Prakas on Credit Risk Grading and Impairment Provisioning

The Governor of the National Bank of Cambodia

- With reference to the Constitution of the Kingdom of Cambodia;
- With reference to the Royal Decree NS/RKT/0515/417 of May 11, 2015 on the reappointment of His Excellency Chea Chanto as Governor General of the National Bank of Cambodia, equivalent to Senior Minister;
- With reference to the Royal Kram NS/RKM/0196/27 of January 26, 1996 promulgating the Law on Organization and Conduct of the National Bank of Cambodia;
- With reference to the Royal Kram NS/RKM/1206/036 of December 29, 2006 promulgating the Law on the Amendment of Article 14 and 57 of the Law on Organization and Conduct of the National Bank of Cambodia;
- With reference to the Royal Kram NS/RKM/1199/13 of November 18, 1999 promulgating the Law on Banking and Financial Institutions;
- With reference to Prakas No B8-98-385 Prokor dated 20 July, 1998 on Organizational Structure of the National Bank of Cambodia and functions-duties of all departments of the National Bank of Cambodia;
- With reference to Prakas No B1-010-194 Prokor dated November 26, 2010 on the amendment of Article 3, Article 4, Article 5, Article 12 and Article 13 of Prakas on Organizational Structure of the National Bank of Cambodia and functions-duties of all departments of the National Bank of Cambodia;
- Pursuant to the recommendation made by the National Bank of Cambodia Management meeting on 23 November 2017.

Decides

Chapter I

General Provisions

Article 1.-

The purpose of this Prakas is to set forth the obligations as part of the implementation of a prudent credit risk management framework for Banking and Financial Institutions hereinafter referred to as “Institution”.
Article 2.-
This Prakas aims at ensuring appropriate recognition, measurement, provisioning, and reporting of impaired facilities of the institution.

Article 3.-
This Prakas is applicable to the institutions under the National Bank of Cambodia (NBC)’s supervisory authority.

Article 4.-
For the purpose of this Prakas, the following terms are defined as follow:

- **Facilities**: refers to all loans and other financial products, whether reported on-balance sheet or off-balance sheet, provided by an Institution to a counterparty, which give rise to credit risk exposure on the Institution. Altogether, facilities in an Institution are referred to in this Prakas as the “credit portfolio”.

- **Counterparty**: refers to any customer, borrower or other person, whether legal or not, which have relationship with the Institution. This may include other Institutions with which the Institution has economic ties.

- **Credit risk**: refers to the potential that a counterparty would fail to meet its obligations in accordance with agreed terms. Other than loans, which are the most obvious source of credit risk, other sources of credit risks exist throughout the activities of an Institution, including in the banking book and the trading book, in both on and off-balance sheets are also sources of credit risk. Institutions may face credit risks in various financial instruments other than loans, including but not restricted to acceptances, trade financing, commitments and guarantees, interbank transactions, the settlement transactions, foreign exchange transactions, bonds, equities and derivative instruments.

- **Collateral**: refers to any guarantee, property or other assets that is pledged by a counterparty to cover the credit risk of the Institution.

- **Interest Capitalization**: refers to any accrued and uncollected interest, which has been added to the principal amount of a loan at payment date or at maturity. Interest Capitalization also includes unpaid interest which is transformed into a new loan through refinanced or rolled over into a new loan.

- **Default**: refers to the inability to meet the contractual terms.

- **Fair value**: refers to the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

- **Impairment**: refers to any facility where there is doubt over the timely and fully repayment contracted to be provided by counterparty.

- **Past due**: refers to the failure to make a payment for a facility by the counterparty when it is contractually due.

Article 5.-
Credit risk grading and impairment provisioning is part of the global risk management framework that any Institution should implement. To effectively manage their credit risk, Institutions must have:
1. Credit risk management system that is appropriate to the nature, complexity, and size of their business activities,

2. Regularly review their credit risk management system, based on the change of economic environment, activities, customer base and risks,

3. Robust system for the early identification, monitoring and accurate measurement of their credit risks, including the full identification and reporting of impaired facilities and estimated losses on the credit portfolio,

4. Adequate impairment provisions compliant with the local accounting standards, and

5. Policies, procedures and processes in accordance with the requirements set forth in this Prakas.

Chapter II
Credit Risk Monitoring

Article 6.-

The Board of directors and senior management of an Institution are responsible to ensure that appropriate credit risk assessment, controls and provisioning processes are implemented and effectively to ensure impairment provisions for facilities at an adequate and appropriate level. The Board must also ascertain that these credit risk assessment, controls and processes are appropriate to the nature, complexity and size of the Institution’s activities.

Article 7.-

The Board shall approve the framework and policies for credit risk assessment, controls and provisioning as well as facilities’ write-off policies. These policies should also address appropriate monitoring and reporting mechanisms on recovery efforts undertaken by the Institution.

Article 8.-

The Board shall ensure that:

1. Procedures and processes allow the Institutions for early identification, classification, evaluation and addressing of credit quality issues;

2. Adequate information about facilities’ credit quality and related provisions is provided to the senior management and to the Board on a regular and timely basis;

3. The management and review function judgments are appropriately exercised, in line with the institution’s policies and procedures; and

4. Internal controls on credit risk assessment and provisioning processes are properly and regularly undertaken by persons who are independent from those involved in credit operation of the institution.

Article 9.-

The Board shall review the policies and procedures at least annually in order to ensure that they are continuously consistent with the Institution’s activities, economic environment, customer base and credit risks.
Article 10.-

The Board must ensure that policies and procedures used for establishing facilities impairment provisions on an individual, and a collective basis as well as write-off policies are made in a timely manner and are commensurate with the activities of the institution and its credit risk profile.

