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<u>CIRCULAR TO ALL FINANCIAL INSTITUTIONS</u>

On 9/04/02, The Bank of Uganda issued a circular to clarify some aspects in the Regulations on Prudential Norms on Asset Quality for Financial Institutions. Following the Circular, the Uganda Bankers Association (UBA) pointed out some pertinent issues with regard to classification of Non-performing Overdrafts. Subsequently a meeting was held between UBA and BOU to clear the issues that were raised by UBA.

In this connection, Bank of Uganda is issuing this Circular to amend the APRIL circular under reference so as to provide further clarifications on the Non-performing overdraft facilities. The amendment refers to section 7(2)(d) of the circular as stated hereunder:

Section. 7: **Criteria for Non-Performing Credit facilities.**

1. A credit facility with a pre-established repayment schedule is considered Non-performing when:

   a. Principal or interest is due and unpaid for 90 days or more or
   b. Principal or interest payments equal to 90 days interest or more have been capitalised, refinanced, renegotiated, restructured or rolled over.

2. A credit facility without a pre-established repayment program, such as overdrafts or other forms of open-ended credit, is considered non-performing when any one of the following conditions exist:

   a) Credit facility exceeds the customer's established borrowing limit for 90 consecutive days or more;
   b) The customer's borrowing line has expired for 90 days or more;
   a) Interest is due and unpaid to 90 days or more;
   b) The overdraft or account is inactive, meaning that -

      i) **turnovers or the volume of repayments on the account during the period under review are not equivalent to or greater than the approved credit line plus interest charges; or**

ii) **the account has developed hardcore (permanent debit balance) unless the financial institution can demonstrate that the borrower's current financial condition shows aggregate accounts receivables (debtors) and merchandise inventory (stocks) equivalent to at least twice the approved credit line.**

3. The central bank may, at its discretion, choose to change the objective criteria for non-performing credit facilities, but to a period of not less than 90 days in the criteria given in the above sub-sections.

4. The criteria for non-performing credit facilities apply regardless of what security is held on the facility.

CLARIFICATIONS; *In relation to Sec. 7(4) above, regardless of security held for non-performing facilities, the criteria for Classification of NPAs should be maintained. Banks have tended to attach the value of security in the determination of NPA status of credit facilities, For example a cash-backed security does not necessarily change the NPA status of advance, although cash held as security may be deducted from the outstanding balance of the facility before determining specific provisions.*

Section 9 **Repayment Schedules of Non-Performing Credit facilities**

The Second and third paragraphs of the clarifications issued under section 9 of our earlier circular is herby deleted.

Section 10: **Interest Accrual**

1. All categories of NPAs based on the criteria in Section 7 of this regulation are to be placed on a non-accrual basis, that is interest due but not collected should NOT be accrued to income but instead shown as interest in suspense.
2. All interest on NPAs previously accrued into income but uncollected is to be REVISED and credited into the interest in suspense account until paid in cash by the borrower.
3. Only when all outstanding due and unpaid obligations of an NPA have been paid up to date, may the credit facility be returned to an accrual basis.
4. The above subsections apply regardless of security held on a credit facility.

CLARIFICATION: *Some banks have tended to suspend interest on selective basis. All financial institutions are now reminded that all categories of NPAs are to be placed on a Non-Accrual basis regardless of security held. The following entries have to be passed once an account is identified as non-performing.*

(a) To record interest due but not collected.

(Dr) Loans and Advances	xx
(Cr) Interest in Suspense	xx

(b) To reverse income previously accrued -

(Dr) Interest Income	xx
(Cr) Interest in Suspense	xx

Section 12: **Provisions on Classified Credit Facilities**

1. Financial Institutions are to establish specific provisions for non-performing Credit facilities as defined, with such provisions to be reviewed quarterly and changes to the provisions to be made to the Central Bank on quarterly basis.
2. Classified credit facilities are to be subject to specific provisions, regardless of whether the subjective or objective criteria ere used in determining classifications.
3. Specific provisions for substandard assets are to be maintained at no less than 20% of the outstanding balance.
4. Specific provisions for doubtful assets are to be maintained at no less than 50% of the outstanding balance.
5. Specific provisions for loss assets are to be maintained at 100% of the outstanding balance. Such assets are to be written off the books within three months of being identified as loss unless prior permission of the Central Bank has been obtained.
6. The outstanding balance is to consist of principal, interest which has been capitalised, and all other charges, fees, and other amounts which have been capitalised to the outstanding balance. Interest suspended can be netted off from the outstanding balance before determining the provisions.
7. In addition to specific provision, banks and financial institutions are encouraged to maintain a general provision of at least 1% of the total outstanding credit facilities, net of specific provisions and unearned interest.

CLARIFICATIONS: In relation to Sec. 12(6) interest in suspense and cash-backed security may be netted off from the outstanding balance before determining the provisions and in relation to sec 12(7), replace "unearned interest" with "interest in suspense".

With respect to Sec 12(7), while the 1% general provisions not mandatory at this point, all banks and other financial institutions are enjoined to build up their provisions in good times when it is easier to do so and to have something to draw from in bad times. Moreover, general provisions qualify as Tier 2 capital subject to certain conditions. For consistency in computing general provisions, apply 1% the base amount which is arrived at after deducting specific provisions and interest in suspense from the total loans and advances as reported in BS 100.

All Financial institutions are enjoined to observe the above sections of the regulations as clarified.

E. Katimbo Mugwanya
Executive Director Supervision

Copy: Governor
Deputy Governor