SICR. Our reasoning is set out in the next few paragraphs.

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[2] Treatment of a default is when loan payment is past due for more than 90 days - DIRECTIVE No 02 2018 OF 15 02 2018 on computation of capital charge for credit, market and operational risks and treatment of leverage ratio of banks.

25. In line with Basel guidance on ECL, NBR expect that the definition of default and the convention for counting days past due adopted for accounting purposes will be guided by the definition used for regulatory purposes. Therefore NBR consider that use of government-endorsed payment holidays by a borrower would not on its own trigger the counting of days past due for the 30 days past due backstop used to determine SICR or the 90 days past due backstop used to determine default.

26. Furthermore, assuming a SICR has occurred for all the borrowers that benefit from a payment holiday as a result of COVID-19, which is likely to be a poor reflection of the reality of the situation. The eligibility criteria is broad and borrowers need not have experienced a SICR for them to access them. In addition, use of payment holidays may indicate short-term liquidity or cash flow problems but is likely to provide little information to enable banks to differentiate borrowers' lifetime credit risk. Under normal circumstances, banks would be expected to gather information about the financial circumstances of the borrower before providing a payment holiday and would tailor the terms of the payment holiday to those circumstances. NBR understanding is that in the short-term the circumstances surrounding a request for a payment holiday will not be investigated sufficiently for the lender to obtain sufficient information to be able to use the granting of the payment holiday as a sole indicator that SICR has occurred or even as the basis to adjust the borrower's probability of default.

27. The treatment above is consistent with payment holidays being granted as part of an unprecedented government-led effort or by banks on a voluntary basis to support the economy amid the COVID-19 outbreak, rather than being granted in response to the circumstances of individual borrowers.

28. For some banks, the treatment described above will flow from their existing accounting policies. For those banks, the option to take a payment holiday is a standard feature of many loan contracts that allows borrowers flexibility to manage their liquidity, so when such options are exercised at a customer's discretion it is not used as an SICR trigger. Customers now have additional rights to payment holidays to manage liquidity, regardless of whether this was a feature of their original contract.

29. Nevertheless, government-endorsed payment holidays are also available to be used in response to some sort of financial difficulty – which may indicate some increase in credit risk for some borrowers. The question is whether that increase in credit risk is significant when judged over the expected life of the loan. NBR understand that some lenders intend to try to differentiate between borrowers who request a payment holiday to manage liquidity due to short-term cash-flow disruption that are expected to return to regular payments (they would remain in Stage 1), and borrowers expected to be more permanently impacted (they would move to Stage 2). This is right in principle but likely to be operationally complex.

30. To assist banks in making these judgements NBR observe that:
  - Some high-level but balanced method would need to be found to allocate a proportion of the loans on which payment holidays have been granted to Stage 2 so as to comply with the principles underpinning IFRS 9. Due to the absence of detailed information, it is

unlikely to be appropriate simply to assume a SICR event unless there is evidence to the contrary.

- provided lenders' other SICR criteria operate effectively, a method that NBR consider to be credible is to assess whether the overall impact on ECL could be material by considering the differential between 12 month and lifetime ECL for the volume of customers that have received a payment holiday but show no other indicators of SICR. If deemed material, an overarching allocation could be made based on a sample of accounts.

31. The accounting analysis above focuses specifically on government-endorsed payment holidays but is expected to be broadly relevant for similar measures by banks on a voluntary basis to respond to the adverse economic impact of the virus.

32. To achieve consistency in the longer term it may be necessary for banks to establish new SICR policies and processes for monitoring, and the accounting treatment of program to respond to the adverse economic impact of the virus.

33. Where banks are able to develop forecasts based on reasonable and supportable information, the NBR expects ECL estimates to reflect the mitigating effect of the significant economic support and payment relief measures put in place by public authorities and the banking sector. While estimating ECL, banks should not apply the standard mechanistically and should use the flexibility inherent in IFRS 9, for example to give due weight to long-term economic trends.

F. Treatment of borrowers breaching covenants due to COVID-19 pandemic

34. NBR recognize the important role loan covenants play in lenders' credit risk management. It is important, however, that such risk management takes into account fully the differences between 'normal' covenant breaches and some of the breaches that might occur because of the COVID-19 pandemic. For example, breaches might arise as a result of temporary changes in borrowers' reported earnings, suspension of business or other material adverse event clauses, modification of the audit report attached to audited financial statements, or as a result of unavoidable delays in providing lenders with unaudited or audited financial statements, covenant compliance certificates, or third-party valuations.

35. The NBR requires banks that when applying the IFRS 9, as mentioned above they are expected to use a certain degree of judgment and distinguish between borrowers whose credit standing would not be significantly affected by the current situation in the long term, and those who would be unlikely to restore their creditworthiness and the later should be automatically downgraded.

36. Banks should also consider if the covenant has been breached due to borrower specific issues, or if it is directly related to the pandemic. If the latter, banks should consider waiving the covenant breach. Businesses who breach covenants due to updated audit statements for financial reports should not automatically trigger a default for rise of ECL.

37. NBR expectation is that that a covenant breach or waiver of a covenant relating to a modification of the audit report attached to audited financial statements because of the COVID-19 pandemic should not automatically, other things being equal, trigger:
    - a default under CRR; and
    - the loans involved being moved into Stage 2 or Stage 3 for the purposes of calculating ECL.

