



AFRICA SME FINANCE FORUM 2018

PRESENTATION ON NON-PERFORMING LOANS

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AGENDA

1. Causes of Non- Performing Loans
2. Housing Bubble in the US
3. Legal framework- Banking Act
4. Legal framework- Prudential Guidelines
5. Risk classification
6. Accounting Standards IFRS 9

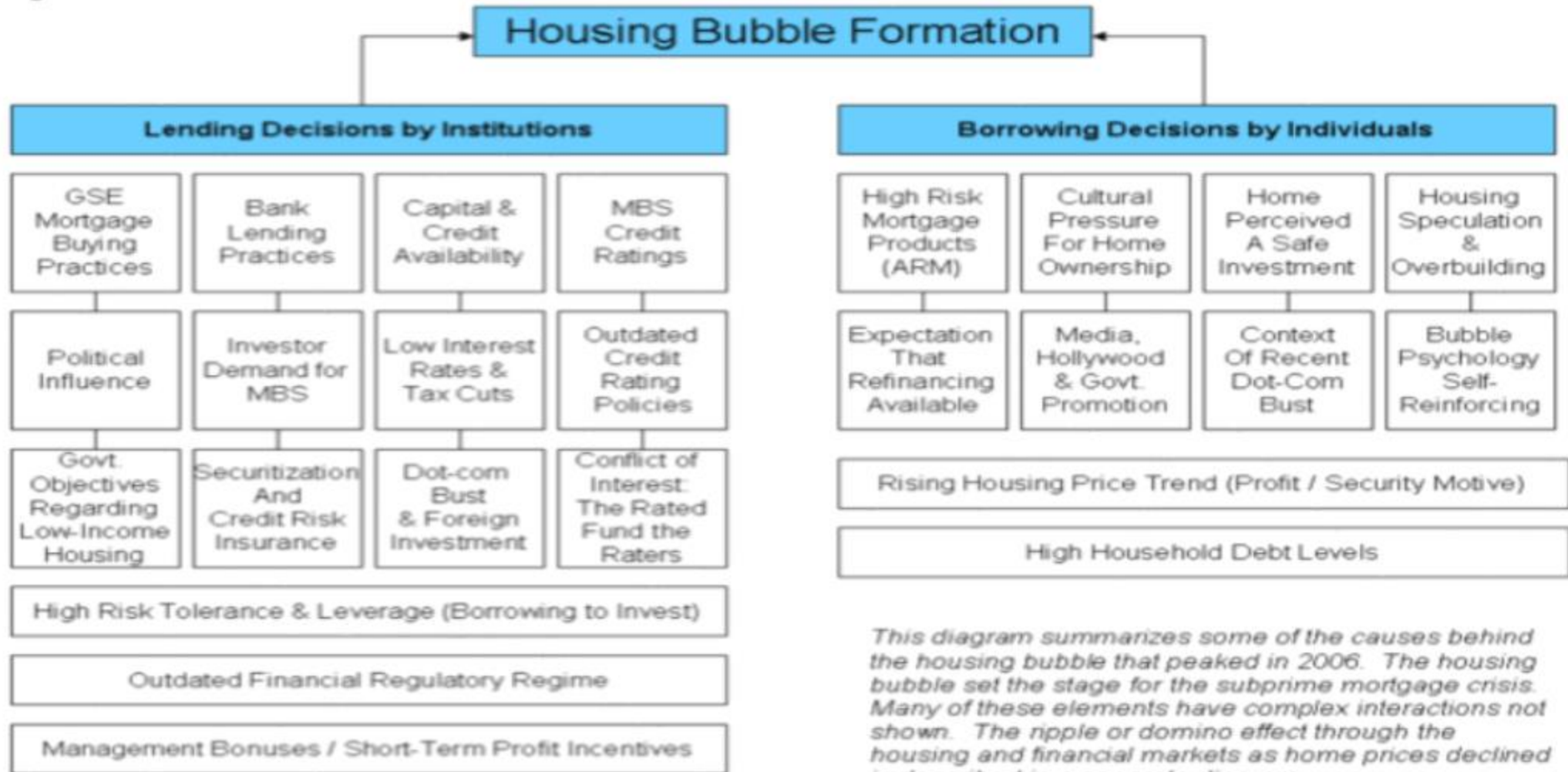
CAUSES OF NON-PERFORMING LOANS

According to recent literature on the same (Nelson Waweru & Victor Kalani- 2009) the causes of Non Performing Loans can be divided into three broad categories:

1. National Economic downturn- “ **EXTERNAL FACTOR**”
2. Customer failure to provide accurate information during the loan application process: “ **CUSTOMER SPECIFIC FACTOR**”
3. Lack of an Aggressive Debt Collection policy: “**BANK SPECIFIC FACTOR**”

HOUSING BUBBLE IN THE US: SUMMARY

Subprime Mortgage Crisis
Diagram 1 of 2



LEGAL FRAMEWORK : BANKING ACT

Instructive clause **Section 20(2)**:

