



**MONETARY BOARD
CENTRAL BANK OF SRI LANKA**

17 February 2020

FINANCE LEASING ACT DIRECTIONS

No. 01 of 2020

CLASSIFICATION AND MEASUREMENT OF CREDIT FACILITIES

In terms of powers conferred by Section 34 of the Finance Leasing Act, No. 56 of 2000, the Director of the Department of Supervision of Non-Bank Financial Institutions (hereinafter referred to as "Director) has determined the classification and measurement of credit facilities for Specialized Leasing Companies (SLCs) as follows;

1. Applicability of the direction
 - 1.1 These Directions set out the minimum requirements on the classification and measurement of all credit facilities granted by an SLC with the adoption of Sri Lanka Accounting Standard, 'SLFRS 9: Financial Instruments' issued by the Council of Chartered Accountants of Sri Lanka and prudential requirements of the Central Bank of Sri Lanka (CBSL).
 - 1.2 The credit facilities shall include the following:
 - (a) All financial instruments measured at amortized cost as per SLFRS 9.
 - (b) Off-balance sheet credit facilities with a commitment to accept contingent liabilities, including guarantees, bonds, warranties, letters of credit and acceptances.
2. Effective date
 - 2.1 These Directions are effective for financial years beginning on or after 1 April 2021.
3. Responsibility of the board of directors and senior management
 - 3.1 The Board of Directors (BoD) and senior management of an SLC is responsible to establish credit risk management framework, including effective internal control system to consistently determine adequate impairment allowances in accordance with the SLC's Board approved policies, applicable accounting standards and regulatory requirements.
4. Classification of credit facilities
 - 4.1 **Credit facilities**
 - 4.1.1 An SLC shall classify the credit facilities as Performing loans (PLs) and non-performing loans (NPLs) in terms of Direction 4.1.2 and 4.1.3.
 - 4.1.2 PLs shall mean all credit facilities other than NPLs classified in terms of Direction 4.1.4.
 - 4.1.3 An SLC shall classify credit facilities as NPLs based on the two criteria; i.e., based on period and/or on potential risk.



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4.1.4 An SLC shall at minimum, classify every credit facility as NPL based on the period and / or on potential risk are given at Table 1 and 2, Appendix A.

4.2 Rescheduled credit facilities

4.2.1 When rescheduling, age should be considered in aggregate, the period of time the credit facility was in arrears before rescheduling and after rescheduling for the purpose of classification.

4.2.2 When rescheduling occurs before a credit facility is classified as NPL, SLCs may disregard aggregating the period of time the credit facility was in arrears if the borrower continues to service the loan for periods specified in Table 3, Appendix A, applicable for Special mentioned category.

4.2.3 When rescheduling occurs after a credit facility is classified as NPL, the rescheduled credit facility shall be classified as NPL when, in aggregate, the period of time the credit facility was in arrears before rescheduling and after rescheduling exceeds the time period specified in Table 1, Appendix A, in respective credit facilities.

4.3 Reclassification of credit facilities

4.3.1 Reclassification of NPLs to PLs

An SLC shall reclassify NPLs as PLs, if such NPLs meet the following criteria;

- (i) Principle and interest in arrears are fully paid by the borrower in relation to the classified NPLs or upon the confirmation to the satisfactory performance of the credit facilities classified as NPLs under potential risk, and after ensuring that the repayment of the remaining principle and interest are in accordance with the terms and conditions of the borrower.
- (ii) A credit assessment of repayment capacity, cash flow and financial position of the borrower in line with the Direction 5 below shall be carried out prior to such reclassification of NPLs as PLs.

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4.3.2 Reclassification of rescheduled NPLs as PLs

- (i) SLCs shall reclassify rescheduled credit facilities as PLs only if the borrower has complied with the rescheduled terms fully and demonstrates the ability to repay under rescheduled terms and conditions in the future.
- (ii) The NPLs which have been subjected to rescheduling, would be eligible to be upgraded to PLs only after ensuring satisfactory performance and subject to specified periods in Table 3, Appendix A in respective credit facilities.

4.4 Multiple credit facilities

An SLC shall classify for credit facilities based on the credit assessment of the borrower.

4.5 New credit facilities

SLCs shall not grant new credit facilities for repayment of NPL in the name of the same borrower or any other related party, unless such credit facility is also classified as NPL and categorized into the same category of the repaid credit facility as per categorization of non-performing credit facilities (Table 1, Appendix A). The reclassification of such NPL as a PL shall be subject to Direction 4.3.

5. Categorization of Non-performing credit facilities

5.1 An SLC at a minimum shall categorize the credit facilities into four credit grades as special mention, substandard, doubtful and loss given at Table 1, Appendix A.

6. Measurement for expected credit losses

6.1 An SLC shall recognize the loss allowance for expected credit losses for all the credit facilities as per Sri Lanka Accounting Standard, 'SLFRS 9: Financial Instruments', (as amended).

6.2 Multiple credit facilities

6.2.1 An SLC shall provide for credit facilities above a certain materiality threshold based on the credit assessment of the borrower, except for homogenous credit exposures (e.g. housing loans, consumer loans, credit card receivables) below a certain materiality threshold.