Article 11.-

The senior management is responsible for the development and the effective implementation of policies and procedures approved by the Board regarding credit assessment, impairment provisioning and writing-off. Senior management shall ensure that:

1. Internal policies, procedures, and processes on credit reviewing and provisioning are clearly known and consistently implemented by all relevant personnel;
2. An appropriate, systematic and consistently applied process is adopted to determine facilities’ impairment provisions which ease the timely collection of any new or additional information about the recoverability of facilities for the purpose of determining impairment provisions. As a minimum, such process shall provide appropriate and timely information on:
   a. Past due facilities,
   b. Facilities that are impaired,
   c. The fair value of collateral held against facilities,
   d. Any other sources of cash flow upon which the Institution may be reliant in determining levels of impairment and the amount of impaired facilities, and
   e. The value of impairment provisions to be recorded.
3. Prudent and proper monitoring and reviewing of impaired facilities, provisioning and of recovery of facilities’ write-off is enforced.

Chapter III
Credit Risk Grading

Article 12.-

The credit risk management system approved by the Board shall include a clearly defined credit risk grading system, with detailed delineation of responsibilities within the Institution.

Article 13.-

Institutions shall have in place a systematic and consistently applied process to reliably classify their facilities on the basis of credit risk. For this purpose, an Institution should adopt a credit risk grading system that appropriately reflects the risks associated with the nature, complexity and size of facilities of the institution. Larger facilities shall be classified on the basis of more sophisticated credit risk methodologies while smaller facilities with homogeneous characteristics and managed on a portfolio basis may be classified on either such systems or on historical loss experience. Reliable credit risk grading will support the
prudent valuation of facilities and the determination of appropriate impairment provisions on these facilities as required in Articles 48 to 52 of this Prakas.

Article 14.-

Institutions shall maintain credit files, whether in hard and/or soft copies, on all counterparties, which shall contain all adequate and timely information on the creditworthiness of the counterparty:

1. To enable the proper and effective monitoring and reviewing of all facilities extended by the Institution, and

2. To enable internal auditor and audit firm to have a comprehensive information from which they can form a clear and objective opinion on the quality of all facilities in the credit portfolio.

Article 15.-

Institutions shall conduct regular and systematic reviews of all facilities whether impaired or not, including off-balance sheets items, so that to help the migration of a facility to impaired status on a timely manner. An institution shall exercise its judgment in deciding the frequency of reviews for the different types of facilities. Facilities which are reviewed on an individual basis and facilities deemed to be of higher risk should be placed on a more frequencies of review. The cycle should not be more than one year.

Article 16.-

The credit risk grading shall be differentiated to a sufficiently granular level based on the degree of credit risk of the Institution. The Institution shall categorize facilities on the basis of its assessment of the capacity of counterparties to repay from their normal sources of income.

The criteria to assess the repayment capacity of a counterparty should include the following but not limited to:

1. Past payment history,
2. Financial condition of the counterparty, both current and expected,
3. Business prospective and cash-flow projections, based on realistic and prudent assumptions,
4. Ability and willingness to repay,
5. Economic environment, and
6. Quality of documentation.

As specified in Article 13 of this Prakas, risk grading may be undertaken on a portfolio basis on facilities that have homogenous and similar risk characteristics, below a materiality threshold.

An event affecting the primary source of repayment may warrant adverse classification even when a facility is current or to be supported by underlying collateral value. Reclassification may also be warranted if the counterparty could not meet the conditions of the contract and may be needed a modification of terms, refinancing, or additional advances.
In cases where different classification grades may be assigned based on subjective
criteria, the more severe classification should apply. Moreover, nothing contained in the
classification definitions indicated in Articles 17 and 18 below shall preclude assigning a
more severe grade when the analysis of a counterparty’s financial condition, ability, and
willingness to repay justifies the more severe classification.

**Article 17.**

There is no single credit grading standard but the mechanism in place in each institution
should be granular enough to adequately capture the graduation of risks. The Institution shall
classify facilities into five categories at a minimum. Unless otherwise stated in Article 18,
these grades are as follows:

1. As for facilities, which have an original term of more than one year:
   a. **Normal:** outstanding facility is repaid on timely manner and is not in doubt
      for the future repayment. Repayment is steadily made according with the
      contractual terms and the facility does not exhibit any potential weakness in
      repayment capability, business, cash flow and financial position of the
      counterparty.
   b. **Special mention:** a facility in this class is currently protected and may not be
      past due but it exhibits potential weaknesses that may adversely affect
      repayment of the counterparty at the future date, if not corrected in a timely
      manner, and close attention by the Institution. Weaknesses include but are not
      limited to a declining trend in the business operations of the counterparty or in
      its financial position, and adverse economic and market conditions that all
      might affect its profitability and its future repayment capacity, or deteriorating
      conditions on the collateral. This class has clearly its own rational and should
      not be used as a compromise between Normal and Substandard.

      Any facility which is 30 days past due shall be classified as “Special mention”.

      When interest payments for 30 to 89 days have been capitalized, refinanced, or rolled
      over into a new facility, this facility shall be classified as “special mention” or worse.

   c. **Substandard:** a facility ranked in this class exhibits noticeable weakness and
      is not adequately protected by the current business or financial position and
      repayment capacity of the counterparty. In essence, the primary source of
      repayment is not sufficient to service the debt, not taking into account the
      income from secondary sources such as the realization of the collateral.
      Factors leading to a Substandard classification include:
      - Inability of the counterparty to meet the contractual repayments’ terms,
      - Unfavorable economic and market conditions that would adversely affect
        the business and profitability of the counterparty in the future,
      - Weakened financial condition and/or inability of the counterparty to
        generate enough cash flow to service the payments,
- Difficulties experienced by the counterparty in repaying other facilities granted by the Institution or by other institutions when the information is available, and
- Breach of financial covenants by the counterparty.

Any facility which is 90 days past due or more shall be classified as “Substandard”.