Every institution shall:

(a) make provision for loans, advances and other assets **before** any profit or loss is declared; and

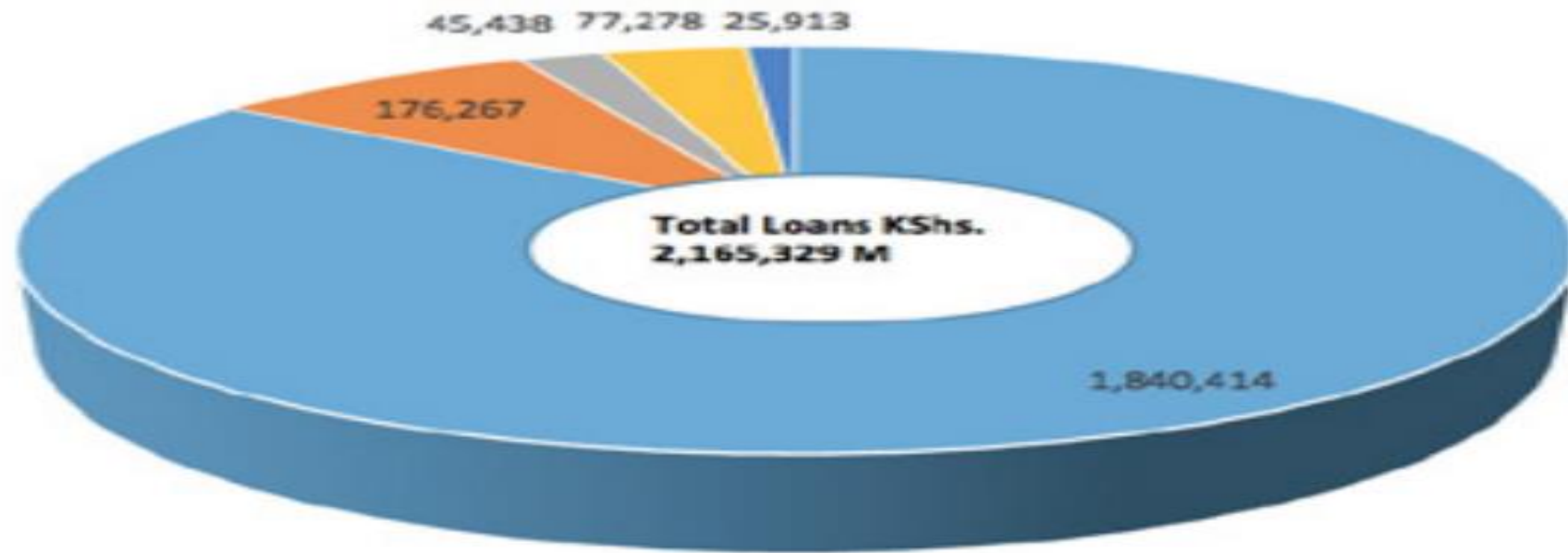
(b) ensure that the provision for loans, advances and other assets made under paragraph (a) is **adequate** according to such guidelines as may be prescribed by the Central Bank.

PRUDENTIAL GUIDELINES. (CBK/PG/04)

- **SUSPENSION OF INTEREST** When a loan is classified to non-performing category, an institution should either cease the accrual of interest or continue to accrue interest suspended in accordance with the criteria set out in this guideline and should not be treated as income. Interest in suspense shall be taken into account in the computation of provisions for non-performing loans.
- **MINIMUM PROVISIONING ALLOCATIONS**
 - (i) for loans classified, **NORMAL** “1%”
 - (ii) for loans classified, **WATCH** “3%”
 - (iii) for loans classified, **SUBSTANDARD** “20%”
 - (iv) for loans classified, **DOUBTFUL** “100%”
 - (v) for loans classified, **LOSS** “100%”

DIAGRAMMATIC PRESENTATION ON RISK CLASSIFICATION

RISK CLASSIFICATION OF LOANS AS AT DEC 2015, KSH.'M



■ Normal ■ Watch ■ Substandard ■ Doubtful ■ Loss

Source: CBK

ACCOUNTING STANDARDS. IFRS 9

- IFRS takes effect from 1s January 2018 (**5 year transition period for implementation**)
- The main objective of the new IFRS 9 is to provide users of financial statements with more useful information about an entity's expected credit losses on financial instruments. IFRS 9 introduces the **Expected Credit Loss model** that would replace the **Incurred Credit Loss model under IAS 39**.
- **Disclosure requirements:** core and capital ratios to be published (including adjusted ratios after the additional expected credit loss provisions have been added back.)
- **Statutory Loan Loss Reserve:** Where the CBK provisions > IFRS 9 then the excess provisions would be appropriated to the retained earnings. Credited to the Statutory Loan Reserve account.

QUESTION AND ANSWER SESSION

