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The Governor

GUIDELINES N^{O} 4230/2023 - 00034[616] OF 05/06/2023 ON IFRS 9 – FINANCIAL INSTRUMENTS IMPLEMENTATION AND DISCLOSURES

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The National Bank of Rwanda;

Pursuant to Law n° 48/2017 of 23/09/2017 governing the National Bank of Rwanda as amended to date, especially in articles 6, 6bis, 8,9 ,10 and 15;

Pursuant to Law N° 007/2021 OF 05/02/2021 Governing Companies, especially in articles 121 and 123;

Pursuant to Law Nº 47/2017 of 23/9/2017 governing the organisation of banking, especially in article 46 and 117;

Pursuant to Law Nº 11/2008 of 06/05/2008 establishing the Institute of Certified Public Accountants of Rwanda and determining its powers, organisation and functioning, especially in article 3;

Noting that IFRS aims to increase transparency, accountability and efficiency and that the use of a single and reliable accounting language reduces the cost of capital and international reporting costs, the adoption of IFRS by Rwanda means that there is no need to reinvent the wheel to establish different local standards;

Noting that the adoption of IFRS means that banks in Rwanda are required to comply with all subsequent revisions and amendments passed by IASB on the existing standards;

Considering that the IFRS has improved to IFRS 9, its implementation requires guidance for its consistent application across the industry;

ISSUES THE FOLLOWING GUIDELINES:

CHAPTER ONE: GENERAL PROVISIONS

Article One: Purpose of these Guidelines

These Guidelines –

(a) Enable smooth implementation of and transitioning to IFRS 9 in banking sector to continue enhancing market discipline, transparency, consistency of application and facilitate greater comparability across the banking sector by detailing 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 standards; and

(b) Are not limited to loans portfolio but also to other financial instruments in the portfolio of banks financial instruments including: investment in securities (Bond and bills); other receivables & commercial papers and derivatives.

Article 2: Interpretation

In these Guidelines:

(a) "IFRS" means International Financial Reporting Standards;

(b) "IFRS 9" means the Financial Instruments of which its final version was issued by 2014 by the IASB to replace IAS 39 (Financial Instruments: Recognition and Measurement). It came into effect for annual periods beginning on January 1, 2018, introduced a new forward looking methodology for computing credit losses 'Expected Credit Loss' as opposed to IAS 39's 'Incurred Loss' model. IFRS 9 requires banks to recognise and account for credit loss at origination of loans or investment in financial instruments and update the losses as information on the financial assets develops. The shift to the 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'.

(c) "IAS 39" means International Accounting Standards;

(d) "IASB" means International Accounting Standard Board;

(e) "Securities" mean bonds and bills;

(f) "ECL" means Expected Credit Loss;

(g) "PD" means Probability of Default;

(h) "LGD" means Loss given default;

(i) "EIR" means Effective Interest Rate;

(j) "CCF" means Credit Conversion Factor;

(k) "EAD" means Exposure at default;

(l) "DpD" means days past due;

(m) "UTP" means Unlikeness to pay;

(n) "SCRA" means Specific credit risk adjustments.

CHAPTER II: EXPECTED CREDIT LOSS

Article 3: Overview

(1) Bank shall 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.

(2) On the application of these instructions, bank shall adopt the expected credit losses 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 need not to 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.

(3) '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/ECL)
Stage 1 Performing (Initial recognition)	Stage 2 Performing (Assets with significant increase in credit risk since initial recognition)	Stage 3 Non-performing