When interest payment for 90 to 179 days have been capitalized, refinanced, or rolled over into a new facility, this facility shall be classified as “substandard” or worse.

d. Doubtful: a facility classified in this category exhibits more severe weaknesses than one classified Substandard such that its full collection on the basis of existing facts, conditions or collateral value is highly questionable or improbable. The prospect of loss is high, even if the exact amount remains undetermined for now.

Any facility which is 180 days past due or more shall be classified “Doubtful”.

When interest payment for 180 to 359 days have been capitalized, refinanced, or rolled over into a new facility, this facility shall be classified as “doubtful” or worse.

e. Loss: a facility is classified Loss when it is not collectable, and little or nothing can be done to recover the outstanding amount from the counterparty.

Any facility which is past due 360 days or more shall be classified as “Loss”.

When interest payment for 360 days or more have been capitalized, refinanced, or rolled over into a new facility, this facility shall be classified as “loss”.

2. As for facilities, which have an original term of one year or less:

As for facilities, which have an original term of one year or less is referred to as short term facility. The maximum days past due have been reduced to:

a. “Normal” payment on time
b. “Special mention” maximum past due 30 days
c. “Substandard” maximum past due 60 days
d. “Doubtful” maximum past due 90 days
e. “Loss” maximum past due 180 days

Overdrafts whatever their maturity and are classified as short term loans must be used only to fund short term needs. Overdrafts shall be classified in the different categories as mentioned in point 2 of this article depending on (1) they have been in excess of approved limits, (2) the account that gives rise to the overdraft has been inactive, or (3) net inflows in that account have not been enough to cover interests payment. Institutions shall modify the original nature of any overdraft facility that has had no net inflow for 60 days into term loan.

Numbers of days past due mentioned above must only be considered as maximum ones. They do not prevent the obligation of the classification of a facility into a worse categories when the Institution deems it proper.
Article 18.-

With regard to facilities with repayments on a quarterly, semi-annual or longer basis, an Institution shall classify such facilities as Substandard or worse depending on the situation of the counterparty as soon as a default occurs, unless the Institution is able to demonstrate that the facility does not exhibit any weakness. For the purpose of Article 18, the default will be considered as having occurred 5 working days after the payment due date. The classification as substandard will be allowed only in cases where the counterparty has clearly demonstrated that its inability to pay in due time is only temporary.

Article 19.-

Facilities that are classified Substandard, Doubtful and Loss will be considered as “non-performing facilities”. Facilities that are classified Normal and Special mention will be considered as “performing facilities”.

Article 20.-

The level of granularity of the credit risk grading should facilitate an accurate determination of the characteristics of the credit portfolio, the reporting of impaired facilities and ultimately the adequacy of impairment provisions.

Article 21.-

Past due facilities are generally considered as carrying a greater risk of default than other facilities maintained in accordance with contractual arrangements. Institutions are expected to have in place appropriate systems to adequately manage past due facilities in a view to minimize their migration to impaired facilities status. Institutions must have procedures and processes to identify, monitor and report to the Board the performance of past due facilities, including when they are not required to be treated as impaired facilities.

Article 22.-

The Institution shall review and update credit grading whenever it obtains any new relevant information. Additionally, all facilities should be subject to a periodic review and documented for all facilities aiming at updating of their grades. All Credit risk grades must be reviewed annually as a minimum. Facilities that are either large or bear higher risk or that have already been classified substandard or worse should be reviewed more frequently, at least semi-annually or more frequently for those facilities that face a clear deterioration of their repayment capacity.

Chapter IV
Restructured Facilities

Article 23.-

A restructured facility is a facility that original contractual terms have been modified to provide for concessions for the counterparty for reasons related to temporary financial difficulties. Concessions that lead to consider a facility’s classification as “restructured” include:

1. Reduction of the principal amount of the facility, or of the amount payable at maturity,
2. Decrease of the interest rate below the terms of the original facility’s agreement,
3. Deferral or extension of interest or principal payments, including interest capitalization,
4. Extension of the maturity date, or
5. Addition and/or modification of co-borrower and/or guarantor if there are any co-
borrower or guarantor.

Article 24.-

For a facility to be classified as restructured, the Institution and the counterparty must formally agree on new terms of agreement. In the event that the new terms of the agreement are not subject to a formal contract, the facility must be considered as impaired but not restructured.

Article 25.-

Where an Institution would lack information about the financial position and repayment capacity of its counterparty, any concession mentioned above in Article 23 shall lead to an impaired status of the facility.

Article 26.-

The Institution shall have in place written policies and procedures approved by the Board that define the circumstances and conditions under which a facility may be restructured and monitor and to manage restructured facilities. Any restructuring must be supported by a well-documented credit assessment and well-motivated assumption of full repayments under the modified terms.

Article 27.-

Facilities restructuring may only be undertaken towards counterparties who still have sustainable business and/or financial prospects and are expected to be experiencing only temporary financial and repayment difficulties. Institutions shall explain in their documented decision referred to in Article 28 why they consider financial and repayment difficulties of the counterparty as temporary. Restructuration of a facility must not be used to avoid:

1. Its recognition as impaired as stated in Articles 48 to 52 of this Prakas,
2. The increase of provision for estimated credit losses, and
3. Disruption of the recognition of interest income on an accrual basis.

Article 28.-

New terms of restructured facilities shall be defined on the basis of the repayment capacity of the counterparty according to new cash-flow projections supported by prudent and reasonable assumptions on its financial and/or business position. The institutions must be able to demonstrate the rational and accuracy of every decision of restructuration with clear explanation in writing and documented.
Article 29.-

A facility should not be restructured more than once. If nevertheless this occurs, the facility shall systematically, be considered as “substandard” or worse.

Article 30.-

When restructuring a facility, the Institution may grant a moratorium on the facility’s repayments not more than 6 months. Such decision shall be subject to close and sound credit risk assessment.