38. The above expectation extends to other covenant breaches and waivers of covenants with a direct link to the COVID-19 pandemic. NBR consider that it is important that banks' assessment of covenant breaches takes into account fully the differences between 'normal' covenant breaches and some of the breaches that might occur because of the COVID-19 pandemic.

Prudential identification of default

39. A breach of the covenants of a credit contract is a possible indication of unlikeliness to pay under the credit risk treatment of default in Section E above. However, a covenant breach does not automatically trigger a default. Rather, banks have scope to assess covenant breaches on a case-by-case basis and determine whether they indicate unlikeliness to pay.

Identifying whether a significant increase in credit risk (SICR) has occurred for IFRS 9

40. To date a counterparty's financial statements being subject to delay, a modified audit opinion or material uncertainties about going concern would typically be the result of a change in the borrowers' operating results or ability to meet its debt obligations as they fall due, and would therefore indicate an increase in credit risk. For that reason, they would generally have been regarded as a reliably proxy for identifying whether a SICR or default has occurred.

41. NBR consider that in the short-term such delays, modifications and material uncertainties will be much more frequent and may be due to factors that are not sufficiently closely related to the borrowers' credit risk to be used as a reliable proxy for identifying SICR. For example, an auditor might need to modify an audit opinion because he has been unable to gather the necessary audit evidence to complete the audit in full. This may be because of an inability to do onsite work or access geographical locations subject to a lockdown, or because the level of uncertainty has meant the auditor has not been able to conclude its going concern assessment.

42. In NBR view, the underlying reason for delays, modified audit opinions or material uncertainties about going concern in the context of the current environment will need to be assessed on a case-by-case basis. Subject to that individual assessment, NBR would expect that when the reasons are of a general nature or are bank specific but unrelated to the solvency or the liquidity of the borrower, the conclusion will generally be that neither a SICR nor default has occurred.

43. The accounting analysis above focuses specifically on a modification of the audit report but is expected to be broadly relevant for other covenant breaches with a direct link to the COVID-19 pandemic.

G. Treatment of Regulatory Capital related to the COVID-19 pandemic

44. Banks should ensure that only loans with performing status or the conditions not regarded as distressed restructures as specified in Section D above, shall be classified as retail (which include residential mortgage advances, retail revolving credit, SME retail and retail other) or corporate (which include corporate, LSME/ corporate and the various specialised lending asset classes) as per Directive No. 02 2018 of 15 02 2018 on computation of capital charge for credit, market and operational risks and treatment of leverage ratio of banks,

45. Those loans that are not reasonably expected to remain in good standing or those loans that despite the relief measures, still exhibit signs of distress, must be treated as overdue/non-performing in terms of the existing regulation[3] to determine the relevant minimum required amount of capital and reserve funds to be held against the bank's credit risk exposure.

46. When calculating the minimum required amount of capital and reserve funds relating to credit risk under the standardized approach for credit risk respectively specified in the above Directive. The risk weight assigned to the COVID-19 related restructured loans must be based on similar, but no better classification (where the classification is done in accordance with Directive on capital charges) than before the COVID-19 related restructure. Therefore, the same risk weight assigned to the loan before the said restructure may be applied to the COVID-19 related restructured loan, as if these loans are not considered to be distressed.

47. In line with the transitional arrangement [4] for IFRS 9 implementation, banks will benefit from the adjustment on their regulatory capital for 2 years on a straight line basis to reduce the impact of ECL due to COVID-19 pandemic.

48. Banks will add Common Equity Tier 1 (CET1) equivalent to up to 50% of new provisions of stage 2 loans due to COVID-19 to capital for 2020 and 2021 respectively, as part of the transitional arrangement.

49. Banks should disclose: (a) whether a transitional arrangement is applied; and (b) the impact on the bank's regulatory capital and leverage ratios compared to the bank's "fully loaded" capital and leverage ratios had the transitional arrangements not been applied.

H. Treatment of write-off and disposals of fixed assets.

50. Based on the difficulty to meet financial obligation and temporary restructuring due to consequences of the COVID-19 pandemic, banks may extend by 365 days the write off date

[3] Regulation n°12/2017 of 23/11/2017 on credit classification and provisioning.

[4] Transitional arrangement for the guideline on IFRS 9 implementation for banks of 02/08/2018 provides the phase in arrangement of 4 years.

of credit facilities classified as loss and 365 days for disposal of fixed assets held for sale, if and only if, the write-off or disposal date falls due within the 12 month period of this guideline.

51. The time for collateral realization is 3 years and this should be taken into consideration in computation of ECL (i.e. Loss Given Default-LGD) under this guideline.

I. Miscellaneous and Final Provisions

52. This guideline does not change, remove nor add to the requirements of IFRS 9 or the IFRS guidance and other implementing regulations or guidelines; instead, it intends to support the consistent and robust application of IFRS 9 and regulatory framework issued by NBR.

53. In order for the NBR to monitor the extent and impact of COVID-19 related restructured loans and other relief measures, additional reporting requirements may be required by the NBR as part of its ongoing supervisory processes.

54. This guideline comes into force on the date of signature. However, it shall take effect for 12 months effective from 1st June 2020 until the end of May 2021 and shall apply to all credit facilities, including those approved but not yet disbursed as at the end of February 2020. The NBR may, however, extend this deadline, depending on the evolution of the effects associated with the COVID-19 pandemic.

Done in Kigali on 11 / 06 / 2020

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

RWANGOMBWA John
Governor