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

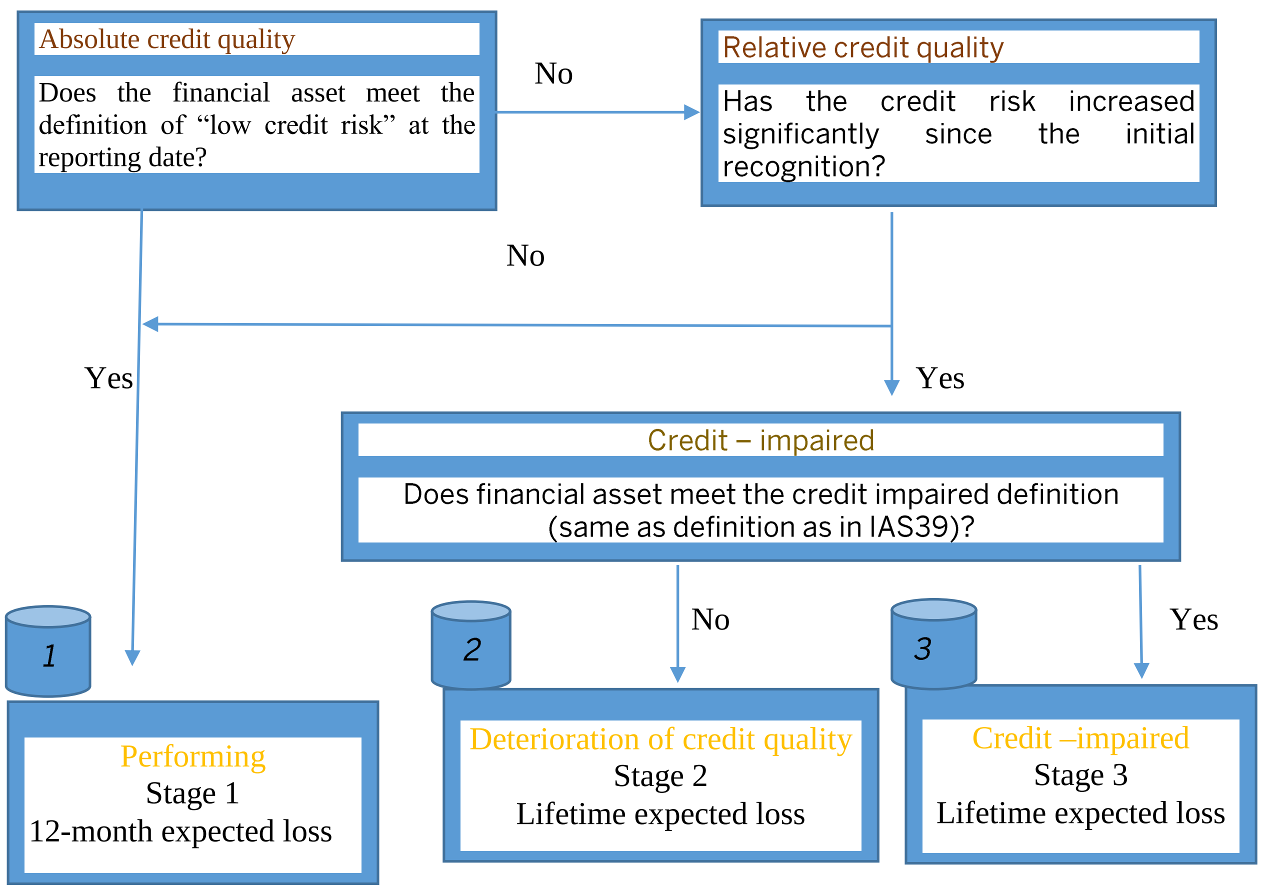
(a) Performing credit accounts: the instructions in stages 1 and 2 in this section will be applicable;
(b) Non-performing credit accounts: bank will continue to apply relevant provisions of the applicable regulations. However, Bank shall use provisions of IFRS 9 for stage 3 and will therefore continue to have dual reporting if IFRS 9 stage 3 impairment is lower than regulatory. The excess of Regulatory provisions over IFRS 9 should be taken as reserve.

Article 4: Alignment with Risk Management

(1) To ensure appropriate identification of significant increase in credit risk, bank is prohibited to apply 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.

(2) Bank shall 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.

(3) 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, an entity also needs 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.



(4) 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.

(5) 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 the Central Bank's instructions.

Article 5: Credit Commitments and Financial Guarantees (Payment Guarantees)

(1) 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".

(2) An estimate of ECL on credit commitments shall be consistent with expectations of drawdowns on that credit commitment. Bank shall 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.

(3) 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.

(4) Bank shall 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. Bank shall use the credit conversion factors established by Basel III and Central Bank's instructions in this regard. The banks will be required to compute the historical conversion rates. This CCFs shall be compared against Basel III and the Central Bank's instructions. Bank shall apply the higher CCF which should be applied only to the unutilized portion of the facility.