Article 31.-

Facilities’ restructuring shall be carried out by a unit or person different from the one in charge of the lending process. Any restructuring decision must be made at an appropriate level of management and, at a minimum, involves from senior management.

Article 32.-

The senior management should be provided with periodic reports at least quarterly on the performance of restructured facilities so that it may verify their compliance with their new terms of agreement and with the global risk management framework of the Institution and be able to take appropriate remedial actions in case of any deficiencies.

The senior management should be provided with an immediate report when there is any deficiency on the performance of a restructured facility.

Article 33.-

Following the completion of its restructuring, a facility shall keep its classification until it may be upgraded under the conditions set forth in Articles 81 and 82 of this Prakas.

Chapter V
Refinancing

Article 34.-

“Refinancing” is any practice or mechanism within an institution that allows for the replacement of an existing debt obligation with another debt obligation under new terms of agreement.

Article 35.-

“Refinancing” shall not be used to “evergreen” credit facilities of poor quality to avoid provisioning or writting off. Institutions must be able to explain to the NBC the rationale for multiple “Refinancing” that would have been made in favor of a counterparty of the institutions. When refinancing, Institutions shall maintain available a full set of historical data on facilities that have been “refinanced” and their periodical and final repayments. Institutions must be able to demonstrate that the succession of these facilities is under a well-defined and sound credit granting process with formal approval at the proper management level.

Factors to be considered and documented in “Refinancing” should be similar to the conditions for the first facilities granting include: 1). the purpose of the credit and the sources of repayment, 2). the current risk profile of the counterparty including its repayment’s history
and current capacity to repay and 3), the adequacy and enforceability of the collateral or guarantees.

Article 36.-

"Restructured facilities" referred to Article 23 to 33 of this Prakas are a particular category of the "refinanced facilities" that is only dedicated to counterparties that face temporary financial difficulties. When "refinancing" a facility, an Institution shall consider whether or not the "Refinancing" occurs under the conditions specified in Article 23 above, in which case the new facility shall necessarily be considered as "restructured" and will have to comply with the obligations set forth in Articles 23 to 33 of this Prakas.

Article 37.-

When not falling under the qualification of "Restructured facilities", "Refinancing" shall only be used in order to allow a counterparty that has not proved any financial difficulty to benefit from improved terms of agreements, such as a better interest rate, switching between variable and fixed rate, reduced monthly payment, modified term, substantially increased amount of the principal or a consolidation of several debts. Refinancing shall not be used to substitute the identification of a facility as impaired.

An institution is not allowed to practice refinancing with a customer when there is doubt that the repayment of the refinancing facility has been allowed thanks to another borrowing with another fund provider, whether it is an institution or a person, which is not under the authority of the NBC.

Article 38.-

Institutions shall have written and sound policies and procedures, which approved by the Board, governing the conditions and limits imposed to "Refinancing". These policies and procedures are part of the credit risk management referred to in Article 5 of this Prakas aiming at identifying, measuring, monitoring and controlling credit risk in the Institution.

In any given economic and financial context, except very particular reasons that should be carefully documented, there is no rationale in multiple "Refinancing" with the same counterparty in a short period of time to "evergreen" a facilities as mentioned in Article 35 of this Prakas, or to avoid facilities restructuration or identification as impaired. The Institutions may be required to reconsider the extent to which they operate the "Refinancing" of their counterparties' facilities.

Chapter VI

Collateral

Article 39.-

Provision in Article 40 to 47 of this Prakas provides guidance on collaterals for the purpose of impairment provision under local accounting standards.

Article 40.-

Collateral is held to lessen the credit risk. It may be in the form of guarantee, property or other types of assets, particularly a marketable financial asset such as stocks and bonds, which are marketable promptly under market conditions at a reasonable price.
Article 41.-

High quality valuations are crucial for the estimation of the fair value of a collateral. The Institution shall have clear written policies and procedures for establishing and reviewing the value of any collateral held against facilities. At a minimum, these policies and procedures must include:

1. The specification of the various forms of accepted collateral and the conditions under which they are accepted by the Institution,

2. The methods and means developed by the Institution to carefully analyze the quality and the financial value of the collateral prior to entering into a collateralized facility. Any collateral should be precisely identified and documented in the facility’s documentation. The Institution must ensure that the relevant legal requirements are met to maintain its legal rights over the collateral and allow for their enforcement,

3. The methods and means developed by the Institution to carefully update the valuation of the collateral over the life of the facility. This is particularly important for: 1). collateral changes significantly in value over time, 2). collateral ascribed to facilities with high loan to value ratio and 3). collateral securing medium/long term facilities. Valuation and reviews of valuation of the collateral over the life of a facility must be prudent and take into account the time, costs and difficulties related to the realization of the collateral, and

4. The regular review of the sustained capacity to obtain the realization of the collateral.

Article 42.-

Assets taken as collateral shall be valued at their fair value, using the method in accordance with the local accounting standards.

Article 43.-

Before entering in the providing of any new collateralized facility, the Institution must carefully analyze the quality and the value of the collateral as well as the certainty that it will have the full legal capacity to exercise the collateral so that to recover all cash flows contractually due to be received, in case of any failure of the counterparty.

Article 44.-

In determining the fair value of a collateral, the Institution shall call upon valuations by qualified internal and/or external appraisers/valuers. Policies and procedures referred to above in Article 41 of this Prakas must address the conditions under which valuations are undertaken.

Article 45.-

The Internal and external appraiser of the institution shall have qualification and recognized professional experiences in such valuation. The institution shall choose external appraisers from the list of appraisers accredited by the NBC.
Article 46.-

When assessing the value of a property held as collateral against a facility, the time allocated to market the property is of particular importance. A 12 months’ length of time is usually a good period of reference, unless particular circumstances require that a longer period be taken into account; in the latter case, the Institution shall rely on the longest period for the fair value valuation.