6.2.2 An SLC shall pool all homogenous credit exposures together except 6.2.1



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above, and provide for collectively based on risk characteristics.

6.2.3 An SLC shall develop an internal rating if 6.2.1 and 6.2.3 above are combined and shall provide for based on the credit assessment of the borrower.

7. Regulatory requirement

7.1 **Regulatory Provisioning**

7.1.1 An SLC shall maintain specific provisions, as per the credit facilities categorized in Table 1 and 2, Appendix A on the amount outstanding, net of realizable security value of collaterals as specified in Appendix B and accrued interest on NPL specified in section 7.2 as per the following:

Categories of Non-performing Credit Facilities	Minimum Specific Provisioning Requirement
Special mention	5%
Substandard	20%
Doubtful	50%
Loss	100%

7.1.2 The amount of specific provision made earlier, in respect of rescheduled NPLs of the respective categories, could also be reversed only after the period specified in Table 3, Appendix A.

7.1.3 An SLC shall provide for multiple credit facilities based on the credit assessment of the borrower.

7.2 **Accrued interest on NPLs**

On a memorandum basis, an SLC shall report the accrued interest but uncollected from the date a credit facility is classified as NPL.

7.3 **Write off/write down of non-performing credit facilities**

An SLC shall have a well-designed write off/write down policy approved by the BoD.

8. Transitional provisions

8.1 As a transitional provision in classifying for Special mention category, SLCs shall adopt 120 past due date with effect from 01.04.2021 for 12 months and required to adopt 90 past due date for classifications with effect from 01.04.2022.



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9. Definition 9.1 “Director” means the Director of the Department of Supervision of Non-Bank Financial Institutions of the Central Bank of Sri Lanka.
10. Revocation of Previous Direction 10.1 The Finance Leasing (Provision for Bad and Doubtful Debts) Direction No. 02 of 2006 and the Finance Leasing (Accrued Interest) Direction No. 05 of 2005 will be revoked from effective date of these Directions.

J P Gamalath

Director, Department of Supervision of Non-Bank Financial Institutions, Central Bank of Sri Lanka

Table 1: Non-Performing Loans - Based on Period

Facility type	Classification criteria	Categorization of NPLs			Loss
		Special Mention	Substandard	Doubtful	
Credit facilities repayable in daily basis	Principle or interest or both past due for more than 7 days from the due date	Payment due and unpaid for more than 7 days but less than or equal 30 days from the due date	Payment due and unpaid for more than 30 days but less than or equal 60 days from the due date	Payment due and unpaid for more than 60 days but less than or equal 90 days from the due date	Payment due and unpaid for more than 90 days from the due date
Credit facilities repayable in weekly and bi-weekly basis	Principle or interest or both past due for more than 30 days from the due date	Payment due and unpaid for more than 30 days but less than or equal 90 days from the due date	Payment due and unpaid for more than 90 days but less than or equal 180 days from the due date	Payment due and unpaid for more than 180 days but less than 270 days from the due date	Payment due and unpaid for more than 270 days from the due date
Credit facilities repayable on monthly basis or more	principle or interest or both past due for more than 90 days from the due date In the case of credit card, minimum payment is in arrears for more than 90 days from due date	Payment due and unpaid for more than 90 days but less than or equal 180 days from the due date In case of credit card, minimum payment arrears for more than 90 days but less than or equal 180 days from due date	Payment due and unpaid for more than 180 days but less than or equal 270 days from the due date In case of credit card, minimum payment arrears for more than 180 days but less than or equal 270 days from due date	Payment due and unpaid for more than 270 days but less than or equal 360 days from the due date In case of credit card, minimum payment arrears for more than 270 days but less than or equal 360 days from due date	Payment due and unpaid for more than 360 days from the due date In case of credit card, minimum payment arrears for more than 360 days from due date
Credit facilities repayable in one	Installment (fully /partly) past due for	Payment due and unpaid for more than 90	Payment due and unpaid for more than	Payment due and unpaid for more than 270 days but	Payment due and unpaid for more than

Facility type	Classification criteria	Categorization of NPLs			
		Special Mention	Substandard	Doubtful	Loss
installment at the end of specific period or on a due date (bullet payments)	more than 90 days from the end of agreed period or the due date	days but less than or equal 180 days from the end of agreed period or the due date	180 days but less than or equal 270 days from the end of agreed period or the due date	less than or equal 360 days from the end of agreed period or the due date	360 days from the end of agreed period or the due date