Article 6: Treatment of restructured loans

(1) Debt restructuring can take various legal forms including:

(a) An amendment to the terms of a debt instrument (e.g: the amounts and timing of payments of interest and principal) or

(b) A notional repayment of existing debt with immediate re-lending of the same or a different amount with the same counterparty. The treatment of the debt modification depends on whether it is considered to be 'substantial' or 'non-substantial'.

(2) IFRS 9 requires that a financial asset is derecognized when the contractual rights to its cash flows expire. The standard also states that in some circumstances the renegotiation

or modification of the contractual cash flows of a financial asset can lead to its de-recognition.

(3) Bank holding financial assets shall perform a quantitative and qualitative evaluation of whether the modification is substantial i.e whether cash flows of the original financial asset and the modified or replacement financial asset are substantially different. And if they are substantially different, the contractual rights to cash flows from the original financial asset are deemed to have expired.

(4) In making this assessment for financial assets, bank shall use the de-recognition criteria for financial liabilities. There are two tests to check whether the modification is substantial, and these are as follows:

(a) Qualitative test - A significant change in the terms and conditions such that immediate de-recognition is required with no additional quantitative analysis.

(b) Quantitative test - The net present value of the cash flows under the new terms discounted at the original EIR is at least 10% different from the carrying amount of the original debt. This is described as the '10% test'.

(5) Notwithstanding the above assessment, debts/loans whose principal or interest payments equal to at least ninety days have been capitalized, refinanced, renegotiated or restructured shall be considered as substantially modified and non-performing hence should be classified downwards in stage 3.

(6) Non-substantial modification should be assessed for management to determine whether it qualifies for Significant increase in credit risk or not. The assessment should be documented to support management's conclusion.

(7) Bank shall submit quarterly report on restructured loans to the Central Bank. The report shall indicate amount restructured and capitalized interest and provision thereon (both regulatory and IFRS 9) as well as classification (both regulatory and IFRS 9 stages).

Article 7: Purchased or Originated Credit impaired Financial assets

(1) Bank shall determine whether a financial asset is credit impaired on its initial recognition. A financial asset is credit impaired when one or more events that have a material/detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidences that a financial asset (on purchase or origination) is credit impaired include:

(a) Significant financial difficulties of the issuer or the borrower;

(b) A breach of contract, such as default or past due event;

(c) The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;

(d) It is becoming probable that the borrower will enter bankruptcy or other financial reorganization;

(e) The disappearance of active market for that financial asset because of financial difficulties; and

(f) The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

(2) Bank shall explain and document how it has determined that assets are credit impaired including the inputs, assumptions and estimation techniques used.

(3) For financial assets that are considered to be credit impaired on purchase or origination, the EIR is calculated taking into account the initial lifetime ECLs in the estimated cash flows and there is no additional 12 month ECL allowance.

(4) In subsequent reporting periods, bank shall recognize:

(a) The cumulative changes in lifetime ECLs since initial recognition as a loss allowance; and

(b) In profit or loss, any change in life time ECLs as an impairment gain or loss. An impairment gain is recognized when favourable changes result in the lifetime ECLs estimate becoming lower than the original estimate that was incorporated in the estimated cash flows on initial recognition.

Article 8: The approach to prepare the ECL model

(1) Once the financial assets have been categorized into relevant provisioning stages, bank shall calculate 12-month expected losses for stage1 and lifetime expected losses for stages 2 and 3.

(2) Bank shall use the following general model to measure the provision for ECL for assets in stage 1& 2 and stage 3 as follows:

(a) Stage 1: Probability of default (PD) x Loss given default (LGD) x Exposure at default (EAD) x Discount factor (12 months);

(b) Stage 2: Probability of default (PD) x Loss given default (LGD) x Exposure at default (EAD) x Discount factor (Lifetime); and

(c) Stage 3: EAD lifetime X LGD lifetime.

(3) Bank shall consider watch category as a backstop indicator to stage 2 while defaulted customers will constitute stage 3 and normal loans for stage 1 before considering other qualitative information that would lead to further downgrade.

