P O Box 427 Pretoria 0001 South Africa
370 Helen Joseph Street Pretoria 0002
+27 12 313 3911 / 0861 12 7272
www.resbank.co.za

South African Reserve Bank
Prudential Authority

Ref.: 15/8/1/3

To: All banks, branches of foreign institutions, controlling companies, eligible institutions and auditors of banks or controlling companies

Proposed directive issued in terms of section 6(6) of the Banks Act 94 of 1990

Regulatory treatment of accounting provisions

Executive summary

In July 2014 the International Accounting Standards Board (IASB) issued International Financial Reporting Standard 9: *Financial Instruments* (IFRS 9). IFRS 9 became effective on 1 January 2018 and banks, branches of foreign institutions and controlling companies (hereafter collectively referred to as 'banks') commenced reporting in terms of the new requirements for financial years starting on or after that date.

IFRS 9 represented a fundamental change in accounting for financial instruments and has a significant impact on how banks determine impairments. While International Accounting Standard (IAS) 39 was based on an incurred loss approach, IFRS 9 does not require a loss event to occur before a provision is raised. The expected credit loss (ECL) model required by IFRS 9, which takes into account forward-looking information, resulted in a significant increase in impairments raised by banks thereby affecting available capital that was managed through transitional arrangements.

This proposed directive directs banks and auditors of banks regarding the classification of impairments as either general or specific under IFRS 9 post the conclusion of the transition period and replaces Directive 5/2017 issued during November 2017.

1. Introduction

1.1 In July 2014 the IASB issued IFRS 9, which became effective for reporting periods beginning on or after 1 January 2018, replacing IAS 39 – *Financial Instruments: Classification and Measurement*.

1.2 IFRS 9 fundamentally changed the way banks calculated provisions for credit losses/impairments given that IAS 39 impairments were based on an incurred loss model which required a loss event to occur prior to a provision being raised. Under IAS 39, losses expected because of future events, no matter how likely, were not recognised[1].

[1] IAS 39, paragraph 59

1.3 IFRS 9 requires entities to take into account all information that is available without undue cost or effort, including that which is forward-looking when determining impairments to be raised, effectively introducing the concept of ECL for financial reporting purposes.

1.4 The move towards an ECL accounting framework was an important step towards resolving weaknesses identified during the global financial crisis and was aligned with the April 2009 call by the Group of Twenty (G20) leaders for accounting standard setters to "strengthen accounting recognition of loan loss provisions by incorporating a broader range of credit information"[2].

1.5 At the time of transitioning to ECL accounting models, it was important for banks to define which, if any, portions of provisions should be regarded as specific provisions (SP) and general provisions (GP) respectively for regulatory purposes, pending the Basel Committee on Banking Supervision's (BCBS) determination of the appropriate longer-term regulatory treatment of provisions. As such, a distinction between GP and SP did not exist under accounting frameworks; the BCBS recommended that regulatory authorities provide guidance, as appropriate, on how they intended to categorise ECL provisions as GP or SP respectively in their jurisdictions, to ensure consistency of the categorisation by banks within their jurisdictions.

1.6 The PA, through Directive 5/2017, provided clarity to banks operating in South Africa on how to categorise ECL provisions as GP or SP respectively. Further, the directive clarified the phase-in period of the day-one impact on common equity tier 1 (CET 1) capital, calculated once at the point of transition, as well as consequential adjustments.

1.7 The transitional arrangements were implemented to allow banks who elected such to rebuild capital resources following the initial negative impact arising from the introduction of IFRS 9 through increased impairments and was in place for a period of 3 years. With the transition period having concluded, it became necessary for Directive 5/2017 to be updated.

2. Directive

2.1 Based on the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks are hereby directed to categorise accounting provisions as either GP or SP as follows:

2.1.1 Any relevant provision in relation to financial instruments for which the bank determined that at the reporting date[3] there had been no significant increase in credit risk since initial recognition in line with section 5.5 of the IFRS 9 requirements. As such Stage 1 exposures shall be treated as GP for regulatory purposes.

2.1.2 Any relevant provision in relation to financial instruments for which the bank determined that at the reporting date there had been a significant increase in credit risk since initial recognition, in line with section 5.5 of the IFRS 9 requirements, but that are not credit-impaired as defined by IFRS 9 requirements. As such, Stage 2 exposures, shall be treated as GP for regulatory purposes.

---

[2] Available at www.g20.org

[3] Reporting date in this directive refers to reporting prescribed in terms of regulation 7 of the Regulations relating to Banks.

2.1.3 Any relevant provision in relation to financial instruments for which the bank determined that at the reporting date they were credit impaired as defined by IFRS 9 requirements, that is, Stage 3 exposures, shall be treated as SP for regulatory purposes.

2.2 The provisions in respect of exposures in stages 1, 2 and 3, in terms of IFRS 9, shall be deducted from the exposure measure when calculating the leverage ratio in the form BA 700.

3. Invitation for comments

3.1 Banks, controlling companies, branches of foreign institutions and other interested parties are hereby invited to submit their comments on the proposed directive to SARB-PA@resbank.co.za and vukosi.msindo@resbank.co.za for the attention of Mr Vukosi Msindo, by 24 February 2023.

3.2 The comments received may be published on the PA's website, unless a respondent specifically requests confidential treatment.

Fundi Tshazibana

Fundi Tshazibana
Chief Executive Officer

Date: 01/02/23