

## **Guideline for asset classification of credit institutions**

This guideline is devised so as to achieve a clear and transparent definition of classification of facilities in banks and credit institutions.

### **Article 1: Definitions**

1-1- Facilities: include facilities (Rial or foreign exchange) such as net granted facilities to entities (except direct investments and legal partnership), interbank facilities, customers' debt in the account of temporary debtors, facilities made via foreign exchange reserve account, debtors due to paid documentary credits, debtors due to paid letters of guarantee, debtors due to term documentary credits and foreign exchange bills, advance payments for purchase of transaction goods, properties purchased for the contract, goods for forward transactions, Joalah work in progress and debt purchase, and purchased documents and bills.

Note: Net facilities refer to position of granted facilities after deduction of future interest of facilities, account for Mozarabah received funds, and joint account for civil partnership.

1-2- Credit institution: All public and non-governmental banks, non-bank credit institutions and (when necessary) credit cooperatives, Gharzulhassanah funds, leasing companies and other credit associations which are licensed or regulated by the central bank.

1-3- Customer: All real and legal entities that receive facilities from the credit institution and/or there is an obligation to exit some funds in their favor from the credit institution based on an event, contract or transaction with the credit institution.

1-4- Material facilities: facilities for any single beneficiary which exceed ( $1 \div 200000$ ) of the total sum of the position of facilities of the previous year of the credit institution are regarded as material.

### **Article 2: Asset classification:**

Based on their quality, assets are classified in four categories in this guideline. Their quality is assessed based on three parameters of time, financial condition of the customer, and relevant industry or field of activity. Assessment of performance and financial condition of the customer is a qualitative procedure which is based on the customer's financial information including audited financial statements, credit rating of the customer and the relevant industry of field of activity. This procedure requires a high level of expertise and some committees in the credit institution that coordinate with the central bank and conduct the assessment of material facilities based on the existing information. The classification includes the following categories:

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2-1- Current:

- A) Payment of principal and interest of facilities and/ or repayment of installments are made in due time or they are maximum two months overdue.
- B) The customer has desirable financial conditions and the analysis of their financial indexes including profitability and liquidity reveals that they will not face any problems in repayment of the principal and interest of facilities.
- C) The prospect of the relevant industry or field of activity is bright and the market for their products and services is stable enough.

2-2- Overdue:

- A) The payment of principal and interest of facilities or repayment of installments has been delayed for more than 2 months but less than 6 months. In such a case, only the matured amount can be transferred to this category.
- B) The financial indexes of the customer including profitability and liquidity represent desirable financial conditions. However, the analysis of performance and financial conditions signals alarms about probability of delay in repayment of facilities.
- C) The relevant industry or field of activity has limited growth and a relatively stable market.

Note: In any of the above situations the total position of related facilities shall be transferred to this category.

2-3- Past due:

- A) The payment of principal and interest of facilities or repayment of installments has been delayed for more than 6 months but less than 18 months and the customer has taken no action to repay the debts. In such a case, the matured amount can be transferred to this category.
- B) Based on determinants, the financial condition of the customer is undesirable and the analysis of their financial condition reveals that they probably will not be able to meet part of their obligations in due time.
- C) The growth of relevant activity is strictly limited and faces stagnation while the market for its products and services is also restricted and unstable.

Note: In any of the B and C situations, the total position of related facilities shall be transferred to this category.

2-4- Doubtful:

- A) The payment of principal and interest of facilities or repayment of installments has been delayed for more than 18 months and the customer has done nothing to repay the debts.

B) Financial indexes of the customer including profitability and liquidity represent undesirable financial conditions. The analysis of their financial performance also indicates the possibility of default.

2-5- The weakest indicator is the criterion for classification of assets in the categories of overdue, past due, or doubtful. In other words, whenever a typical facility has the weakest indicator which makes it eligible to be classified in a category, that indicator shall be the only criterion and other indicators for upper categories will be overshadowed. For instance, if a typical facility is assessed according to indicators mentioned in A and C (that is, timing and growth of industry and market conditions) and is recognized as eligible for past due category but the index of financial condition shows an undesirable situation, such facility shall be classified as doubtful.

2-6- In case the claims of the credit institution regarding “debtors due to paid documentary credits” and “debtors due to paid letters of guarantee” are not recovered in two months, such claims will be classified as doubtful.

2-7- Disregarding the maturity date, those claims of the credit institution which are considered as unrecoverable because of justifiable evidence such as bankruptcy shall be recognized as uncollectible upon the approval of management and be written-off. However, if, for whatever reason, it is decided that the position of such facilities be kept in the accounts of the credit institution, it is required that such position be placed in doubtful category.

Note: The guideline for transfer of claims to uncollectible chapter will be prepared by the central bank and approved by the Money and Credit Council.

2-8- Regardless of the asset classification, the credit institution is required to take administrative and legal measures, relative to its good and benefit, to recover its claims.

### **Article 3: Restructured facilities:**

Such facilities are classified in categories 2-2 or 2-3. All facilities restructured upon government approval shall be placed in category 2-3 while other restructured facilities are classified in categories 2-2 and 2-3 based on their specifications. In case of improvement of credit rating of the customer, due payment of obligations and meeting the conditions to be eligible for higher categories, the restructured facilities can be transferred to one of higher categories.

### **Article 4: Claims against the government:**

Facilities for which repayment is guaranteed by the government or the permit for their guarantee has been issued by the government and the organisation of Planning and Management has agreed

to guarantee them shall be subjected to this guideline similar to other facilities of the credit institution.

**Article 5: periods of review of asset quality:**

The credit institutions are required to make arrangements so that

- A) Immediately after the due time, facilities are classified in accordance with clause A of sub-articles 2-1 to 2-4, article 2 (time factor).
- B) With coordination with the central bank and in order to implement clauses B and C of article 2, the committees subject to article 2 are required to assess the material facilities based on indexes every three months and reflect them in relevant categories.

**Article 6: Classification of assets granted to one customer:**

When a customer receives more than one credit facility from the credit institution and more than 40% of its facilities (in Rial) is classified as doubtful, all facilities shall be classified in the same category.

This guideline includes 6 articles and 4 notes. It was approved in the 1074<sup>th</sup> meeting of the Money and Credit Council in 2006. This guideline replaces the “executive guideline for identification and registration of overdue and past due bank loans” which was ratified in 2002.