Article 9: Probability of default

(1) 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 shall be forward-looking. In measuring ECL for 12-month and lifetime of an exposure, a bank shall consider all reasonably available information, especially forward-looking information about macroeconomic factors that have an impact on the PD of an exposure. Bank may derive the lifetime PDs from models, which are already in place at bank. However, bank shall ensure that the information produced by such models is fit for the purpose of IFRS 9 ECL measurement.

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

(3) The likelihood of PDs does not necessarily increase in the form of linear relationship with time, and therefore, bank shall provide information about changes in PDs across different time periods.

(4) Bank shall estimate PDs prudently taking into account all the relevant information that can be gathered.

(5) Bank shall ensure that the PDs that are used for the purposes of applying the IFRS 9 ECL model, are those that provide an estimate over the next 12 months and lifetime of the credit exposure and is forward-looking in nature.

(6) Bank shall 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 guideline.

(7) Bank shall make sure that no customer has lower PD than the Government PD and where a bank has granted more than one credit facility to a borrower and any of the facilities is downgraded to lifetime PD category, bank shall consider the highest PD to all other outstanding credit facilities to the borrower and to the interconnected parties.

(8) Based on the information provided by banks, the Central Bank 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.

(9) In addition to the criteria provided in paragraph B5.5.17 of the Standard, bank shall 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.

(10) Financial assets which are more than 30 days past due or have been granted forbearance shall be considered to have significantly increased in credit risk. However, bank shall not 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.

(11) Where the 30 days past due presumption is rebutted on the basis that there has not been a significant increase in credit risk, bank shall accompany the assertion by documented, reasonable and supportable information that a more lagging criterion is appropriate. However, bank shall only use this in limited circumstances.

(12) Macroeconomic Factors. In order to derive forward-looking PD information, bank shall overlay specific macroeconomic information to the PD information. Bank shall perform its own analysis to assess the impact of such macroeconomic factors on its credit exposures and determines forward-looking PD information to be used for ECL calculations. But, the Central Bank 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, therefore, bank shall develop models that can be used to convert macroeconomic factors into forward-looking PD indicators and it shall invest in such infrastructure to ensure expected risk in an exposure is appropriately captured and recorded.

(13) Retail and Personal Credit. Bank shall provide information about the internal credit risk rating systems for retail lending and the techniques used to estimate 12 month and lifetime PDs. Bank can be guided by the credit assessment provided by the Credit Reference Bureau (CRB) for personal facilities. It 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).

(14) Historical data time frame in PDs modelling. For the purpose of historical trend in credit risk, Bank shall use 5 years historical data backward and a bank that is in operations for a period of less than 5 years shall use data for years it has been in operations. Bank shall maintain the PD information in a five year rolling basis going forward.

(15) PD shall be quarterly calibrated to add conservative add-ons that should cover the gap of information due to scarce default event data.

(16) Probability-weighted outcome: ECLs shall be a probability-weighted estimate of credit losses over the expected life of the financial instrument (i.e., the weighted average of credit losses with the respective risks of a default occurring as the weights).

(17) When measuring ECLs, in order to derive an unbiased and probability-weighted amount, an entity needs to evaluate a range of possible outcomes. This involves identifying possible scenarios that specify:

(a) The amount and timing of the cash flows for particular outcomes; and
(b) The estimated probability of these outcomes.

(18) Although an entity does not need to identify every possible scenario, it will need to take into account the possibility that a credit loss occurs, no matter how low that probability is. This is not the same as a single estimate of the worst-case or best-case scenario or the most likely outcome (i.e., when there is a low risk or probability of a default with high loss outcomes, the most likely outcome could be no credit loss even though an allowance would be required based on probability-weighted cash flows). Therefore, a bank shall use weighted probabilities in estimating its ECLs.

Article 10: Loss Given Default

(1) 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: $$\frac{\text{EAD – Expected recovery}}{\text{EAD}}$$

(2) 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	Bank shall 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	Bank shall apply reduction to the value of the collateral due to forced/ distressed foreclosure. The haircut applied shall be based on the bank’s 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 the Central Banks’s instructions to Banks.

Cost of recovery	The costs incurred to possess and sell the collateral, e.g. legal fees, agent fees, etc. shall be deducted when measuring the amounts recoverable.
Time to recovery	Bank shall be guided by its past experiences as to the time required between default and recovery of collateral.
Interest rate	The discount rate used shall be the original EIR of the instrument.