Article 47.-

In the case where the “fair value” of an asset acting as collateral is based on observable market values, consideration must be given to which market of reference is to be used, the liquidity of the asset on that market, the time for the selling, the costs associated to the selling and disposing to the proceeds, and the potential effect of the selling on the market price.

Chapter VII
Impairment recognition and measurement

Article 48.-

The appropriate recognition and measurement of impaired facilities are key elements for an appropriate impairment provisioning policy of an institution and, most importantly, in the assessment of its capital adequacy.

The provisions in Article 49 to 71 of this Prakas provide a minimum guidance for the impairment recognition and measurement of provision specified in the local accounting standard.

Article 49.-

The scope of impaired facilities must cover all on-balance sheet and off-balance sheet’s assets. **In recognizing impaired facilities**, an Institution must not limit itself to lending activities but must also cover all other facilities that give rise to credit risk exposure with a counterparty. The Institutions shall recognize impaired facilities in conformity with the principles and requirements specified in the local accounting standards.

A Facility must be recognized as impaired regardless of whether it is 90 days (60 days for short-term facilities) or more past due, as soon as there is doubt as to whether the full amount due, including interest and other amounts due will be achieved in a timely manner. This is the case even if the full extent of the loss cannot be clearly determined.

The following factors will, constitute a doubt and require the outstanding amount of the facility to be regarded as impaired:

1. As for facilities with monthly installment or less, the facility is 90 days (60 days for short-term facilities) past due without being sufficiently well secured.
2. The counterparty to which the facility has been granted is subject to failure or bankruptcy proceedings, unless the facility is sufficiently well secured, or
3. A partial write-off has been taken on the facility whatever the reason may be.

Other factors that may evidence impairment include, but not limited to:

1. A significant financial difficulty of the counterparty,
2. Concession that may have been granted by the Institution to the counterparty due to financial difficulties of the latter, or

3. Any observable information or data indicating a measurable decrease in estimated cash flows to be recovered from the counterparty and any modification in global or local economic conditions that affects the estimated cash flows to be recovered from the counterparty

Repayment of each installment must have been made in full. For facilities in arrears, a partial repayment made on an installment amount shall be deemed to remain in arrears.

When repayments are scheduled on intervals of 90 days or longer, the facility is classified as impaired as soon as a default occurs, unless the Institution is able to demonstrate that the facility does not exhibit any weakness that would justify it to be classified as substandard or worse. The default will be considered as having occurred 5 working days after the payment due date.

Overdrafts and other revolving facilities that have remained continuously outside approved limits for 90 or more consecutive days (60 days or more for short-term facilities) must be treated, for the total outstanding amount, as impaired.

Loan commitment facilities that are irrevocable must also be classified as impaired when the creditworthiness of the counterparty has deteriorated to the extent that there is doubt about the timely repayment in full by the counterparty of any potential loan drawdown and/or associated interest payments or fees.

Other off-balance sheet facilities are also captured by the present Prakas. Direct credit substitutes such as guarantees and letters of credit are usually converted into on-balance sheet exposures when they are drawn. There may be cases where the Institution is reasonably certain that such instruments will be called upon at a future date under circumstances that cause the Institution to believe it may not be able to recover, in a timely manner, the full amount it will be required to advance. In such cases, the facilities in question must be regarded as impaired by the Institution.

Exposure to potential losses may also arise from other off-balance sheet facilities such as derivative transactions, particularly when the credit standing of the counterparty declines. When an Institution has doubt regarding the receipt in full and in a timely manner of cash flows entitlements which are or will be due from a counterparty in relation to such off-balance sheet facilities, the Institution must regard the facility as impaired.

Article 50.-

The Institutions shall ensure that the recognition and measurement of impairment on all facilities comply with the requirements specified under the local accounting standards.

Measurement of impairment of facilities carried at amortized cost shall be made firstly on an “individual basis” except for homogeneous facilities below a materiality threshold that may be assessed on a “collective basis”. Facilities that are assessed on a collective basis include, but not limited to, credit cards and other small consumer lending facilities and motor vehicle financing under a materiality threshold.
In assessing the impairment of facilities on a “collective basis”, an Institution shall segment its portfolio in as many groups as necessary to only pool together homogeneous facilities with similar credit risk characteristics such as facility’s type, counterparty’s nature, past due status, credit risk grading, collateral type and geographical situation. The impairment measurement shall be made separately on each group of facilities.

When a single counterparty has multiple facilities where one of the facilities is above the materiality threshold and impaired, or where the sum of impaired facilities is above the materiality threshold, the impairment measurement of all these facilities shall be made on an individual basis even for those which are below the materiality threshold.

**Article 51.-**

Facilities that have been individually assessed in accordance with Article 50 and that have not proved to be individually impaired, thus not having called for an individual provision, shall then be pooled together in groups of facilities with similar risk characteristics and collectively assessed in a second round of impairment analysis following the same methodology as for groups of facilities under the materiality threshold. The pooling in groups of facilities will be adjusted to the size and nature of the facilities assessed. Facilities with the highest amounts and particular singularity may be exempted of this second round of impairment; such exemption should be restricted to a limited number of particular facilities.

**Article 52.-**

The impairment of any individual facility or group of similar facilities carried at amortized cost is measured as the “expected credit losses” (ECL) which are a probability-weighted estimate of credit losses (the present value of all cash shortfalls) over the expected life of the facility. A cash shortfall is the difference between the cash flows that are due to an institution in accordance with the contract and the cash flows that the institution expects to receive. If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an institution shall measure the loss provision for that facility at an amount equal to 12-month expected credit losses. Details on the calculation of ECL shall be referred to the relevant local accounting standard.

