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To all Banks, Development Bank of Seychelles and Housing Finance Company Limited

Guidance on the requirements of International Financial Reporting Standard 9- Financial Instruments

Section 35(1) of the Financial Institutions Act, 2004 as amended (FIA), requires “every local and foreign financial institutions (FIs) to prepare their financial statements at the expiration of each calendar year in accordance with an internationally recognised financial reporting framework.” As such, banks and other institutions in Seychelles have adopted the International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) framework including IFRS 9-financial instrument which has replaced IAS 39 since January 1, 2018.

CBS hereby provides additional supervisory guidance on IFRS 9 with the aim of promoting sound and prudent credit risk practices by banks and provide further guidance on expectations relating to implementation of IFRS 9.

The below guidance is provided in respect to credit risk and accounting for ECL and these are based on the principles issued by the Basel Committee on Banking Supervision (Guidance on credit risk and accounting for Expected Credit Losses issued in 2015:

- 1. The Board of Directors (or equivalent) and Senior Management of all banks and other institutions are responsible to ensure that the institution has in place a strong control environment which includes relevant credit risk policies and practices to create an effective system of internal control. This will facilitate the consistent determination of adequate allowances, in line with the institution’s policies and procedures, applicable laws and supervisory guidances set by CBS as well as IFRS 9.**

The relevant criteria for an effective internal control system include but are not limited to the following control activities*:

1. (a) Measures to comply with applicable laws, regulations, internal policies and procedures;

(b) Measures to provide oversight of the integrity of information used and reasonably ensure that the allowances reflected in the financial statements and supervisory reports of the bank and other institutions are prepared in accordance with applicable laws, relevant supervisory guidances set by CBS as well as IFRS 9;

(c) Clear formal communication and coordination among credit risk staff of banks and other institutions, financial reporting staff, Senior Management, the board and others who are involved in the credit risk assessment and measurement process for an ECL accounting framework;
2. Credit risk assessment and measurement processes which contain:

(a) An assessment policy that explains the measurement of ECL across lending exposures;

(b) An effective process which ensures that all relevant and reasonable and supportable information, including forward-looking information is appropriately considered in assessing and measuring ECL. This includes maintaining appropriate reports, details of reviews performed, and identification along with descriptions of the roles and responsibilities of the personnel involved;
3. Information systems that provide an effective model validation process to ensure that the credit risk assessment and measurement models are able to generate accurate, consistent and unbiased predictive estimates on an ongoing basis;
4. A monitoring process which includes:

(a). An internal audit function that independently evaluates the effectiveness of the credit risk assessment and measurement systems and processes of banks and other institutions, including the credit risk rating system.

(b). Annual review and model validation.

*The above control activities are advocated by the Committee of Sponsoring Organisations' Internal Control Integrated Framework (COSO Framework). The Basel Committee on Banking Supervision issued the Framework for Internal Control Systems in Banking

Organisations in 1998 which included components from the COSO Framework. This is accessible at <https://www.bis.org/publ/bcbs40.pdf> .

2. **Banks and other institutions should not simply replicate the illustrative disclosures in IFRS 9 but ensure that public disclosures are adequate and relevant in order to allow informed decisions to be taken by users. The following aspects should be considered in that regard:**
 1. Adequate and relevant disclosure notes should be provided in the audited financial statements regarding the change in classification and measurement of their financial instruments, including explanations of significant changes to the estimation of ECL from period to period;
 2. Disclosure notes should include both relevant qualitative and quantitative aspects in a manner that enhances the understanding of how ECL estimates have changed;
 3. Quantitative and qualitative disclosures, taken together, should communicate to users the main assumptions/inputs used to develop ECL estimates;
 4. Banks and other institutions to provide qualitative disclosures on how forward-looking information has been incorporated into the estimation process, in particular when the assessment is carried out on an individual basis;
 5. Management to regularly review its disclosure policies to ensure that information disclosed continues to be relevant to its risk profile, product concentrations, industry norms and current market conditions.
 6. the definition of default including the reason(s) for selecting those definitions (IFRS 7, para 35, F(b))
 7. Significant Increase in Credit Risk (SICR) criteria (IFRS 7, para 35, F(a))
3. **Banks and other institutions' policies and procedures should appropriately validate models used in assessing and measuring ECLs. This will be essential when the ECL models are initially developed and when significant changes are made to the models. Nonetheless, banks and other institutions should review their ECL models regularly, at a minimum annually. Particular emphasis should be placed on provision for instruments with significant increase in credit risk.**

In view of its importance, banks and other institutions should define what constitutes a significant increase in credit risk. Accordingly, the estimation of ECL to that regard should be based on the banks' and other institutions' judgement by using all reasonable and supportable information. The models should be built upon robust methodologies and result in the appropriate and timely recognition of ECLs.