(3) Bank can leverage its 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, it shall 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, bank shall 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.

(4) Collateral realization period. Once a default event has occurred, bank shall use its internal models to arrive at collateral realization period but in any case this period shall not be less than 2 years for the purpose of LDG computation with exception of cash collateral. However, when minimum period (2 years' period) is used, sufficient and supportable information shall be availed to support such decision.

(5) Use of Minimum LDG. As mentioned above, LGD is the credit loss incurred if an obligor defaults and is dependent on the characteristics of the loan. Losses are influenced by the presence of collateral and when no collateral exists the cash flows that the borrower pays after default determine the LGD of the loan. For effective implementation of the standard, Bank shall determine a minimum LGD on those loans that are covered by immovable collaterals i.e. Residential and commercial real estate collaterals.

(6) Only fully cash covered (principal & interest) loans shall be identified as low or null loss given default.

Article 11: Exposure at Default

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.

Article 12: Default

(1) Under IFRS 9 default does not occur later than when a financial asset is 90 days past due with rebuttable presumption. To rebut this presumption a bank needs reasonable and supportable information that demonstrates that a more lagging default criterion is more appropriate.

(2) Defaulted Financial Instruments will include impaired restructured loans and certain other risky exposures not considered as NPLs.

(3) For bank to implement this new guidance on Default it is important to consider the holistic view of all processes impacted. In this respect, the key aspect to consider is a robust control framework from a risk management perspective. This can be separated into aspects related to external data, application of the definition of default from a broader banking perspective and specific features linked to retail exposures.

(4) In determining whether a financial asset has defaulted, along with days past due (DpD) calculations, changes to relative and absolute thresholds and default triggers shall be considered and appropriately documented by bank.

Article 13: Review of impairment Methodology

(1) The methodology for the expected credit loss calculation shall be reviewed regularly so that differences between loss estimates and actual losses are minimized (back testing/stress tests). The back tests shall 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 shall take place at least on an annual basis. When new ECL estimation methods are introduced, the rationale shall be documented and the credit loss results in case of the new and old methodology shall be provided for the first year of the update.

(2) Bank 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) Bank shall review and revise its existing trigger events to ensure that a trigger identifies stage 2 and stage 3 losses as early as possible. This must result in the earliest possible recognition of losses within the IFRS framework.

(4) Bank provides to the Central Bank an independent certification done by an independent expert other than the bank's external auditor to validate bank's model framework with its latest ECL model and outcome at least once every two years not later than two months after end of financial year in which this certification is undertaken.

(5) If back testing results into 5% deviation between ECL and Actual loss on financial instruments, then bank shall recalibrate its Models to minimize the deviation.

(6) The Central Bank may on its own discretion require an independent certification validating financial institution's model framework with their latest ECL model and outcome.

Article 14: Accounting Judgment

(1) In this article, the Central Bank 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 bank in making those

judgments and to achieve highest degree of consistency of application across the banking industry in Rwanda, the Central Bank has provided its views with which bank is required to comply as a minimum standard. However, bank shall not consider these requirements as exhaustive. Bank is 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 directors.

(2) Bank and its auditors shall 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, all audit firms through the Central Bank or the Institute of Certified Public Accountants of Rwanda shall 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 the Central Bank the agreed upon results and proposals. This will provide the Central Bank the comfort that all issues are resolved using views that are consistently applied across the banking sector and are carefully considered.

(3) 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. Bank shall 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.

(4) Bank shall report how the significant deterioration in credit quality is determined. In all cases, bank shall 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.

(5) Backward transition.

(a) Stage 3 to stage 2 to stage 1.

(i) 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’). Bank shall comply with the instructions stated.

