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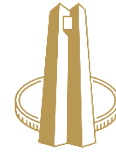

SOUTH AFRICAN RESERVE BANK
Prudential Authority

Ref.: 15/8/2/3

D3/2023

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

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 (IFRS) 9, *Financial Instruments*. IFRS 9 became effective on 1 January 2018, and banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as 'banks') commenced reporting in terms of the new requirements for the financial years commencing on or after the effective date.

IFRS 9 represented a fundamental change in accounting for financial instruments and had 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 the available capital. The capital impact was managed through transitional arrangements.

This 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 in November 2017

1. Introduction

1.1 In July 2014, the IASB issued IFRS 9, which became effective for reporting periods commencing 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]

1.3 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 to 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 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 IFRS 9, it was important for regulatory purposes to define which provisions should be regarded as specific provisions (SP) and general provisions (GP). Given that a distinction between GP and SP did not exist under the accounting frameworks, the Basel Committee on Banking Supervision (BCBS) recommended that regulatory authorities provide guidance to banks on how they should classify ECL provisions as either GP or SP, to ensure the consistency of categorisation by banks within their jurisdictions.

1.6 The Prudential Authority (PA), through its Directive 5/2017, provided clarity to banks conducting business in South Africa on how to classify ECL provisions as GP or SP. Further, the directive clarified the phase-in period of the day-one impact on common equity tier 1 (CET1) capital, calculated once at the point of transition, and other 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. These arrangements were in place for three 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

[1] IAS 39, paragraph 59
[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.

that are not credit impaired as defined by IFRS 9 requirements. As such, Stage 2 exposures shall be treated as GP for regulatory purposes.

2.1.3 Any relevant provision in relation to financial instruments for which the bank determined that, at the reporting date, 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. Acknowledgement of receipt

3.1 Kindly ensure that a copy of this Directive is made available to your institution's external auditors. In addition, the attached acknowledgement of receipt, duly completed and signed by both the Chief Executive Officer of the institution and the said auditors, should be returned to the PA at the earliest convenience of the signatories.

Fundi Tshazibana
Chief Executive Officer

Date:

The previous Directive issued was Directive 2/2023, dated 22 February 2023.