1. A sound model validation framework should include, but not be limited to the following elements:
 - (a) Clear roles and responsibilities for model validation with adequate independence and competence. Model validation should be performed independently of the model development process;
 - (b) Where a bank or other institution has outsourced its validation function to an external party, the bank or other institution remains responsible for the effectiveness of all model validation work and should ensure that the work done by the external party meets the elements of a sound model validation framework on an ongoing basis;
 - (c) An effective model validation process should enable potential limitations of a model to be identified and addressed on a timely basis. In determining the scope for validation, inputs, designs and outputs/performance of all models should be reviewed;
 - (d) A review of the model validation process by independent parties (i.e. internal or external parties), to evaluate the overall effectiveness of the model validation process and ascertain its independence from the development process. The finding of the review should be reported either to Senior Management or to the Audit Committee;
 - (e) If an external auditor is engaged to undertake an audit of a bank or other institution's financial statements and the independent review of the bank's or other institution's model validation process, the bank or other institution should consider any potential conflicts of interest to ensure that the auditor's independence remains intact.
4. **Banks and other institutions should have clearly defined key terms for their methodologies used especially in reference to credit risk. In addition, the measurement of allowances for credit risk purposes, should reflect and build upon these methodologies.**

1. Sound ECL methodologies will contain the following elements. Note that these are not exhaustive:
 - (a) An adequate process in place to allow the institution to identify the level, nature and drivers of credit risk upon initial recognition of the lending exposure so as to ensure that subsequent changes in credit risk can be identified and quantified;
 - (b) Criteria to duly consider the impact of forward-looking information, including macroeconomic factors;
 - (c) ECL assessment and measurement methods (such as a loss rate method or the PD/LGD methods) are identified and documented to be applied to each exposure or portfolio of exposures;
 - (d) Documentation of the following factors:
 - (i) Inputs, data and assumptions used in the allowance estimation process (such as historical loss rates, PD/LGD estimates and economic forecasts)
 - (ii) how the life of an exposure or portfolio is determined (including how expected prepayments and defaults have been considered)
 - (iii) the time period over which historical loss experience is evaluated and any adjustments necessary for the estimation of ECL in accordance with IFRS 9.
 - (iv) Definition of default
 - (v) Significant increase in credit risk
2. Situations that would generally lead to appropriate changes in ECL measurement methods, inputs or assumptions from period to period are identified at the onset.
3. The extent to which factors such as the value of collateral and other credit risk mitigants may affect ECL are determined.
4. Policies and procedures on write-offs and recoveries are outlined.
5. The overall adequacy of allowances in accordance with the IFRS 9 are assessed on a timely basis.
5. **Banks and other institutions are expected to use robust credit judgement especially in consideration of reasonable and supportable forward-looking information. This includes macro-economic factors which are essential for the assessment and measurement of expected credit losses. Moreover, a bank or other institution's use of its experienced credit judgment must be documented in the bank or other institution's credit risk methodology and subject to appropriate oversight.**

- 6. In line with section 40 of the FIA and to reflect the provisioning aspects of IFRS 9, banks and other institutions will be required to submit quarterly returns to CBS, 25 days following the end of the quarter. Submissions should be made to the Financial Surveillance Division via fsdreturns@cbs.sc .**

The above guidance is not exhaustive and CBS expects banks and other institutions to refer and adopt the relevant guidance set by BCBS with reference to the ‘Guidance on credit risk and accounting for Expected Credit Losses’¹.

This circular replaces and supersedes the circular dated April 5, 2018 relating to guidance on the requirements of IFRS 9.

CBS trusts in your co-operation for adherence to this circular.

Yours faithfully,

 Caroline Abel
Mar 22 2023 5:44 PM



C. Abel (Ms)

Governor

¹ <https://www.bis.org/bcbs/publ/d350.pdf>