(ii) There are conditions that a financial institution should consider in transitioning of a financial instrument such as Days Past Due (DpD), Unlikeliness to Pay Criteria (UTP), Return to Non-Default Status (probation period), and Other Significant Changes. Below element shall be considered:

a. Unlikeness to pay criteria (UTPs) will be recognized if the credit obligation gets a non-accrued status according to the accounting framework. Specific credit risk adjustments (SCRA) can be as follows:

I. Sale of client's credit obligation recognized as defaulted if economic loss exceeds 5%;
II. Distressed restructuring if the net present value of the obligation decreases by more than 1% the obligation is considered defaulted;

III. Bankruptcy;

IV. Additional indications of UTP (including fraud, significant increase in obligor leverage, individual voluntary arrangements, significant delays in payment to other creditors, impaired credit history indicators, expecting worst status).

b. A minimum probation period of three and six months is required for all defaults to transition to stage 2 and 1 respectively. The exemption stands for distressed restructurings that applies a 1-year minimum probation period. A stage 3 facility with lessor than 180 days past due may transition to stage 2 after full clearance of all arrears (both interest and principal).

c. It is also required to monitor the effectiveness of the cure policy on a regular basis, including impact on cure rates and impact on multiple defaults.

d. A forborne exposure can also cease to be categorized as such when both an objective criterion (a probation period) and a solvency criterion are met as set in this guideline.

(b) **Stage 3 to 2 or 1**

(i) Credit exposure may transition from stage 3 to stage 2 or 1 when and if there has been a significant decrease in risk and this must be supported with evidences that the borrower's capacity to repay and financial conditions have substantially improved.

(ii) Examples of 'improvements' to a loan (in form) that fail (in substance) to provide sufficient support for upgrading the said loan include:

a. Loan renewal that simply delays repayment requirements without strengthening repayment prospects;

b. Additional guarantees from parties that have not demonstrated a willingness to perform; or

c. Stabilisation or slight improvement in market trends that remain below levels that are consistent with sound economic conditions.

(c) **Stage 2 to stage 1**

(i) 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:

a. Up-to-date with payments: All outstanding payments on the credit facility are made on time and no payments are in arrears.

b. Probation period: The PD has remained below the threshold that is considered a 'significant increase' for a minimum period of 12 months.

(6) Bank shall provide before the end of each quarter details about all the exposures that were transferred and exposures that they intend to transfer from stage 3 to stage 2 or 1, 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 bank shall provide all necessary information that was considered in arriving at the decision to backward transition their exposures including any policy prepared by the bank.

(7) 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. Bank shall 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, bank shall ensure that it complies 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.

(8) Bank shall comply with the following: ECL Provision is presented, including the relevant movement, as a separate item in the statement of profit or loss and other comprehensive income. Bank shall 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 shall 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. Bank shall 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 15: Governance requirements

(1) To ensure a successful, well thought through and managed transition from IAS 39 to IFRS 9, bank shall 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. Bank shall comply in this regard with the following requirements as a minimum:

(a) IFRS 9 project steering committee. Each Bank shall form an IFRS 9 project steering committee to manage the implementation process.

(b) 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.

(2) The Board of Directors shall ensure that an IFRS 9 policy framework is established to guide appropriate and effective implementation of ECL Model.

(3) Board and senior management shall be aware of the limitation and uncertainties attached to risk measurement, even when models are reviewed and validated by an independent party hence appropriate measures shall be established to ensure that at least once every two years Model risk review is made and Board of directors shall oversee this process.

Article 16: Leveraging existing Infrastructure

(1) The Shape of ECL Model for the application of IFRS 9 requirements relating to calculation of ECL, requires bank to collect significant data, particularly in relation to lifetime PD at credit facility origination and at the impairment assessment date. Therefore, bank shall have models for the calculation of PDs. Additionally; bank shall calculate losses on an expected basis. As result, bank shall 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.

(2) Bank may use some of its 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 are 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.

(a) Time horizon: generally, existing PD models would provide 12-month PD estimates. However, under IFRS 9, banks would also require lifetime PD information. Accordingly, bank shall 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.

(b) 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), bank shall ensure that the definition of 12 month ECL is aligned to IFRS 9 definition.

(c) 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'.

(d) 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, the Central Bank instructs bank that such differences shall necessarily be adjusted before using any existing PD models for IFRS 9 application.

CHAPTER III: EFFECTIVE DATE AND TRANSITION RULES

Article 17: Effective date

The full implementation of IFRS 9 is effective for financial reporting periods since January 1, 2018.

CHAPTER IV: FINAL PROVISIONS

Article 18: Repealing provision

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

Article 19: Entry into force

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

Done at Kigali, on 6th June 2023.

Digitally signed by BNR(GOVERNOR)

RWANGOMBWA John
Governor