**Article 53.-**

For syndicated loans, each participating institution has the responsibility to maintain adequate credit information on the counterparty, to assess and make provisions for its portion of the syndicated loan. The lead institution has the responsibility to provide all other participating institutions with the last updated credit information it holds on the counterparty. Where information has come to the attention of a participating institution that the lead institution or another participating institution has lowered the grading of a syndicated loan, it shall likewise lower the grading of its own participation.

**Article 54.-**

Institution shall not close in advance a facility while providing a new one to the same counterparty or any related person with the counterparty in order to avoid classifying the initial facility with an impaired status. Would the Institution nevertheless grant a new facility, this one should be given an impaired status right from the opening.
Article 55.-

Institution shall have written sound policies, procedures and information systems and processes to ensure the timely and reliable recognition and measurement of impaired facilities. Such policies and procedures must provide a documented analytical framework approved by the Board for assessing impairment. The policies and procedures, at a minimum, shall:

1. Specify the roles and responsibilities of the Board, senior management, and all related parties within the Institution that are involved in the framework,

2. Identify facilities that are impaired,

3. Determine which facilities are assessed on an individual basis and which are assessed on a collective basis. The Institution must be able to demonstrate to NBC that its policies for determining whether a facility is managed and assessed on an "individual basis" or on a "collective basis" provide for prudent analysis of the credit risk that may be associated to each individual facility;

4. Determine how the amount of any impairment is measured, and

5. Provide for regular reviews of the amounts of impairment of facilities and methodologies used in calculating measures of impairment.

The policies and procedures shall cover the collection and the maintenance of all data and other information required to underpin the adequacy of the provisioning. This includes the maintenance of all types and volumes of data of high quality necessary for use in credit risk models, statistical techniques and other tools utilized by the Institution in its credit risk assessment. The integrity of such data and information shall be preserved.

Article 56.-

Institution shall set up and maintain an effective credit review system to manage and control facility quality issues in accurate, systematic and timely manner consistent with the principles stated in Articles 5 to 10 of this Prakas. As part of the credit review process, an Institution shall have in place a mechanism to establish and regularly assess the adequacy of the level of provisions required to absorb all estimated losses inherent to the credit portfolio, taking into account all factors that would reveal a reduced ability by the Institution to collect all amounts due by counterparties.

Recognition and measurement of impaired facilities require that the credit review covers all facilities provided by the Institution, including facilities that are classified "Normal" and "Special mention".

Article 57.-

Functions within an Institution in charge of activities related to the implementation and operation of impairment policies and procedures should be performed by competent and well trained persons. These policies and procedures must be reviewed at regular intervals by the internal and external auditors, and the results of such audits be reported to the Board and senior management. Institutions shall promptly address any deficiencies identified either by the persons in charge of credit activities, or in charge of the activities related to the
implementation and operation of impairment policies and procedures, or by internal or external auditors.

Article 58.-

Recognition and measurement of impairment cannot solely rely on formulas and rules; it also requires experienced credit judgment by the management of the Institution. The scope for the exercise of such discretion in assessing impairment shall be prudently limited and the extent of its application fully documented to enable a clear understanding of the judgments that have been exercised. Institutions must be able to demonstrate that the exercise of judgment does not lead to any systematic misstatement of estimates of impairment and provisions reported. The exercise of judgment must be based on supportable assumptions, having regard to all relevant circumstances, and conducted with prudence. It may be particularly useful:

1. In determining what may be an acceptable period that will allow the computation of appropriate historical loss data. An Institution should not restrict itself to the use of a fixed period to determine the average historical loss experience for each of all groups of facilities. During a period of economic stability, it may be appropriate to use a relatively longer period of historical loss experience (over 5 years), whereas during a period of significant economic volatility, using a shorter period of historical loss experience may be more appropriate, or

2. In cases where there is limited historical loss experience or where, facility’s loss data are no longer relevant to the current circumstances.

Article 59.-

Adjustment of historical loss data and experience should be contemplated but is not limited to the following cases:

1. Changes in the levels of and trends in delinquency rates and volumes of impaired facilities,
2. Changes in global credit distribution and concentration,
3. Changes in credit policies and procedures in the Institution,
4. Changes in credit facilities’ restructuring,
5. Changes in the experience and ability of the management of the Institution in credit risk management, and recovering past due amount, and
6. Changes in the current and expected local, and global economic conditions and trends.

Article 60.-

When an Institution has multiple facilities to a single counterparty or group of related counterparties, the Institution must have policies and procedures to ensure that if one facility is assessed as impaired, the Institution shall also classify the other facilities as impaired. Extension of impairment to other facilities is not required only if:

1. The various facilities are not cross-collateralized and there are no cross-guarantee arrangement between the related counterparties, or
2. There are cross collaterals and/or guarantees but, in aggregate, the counterparty or the group of related counterparties have enough security to ensure the
collectability of all payments due, principal, interest and others, on both impaired and non-impaired facilities.

Article 61.-

As part of its measurement of impairment, an Institution must have policies and procedures to ensure the reliability, consistency and prudence of estimates of future payments in principal and interests used in determining the level of impairment.

Article 62.-

The institution shall not rely on collateral as a reason to substitute for insufficient information about counterparties nor for a lack of diligence from the Institution in regularly monitoring that counterparties meet their contractual obligations, and the Institution shall not also rely on collateral as a reason to substitute for a lack of diligence in regularly assessing the level of impairment of all facilities and evaluating the needs of impairment provisioning.

Article 63.-

In assessing the impairment facilities, the Institution shall include all factors, both internal and external, that may point out a reduced possibility or inability to collect all payments that are contractually due from counterparties. These factors, include:

1. A deterioration in the payment status of the counterparty in the case of “individual provisioning”, or group of counterparties in the case of “collective provisioning”,

2. Local economic conditions that may affect the ability of counterparties to repay,

3. Any information about local or international significant changes that would have an adverse impact on the local environment and the ability of counterparties to repay. This includes changes in the technological, economic, market, legal and social environments,

4. Adverse country risk indicators that might have a negative impact on the situation of counterparties.

Article 64.-

Impairment assessment must be applied consistently from period to period; any changes in the policies and procedures applied must be justified, approved by the senior management and the Board.