Table 2: Non-Performing Loans - Based on Potential Risk

Facility type	Classification criteria	Categorization of NPLs			
		Special Mention	Substandard	Doubtful	Loss
	Any triggered criteria stated under potential risk in this table.	(i) A declining trend in the operations of the borrower that signals a potential weakness in the financial position of the borrower, but not to the point that repayment is jeopardized; or (ii) Any economic and market conditions that may unfavorably affect the profitability and business of the	(i) Inability of the borrower to meet contractual repayment terms of the credit facility; (ii) Weak financial condition or the inability of the borrower to generate sufficient cash flow to service the payments; (iii) Difficulties experienced by the borrower in	(i) The borrower exhibits more severe weaknesses than those in a 'substandard' credit facility, such that the prospect of full recovery of the outstanding credit facilities are questionable; or (ii) The probability of a loss is high, but the exact amount remains undeterminable as yet. (iii) Unfavorable economic and market conditions or operating problems	(i) Breach of any key financial covenants by the borrower; (ii) The borrower is in a weak financial position or the ability of the customer to earn income is low, which indicates that the customer may not be able to service the debt; (iii) The business of the borrower has become uncertain or the borrower has used the funds obtained for the purposes other than

Facility type	Classification criteria	Categorization of NPLs			
		Special Mention	Substandard	Doubtful	
		<p>borrower in the future.</p>	<p>repaying other credit facilities granted by the same LFC, or by any other financial institutions (where such information is available); or</p> <p>(iv) Unfavorable economic and market conditions or operating problems that would affect the repayment capacity of the borrower in the future.</p>	<p>that already affected the repayment capacity of the borrower.</p>	<p>for which they were meant;</p> <p>(iv) The borrower is deceased and there are no assets to repay the debt;</p> <p>(v) The borrower has ceased or dissolved his business and is in debt to other creditors with preferential rights over the whole of the borrower's assets, where the said creditors' total claims exceed the value of the borrower's assets;</p> <p>(vi) The LFC has filed a bankruptcy suit against the borrower or has applied for participation in property with other creditors who have filed for bankruptcy, where the parties have agreed to restructure the debt</p>

Facility type	Classification criteria	Categorization of NPLs		
		Special Mention	Substandard	Doubtful
				<p>with approval from the Court;</p> <p>(vii) The LFC has applied for participation in property with other creditors who have sued the debtor; or</p> <p>(viii) The LFC is unable to contact or find the borrower.</p>

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Table 3 - Reclassification of rescheduled NPL as PL

Upgrade to PL	Special Mention	Substandard and Doubtful	Loss
Credit facilities repayable in daily basis	Period of 4 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.	Period of 7 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.	Period of 15 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.
Credit facilities repayable in weekly and bi-weekly basis	Period of 15 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.	Period of 30 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.	Period of 60 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.
Credit facilities repayable on monthly basis or more including bullet payments	Period of 90 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.	Period of 180 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.	Period of 360 days after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms.

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Collateral Valuation

1. Expected cash flows from collateral realization shall be based on latest observed reliable market valuations and shall appropriately reflect the inherent uncertainty associated with distressed property liquidation (including the time taken for such realization).
2. Any increase in valuations shall be substantiated by solid evidence that such increases are sustainable.
3. In addition, the minimum criteria for valuation of security for the purpose of the proposed Direction on Credit Risk Management for SLCs are given below:
 - (a) Secured on Gold - The market price of gold, subject to an adequate insurance cover.
 - (b) Assignment of Shares - Quoted - 90 percent of the latest market price.
 - (c) Repossessed vehicles and Machinery - With regard to vehicles and machinery that have been repossessed by the SLC, 80 per cent of the valuation (forced sale value) obtained during the preceding 6 months from acceptable valuer.
 - (d) Quoted Debentures - 90 percent of the latest market price.
 - (e) Guarantees:
 - (i) Licensed Banks – incorporated locally or outside Sri Lanka
Eligible value of guarantee is based on a rating given by an eligible credit rating agency as given below:

Bank's credit rating	Value of security
AAA to AA- or equivalent	80%
A+ to A- or equivalent	50%

- (ii) Government Guarantee of Sri Lanka - Full value
- (f) Sri Lanka Government Securities, free from any lien or charge.
- (g) Central Bank of Sri Lanka securities, free from any lien or charge.
- (h) Time deposits in a licensed commercial bank, licensed specialised bank or a licensed finance company, with an external rating of BB+ and free from any lien or charge.
- (i) Primary mortgage over immovable property
 - (i) Valuation of the immovable property shall be in compliance with the Finance Business Act Direction No. 4 of 2018 - Valuation of Immovable Properties.

- (ii) The value of security is based on progressive discounts on the forced sale value (FSV) of immovable property and on a current valuation report as per the cited Direction.
- (iii) The progressive discounts shall be as follows:

Item	% of FSV of immovable property that can be considered as the value of security
At the first time of classifying credit facility as NPL	75
Period in the loss category	
Less than 12 months	65
More than 12 but less than 24 months	60
More than 24 but less than 36 months	50
More than 36 but less than 48 months	40
More than 48 months	Property should be reviewed on a regular basis, and discounted further based on the Board approved policy

(j) Mortgages other than Primary Mortgages

Mortgages other than primary mortgages over immovable property will qualify for the above purpose subject to complying with the conditions in Section (i) (iii) above and if such property is mortgaged to the same SLC.

Provided that in the case of an occupied residential property taken as collateral without an agreement to hand over vacant possession in the event of sale for the recovery of dues, the value of such property shall not be considered.

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