

BANK OF BOTSWANA

CIRCULAR TO BANKS: NO. 1/2018

ISSUE DATE: June 7, 2018

SUBJECT: REGULATORY TREATMENT OF ACCOUNTING PROVISIONS – INTERIM APPROACH AND TRANSITIONAL ARRANGEMENTS

1. **PURPOSE**

1.1 *The purpose of this Circular is to provide guidance on an interim approach to the regulatory treatment of the accounting provisions by banks in Botswana, following the adoption and implementation of IFRS 9 on January 1, 2018.*

2. **AUTHORITY**

2.1 *This Circular is issued by the Bank of Botswana (Bank) pursuant to Sections 13 and 14 of the Banking Act (CAP. 46:04).*

3. **TREATMENT OF REGULATORY PROVISIONS POST - IFRS 9 IMPLEMENTATION**

3.1 *The current (pre-IFRS 9) treatment of regulatory provisions relating to the distinction between general provisions and specific provisions shall be maintained for an interim period. In addition, the permitted amount of general provisions to be included in Tier 2 Capital shall be limited to 1.25 percent of risk-weighted assets as detailed in the Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II).*

3.2 *As the IFRS 9 provisioning methodology does not categorise provisions into specific and general, in the interim, the following treatment shall apply:*

(a) *Stage 1 provisions under the expected credit loss (ECL) provisioning model shall be recognised as general provisions;*

(b) *In line with the credit exposure categorisation and mapping outlined in the Guidelines on Risk Management, specific provisions shall be raised for stage 2 exposures with significant credit risk and stage 2 exposures with low credit risk shall attract general provisions; and*

(c) *Stage 3 ECL provisions shall be recognised as specific provisions.*

(d) *In addition, two new reporting templates (attached) have been developed for the reporting of general provisions (Schedule M-GP: General Provisions – Loans and Advances) and specific provisions (Schedule M-SP: Specific Provisions – Loans and Advances).*

4. TRANSITIONAL ARRANGEMENTS

- 4.1 *To cushion the potential significant shocks to capital, a three-year transition period shall be allowed for “new” provisions. Such provisions shall constitute the difference between pre-IFRS 9 provisions (closing balance of IAS 39 provisions) and post-IFRS 9 provisions (day 1 of IFRS 9 provisions). The transitional adjustment amounts (“new” provisions) shall be calculated just once (at the point of transition) and would be amortised on a straight line basis. Such adjustments shall be phased in evenly over a three-year period. The yearly phase-in amounts shall be a one-off deduction at the beginning of each year of the transition period. The period of transition would start at the beginning of a bank’s financial year.*
- 4.2 *These transitional arrangements are not compulsory. A bank may opt for a full deduction of the new provisions at the commencement of IFRS 9 implementation. Furthermore, a bank that elects to implement a one-off full deduction of provisions should notify Bank of Botswana in writing of its choice to do so.*

5. CAPITAL METRIC TO BE USED DURING THE TRANSITION PERIOD

- 5.1 *A bank shall use Common Equity Tier 1 (CET1) Capital as a reference metric during the transition period. This means that all transitional adjustment amounts will be made on CET1 Capital, as appropriate, over a three-year period. These amounts will be gradually phased in over the transitional period.*
- 5.2 *In addition, the adjusted CET1 Capital shall be used in calculating other measures of regulatory capital (e.g., total Tier 1 Capital, total Unimpaired Capital and Capital Adequacy Ratios) and related measures, such as the large exposure limits.*
- 5.3 *During the transition period, a bank must also use the adjusted CET1 Capital to meet the requirements of Section 17 of the Banking Act (Cap. 46:04).*
- 5.4 *A new reporting template, Schedule M-CA7: Transitional Adjustment Amount (New Provisions) (attached), has been developed for ease of computation of the adjustment amounts. In addition, Schedule M-CA2 (Composition of Capital) has been revised to include the adjustment amounts.*

6. CONSEQUENTIAL ADJUSTMENTS

- 6.1 *A bank has to make consequential adjustments to the following other areas of the regulatory framework, which are directly affected by the ECL provisions:*
- (a) *Deferred tax assets (DTA) arising from the temporary difference associated with a non-deducted provision amount should be disregarded for regulatory purposes during the transition period; specifically, this means that DTA should not form part of the CET1 Capital regulatory adjustments in the transition period. In the same context, DTA should not be taken into account for risk-weighting under the Standardised Approach for Credit Risk; and*
- (b) *The ECL provision amount not deducted from the CET1 Capital should neither be included in Tier 2 Capital nor reduce the exposure amount in the computation of credit risk-weighted assets (Basel II Returns Schedule M-SRWA 12 (a) and (b)), even if it meets the definition of “general” and “specific” provisions.*

7. **DISCLOSURE REQUIREMENTS**

7.1 *A bank is required to disclose publicly (through Pillar 3 disclosure requirements) a comparison between its regulatory capital ratios with transitional adjustments and its “fully loaded” capital ratios in the absence of transitional arrangements. It will be required that such disclosure be done on a quarterly basis in the attached template (Annexure 1).*

8. **RECAPITALISATION FOR IFRS 9**

8.1 *The Bank of Botswana expects banks to fully comply with the minimum prudential capital adequacy requirements post the transition period. Therefore, a bank should incrementally rebuild its capital resources during the transition period.*

9. **ENQUIRIES**

9.1 *Any further clarification sought with regard to the interpretation of this Circular should be addressed to the Director, Banking Supervision Department, Bank of Botswana, Private Bag 154, GABORONE.*

Lesedi S Senatla

DIRECTOR

BANKING SUPERVISION DEPARTMENT