Article 65.-

The Institution shall establish a level of impairment provisions that is sufficiently prudent to cover all potential credit losses in its portfolio. These include losses that may already exist but have not yet been identified or attributed to specific facilities or groups of facilities. This is important as an adverse credit event may already have been incurred without having yet been reported at the time of the assessment or at the date of the financial statement.
Chapter VIII
Accounting provisioning

Article 66.-
Where a facility has been identified as impaired, either on an individual or a collective basis, an Institution must raise specific provisions to cover any potential shortfall in cash flows contractually due to be received. This includes the impact of any fees due and expenses incurred in generating potential cash flows. Depending on whether the measure of impairment is assessed on an individual or collective basis, specific provisioning is also reported on an “individual basis” or a “collective basis”.

Article 67.-
When calculating impairment specific provisions, an Institution shall conduct the impairment assessment on an individual basis except for homogeneous facilities below a certain materiality threshold, where such facilities may be pooled together and collectively assessed, consistent with the provisions of Article 50 of this Prakas.

As part of its systematic credit review process, the institution shall specify the size of the facilities that warrant an individual assessment so that facilities whose individual value is below the threshold may be grouped based on similar facilities’ characteristics for the purpose of impairment assessment, in order to ensure that all facilities in the credit portfolio without exception are subject to an impairment review either on an individual or a collective basis.

An additional specific provision shall be posted on the basis of the complementary collective assessment to be made in accordance with Article 51 of this Prakas.

Article 68.-
Impairment provisioning of facilities that are individually assessed shall be based on reasonable and well documented estimates of both the current value of the facility and all future payments in principal, interests and other cash flows that the Institution expects to receive on that facility. Larger facilities are expected to be assessed on the basis of more sophisticated methodologies such as the use of models and other statistical techniques.

Article 69.-
Impairment provisioning of facilities that are collectively assessed may be based on the Institution’s historical loss experience appropriately adjusted for current circumstances, conditions and other factors, as mentioned in Article 59 of this Prakas that might affect the payment of facilities on a portfolio basis. Collective provisioning should also involve more complex techniques when they allow more precise impairment estimation.

An Institution shall maintain sufficient historical facilities’ loss data over a full credit cycle to provide a robust and trustworthy statistical estimate of impairment when establishing the level of collective provisions required in each group of similar facilities.

Article 70.-
Provisioning may also have regard to the exercise of experienced credit judgment under the conditions specified in Article 58 of this Prakas.
Article 71.-

In order to determine an appropriate level of collective impairment provisioning, an Institution shall slice its facilities portfolio in as many groups as necessary so that to have in each group only facilities with similar characteristics such as facility’s type, risk classification, maturity, past due status, nature of customer, and type of collateral.

Chapter IX
Regulatory provisioning

Article 72.-

The provisions set forth in articles 72 to 73 of this Prakas are tend to consider as providing a benchmark for regulatory monitoring that institutions have fairly and properly calculated their needs of impairment provisioning level in accordance with articles 49 to 71 of this Prakas.

Calculation of total regulatory provision equal (1) + (2), which:

1. General provision equal 1% of gross facilities for facilities graded “Normal”
2. Specific provision equal (a) + (b) + (c) + (d)
   a = 3% of gross facilities for facilities graded “Special mention”
   b = 20% of gross facilities for facilities graded “Substandard”
   c = 50% of gross facilities for facilities graded “Doubtful”
   d = 100% of gross facilities for facilities graded “Loss”

The Institutions shall assess the credit risk grading on their whole portfolio in conformity with Articles 12 to 22 of this Prakas so that the “regulatory provision” may be commensurate to the actual situation of their portfolio. The regulatory provision is considered as a minimum amount of impairment provision.

Regulatory provision in accordance with Article 72 to 73 of this Prakas also calculate simultaneously with the calculation of impaired provision as stated in Article 49 to 71 above, which is obligated for all Institutions.

Article 73.-

The Institution shall compare the provision calculated in accordance with Article 49 to 71 and the provision calculated in accordance with Article 72, and the record:

1. In case the regulatory provision calculated in accordance with Article 72 is Lower than provision calculated in accordance with Article 49 to 71, the Institution shall record the provision calculated in accordance with CIFRS.
2. In case the regulatory provision calculated in accordance with Article 72 is Higher than provision calculated in accordance with Article 49 to 71, the Institution shall record the provision calculated in accordance with CIFRS and transfer the difference from retained earnings or accumulated loss account into regulatory reserve in shareholders’ equity of balance sheet.
The regulatory reserves are not an item to be included in the calculation of the Institution networth.

Article 74.-

The Board and senior management of Institutions shall take all appropriate measures so that the requirements set out in this Prakas are fully complied with.

Chapter X
Upgrading of Facilities

Article 75.-

Upgrading of any facility shall be supported by strong credit assessment of the repayment capability of the counterparty, analysis of its business and financial situation and of cash-flows generated by its activities, in line with the classification framework set out in Articles 12 to 22 of this Prakas.

Article 76.-

An institution may restore an impaired facility to non-impaired status only when all the following relevant conditions are met:

1. The facility has returned to being fully compliant with its original contractual terms, including the receipt by the Institution of all past due principal, interests and fees’ payments;

2. There are reasonable grounds for the Institution to believe that the counterparty will comply with its repayment obligations in the future;

3. For a facility that has been classified as impaired because of arrears past due 90 days (60 days for short-term facilities) or more, all unpaid amounts have been paid off, provided that the payments of arrears have not resulted from further advance by the Institution. As for facilities with monthly installments, the counterparty must have complied with all its payment obligations during a period of at least 6 months (3 months for short-term facilities). In case, the Institution has any doubt that the repayments have been made thanks to further advances granted by another institution or any other person, it should not either improve the classification of the facility. In any case, the Institution must also ensure that the repayment capacity of the counterparty offers a margin of comfort which would prevent the facility from slipping back to impaired status in the foreseeable future; otherwise the facility should remain in the impaired status;

4. For a facility classified as partial write-offs, the repayment shall be made consecutively for at least 6 months or 3 payment cycles;

5. For a facility that for any reason has been subjected to provisioning and the provisioning is no longer relevant to the facility, and

6. For revolving facilities which are not well secured and drawn excess the limits, drawings must have returned within approved limits during a period of at least 3 months.
Article 77.-

An Institution shall exercise prudence in upgrading of any facility from one class to another and should make sure that the facility it intends to upgrade exhibits a sustainable trend of improvement and complies with all criteria for upgrading the classification.

Article 78.-

Any upgrading of classification must be supported by strong underlying evidence that shall be reported by the Institution in a written statement justifying the upgrading decision. These statements shall periodically be reported to the Board and be made available to internal and external auditors and the NBC.

Article 79.-

An impaired facility that would be upgraded to a non-impaired status and that, afterwards, would become impaired again will not have the possibility to be upgraded to a non-impaired status a second time. It shall remain with an impaired status.

Article 80.-

In addition to the provisions of Article 60 of this Prakas, one single facility cannot be split into impaired and non-impaired parts.

Article 81.-

The classification of a facility that has been restructured shall not be improved unless the counterparty has fully complied with the restructured terms of agreement and:

1. Has serviced with all principal and interest payments for a minimum period of six months, in the case of a facility with monthly repayments, or
2. Has serviced with all principal and interest payments for a minimum period of one year, in the case of a facility with quarterly or semi-annual repayments.

For a restructured facility with repayment of principal and interest on an annual or longer basis, the Institution shall only upgrade the facility if the counterparty has fully complied with the restructured terms and has objectively demonstrated his ability to repay after the end of one repayment period. The upgrading shall not occur before the first installment has been timely and fully paid.

The classification of a restructured facility that has been granted a moratorium shall not be improved during the moratorium period and shall only have the possibility to be improved pursuant to the principles set out in this Article with a starting date computed at the closure of the moratorium.

Article 82.-

The classification of a restructured facility that was previously classified as non-performing such as “substandard”, “doubtful” or “loss” shall not be improved to better classification than substandard. In any case, the classification of any facility that would have been restructured more than once shall not be improved.
Chapter XI
Write-off of Facilities

Article 83.-

The Board shall approve write-off policies related to facilities and these policies shall include the circumstances, conditions and approving authority under which facilities can be written off. Such policies should include the nature and periodicity of the information to be given back to the Board on the write-offs. This information shall include all the accurate information about the recovery efforts that were undertaken before the write-off decision.

Article 84.-

As a matter of principle, an institution should remove a facility or a portion of a facility from its balance sheet when the Institution loses control on its contractual rights over that facility or when all or part of the facility is deemed uncollectable; this is particularly the case when there is no realistic prospect of recovery or when the Institution has lost control over its contractual rights on the facility due to any decision of a court of law. Circumstances where a facility should be written off also include, but are not limited to:

1. All forms of securities or collateral have been called and realized but proceeds failed to cover the entire outstanding amount of the facility;
2. The Institution is unable to collect or there is no longer reasonable assurance that the Institution will collect all amounts due according to the contractual terms of the facility’s agreement;
3. The counterparty has become bankrupt or is undergoing other forms of financial restructuring the consequence of which it is unlikely that it may service the facility; or
4. The facility has been classified under loss category.

Chapter XII
Controls

Article 85.-

The NBC may require an Institution that does not comply with the regulatory requirements stated in this Prakas, to modify its policies and procedures and their outcomes for asset classification, assessment of impaired facilities and impairment provisioning. The Board and senior management shall take without delay all appropriate corrective measures.

Chapter XIII
Transitional Provisions

Article 86.-

The Institution shall prepare itself to implement recognition, measurement, and impairment provision facilities in accordance with CIFRS which will be starting from January 1, 2019.

Article 87.-

During the transitional period prior to the implementation of CIFRS, the Institution shall make impairment provision in accordance with Article 72 of this Prakas.
After full implementation of CIFRS, the Institution shall implement accordance with Article 73 of this Prakas for the impairment provision in the financial statement.

In case, any Institution wishes to implement CIFRS before January 1, 2019, the Institution shall inform the NBC in writing.

Chapter XIV
Final Provisions

Article 88.-

Failure to comply with this Prakas may give rise to disciplinary sanctions as set forth in Article 52 of the Law on Banking and Financial Institutions.

Article 89.-

The Prakas No. B7-09-074 dated February 25, 2009 on Asset Classification and Provisioning in Banking and Financial Institutions and Prakas No. B7-02-186 dated September 13, 2002 on Loan Classification and Provisioning Applicable to Specialized Banks for Rural Credit and Licensed Microfinance Institutions are hereby repealed.

Article 90.-

The General Secretary, the General Director of Central Banking, the General Director of Banking Supervision, the General Cashier, the General Inspector, Directors of all relevant Departments in the National Bank of Cambodia, and all Banking and Financial Institutions under the National Bank of Cambodia’s supervisory authority shall strictly implement this Prakas.

Article 91.-

This Prakas shall have effect from the signing date.

Phnom Penh, December 1, 2017

The Governor

Signed and Sealed: Chea Chanto

To:
- As stated in article 90 “for information”
- Files- archives

Cc:
- All members of the Board of Directors
- Council of Minister
  “for information”
- Administrative Department of CM
  “for publication in the National Gazette”