Basic Circular No 143

Addressed to Banks, Financial Institutions, and External Auditors

Attached is a copy of Basic Decision No 12713 of 7 November 2017 relating to the implementation of International Financial Reporting Standard 9 (IFRS 9).

Beirut, 7 November 2017

The Governor of Banque du Liban

Riad Toufic Salamé

Basic Decision No 12689

Implementation of International Financial Reporting Standard 9 (IFRS 9)

The Governor of Banque du Liban,

Pursuant to the Code of Money and Credit, notably Articles 70, 146, 174, and 182 thereof, and

Pursuant to the Decision of the Central Council of Banque du Liban, taken in its meeting of 2 November 2017,

Decides the following:

Article 1:

As of 1 January 2018, banks and financial institutions are required to apply the International Financial Reporting Standard IFRS 9 (concerning Financial Instruments), and the ensuing amendments of IFRS 7 (concerning Financial Instruments Disclosures), on both separate and consolidated financial statements. Accordingly, banks and financial institutions must set the necessary rulebooks in this respect, including technical ones, and ensure their complete readiness prior to 31 December 2017.

Article 2:

Banks and financial institutions must prepare and document one or more business models that are consistent with IFRS 9 requirements and that reflect the strategy set to manage financial assets and ensure cash flows.

Article 3:

Sales of financial instruments must involve those to which one of the business models below apply:

- The business model whose objective is achieved by both collecting contractual cash flows and selling financial instruments.
- The business model whose objective is achieved through trading in financial instruments.

However, if the sale involves financial instruments from the portfolio classified at amortized cost, such sales operation must be exceptional and non-recurrent, and should meet all the selling requirements specified in IFRS 9. Besides, the reasons behind each exceptional sales operation, as well as its consistency with IFRS 9 requirements, must be clearly documented.

Article 4:

Whenever selling financial instruments, banks and financial institutions are required to:

1- Comply with the derecognition requirements of IFRS 9, particularly the assessment of whether these sales operations have led to the effective transfer of all the risks and revenues pertaining to the sold financial instruments.
2- Perform the sales operations according to market rules and at market value (at the latest stated price if the financial instrument is listed on a regulated financial market, or based on the due diligence assessment of the expected selling price if the instrument is not listed or not subject to a periodic pricing mechanism controlled by a reliable party).

Article 5:

First: Banks and financial institutions must amortize the surplus resulting from operations of exchange, and sale and purchase of financial instruments, during the life of the purchased instruments, if such operations aim at realizing immediate profits against the recording of premiums to be amortized over the life of the purchased financial instruments. Such amortization must occur whether these operations involve similar or different types of instruments, and whether they are carried out directly between banks and financial institutions, or with a single or several intermediaries.

Second: Banks and financial institutions must amortize the profits resulting from operations of exchange or sale and purchase of financial instruments undertaken with Banque du Liban during the life of the exchanged instruments, and must not record any immediate profits thereon.

Article 6:

Banks and financial institutions must build up provisions against expected credit losses, according to the approaches that are appropriate to each type of on-balance sheet financial assets and off-balance sheet financial liabilities involving a credit risk, in a way that such provisions reflect the credit risk associated with these assets and liabilities, and any significant change in that risk.

In order to compute the expected credit losses, banks and financial institutions may use the Historical Loss Approach, or the approach based on both the Probability of Default and the Loss Given Default parameters, or other appropriate approaches, with consideration to the historical, current, and forward-looking information and data.

Article 7:

Banks and financial institutions must:

1- Assess periodically, at least quarterly, and as needed, the credit risk associated with each type of on-balance sheet financial assets and off-balance sheet financial liabilities involving a credit risk, particularly to monitor any likely significant increase in credit risk and the magnitude of that increase.
2- Classify these on-balance sheet financial assets and off-balance sheet financial liabilities into three categories:

- Stage 1: Performing on-balance sheet financial assets and off-balance sheet financial liabilities which were not exposed to a significant increase in credit risk.
- Stage 2: Under-performing on-balance sheet financial assets and off-balance sheet financial liabilities which were exposed to a significant increase in credit risk.
- Stage 3: Non-performing on-balance sheet financial assets and off-balance sheet financial liabilities which were credit-impaired and which comprise debts that are rated “substandard”, “doubtful”, and “bad debts” pursuant to Basic Decision No. 7159 of 10 November 1998.

Article 8:

First: The Board of Directors shall approve the IFRS 9 implementation policies and procedures, and shall revise them periodically (at least annually). These policies and procedures shall contain:

- The business model(s), and the financial assets distribution policy based on the business model(s).
- The policy and procedures for classifying and reclassifying on-balance sheet financial assets and off-balance sheet financial liabilities involving a credit risk, within the three stages referred to in Article 7 above.
- The policy and procedures for calculating expected credit losses related to on-balance sheet financial assets and off-balance sheet financial liabilities involving a credit risk.

Second: As far as each is concerned, the Audit Committee and the Risk Committee mentioned in Basic Decision No. 9956 of 21 July 2008, shall hold periodic meetings with the specialized committee(s) in charge of the IFRS 9 implementation. They shall also obtain periodic reports, at least quarterly, and as needed, concerning the implementation of IFRS 9 requirements, in order to keep the Board of Directors updated in this respect and assist it in the exercise of its supervisory role, notably that of ensuring the sound implementation of IFRS 9.

For financial institutions where Audit Committees and Risk Committees do not exist, the Board of Directors shall assume the above-mentioned tasks.

Article 9:

An approval by one or several specialized committees at the Executive Management level, whose members include the financial control officer and the risk management officer, is required for:

- The decisions of classifying and reclassifying, within the three stages mentioned in Article 7, on-balance sheet financial assets and off-balance sheet financial liabilities involving a credit risk.
- The determination of the provisions against expected credit losses.

Article 10:

The Risk Management Unit shall have a key role in ensuring compliance with IFRS 9, notably by monitoring the credit risk associated with on-balance financial sheet assets and off-balance sheet financial liabilities involving a credit risk, and by setting the appropriate approach for calculating expected credit losses on these financial assets and liabilities.

Article 11:

The Internal Audit Unit must carry out an independent assessment of the level of compliance with IFRS 9 implementation policies and procedures, particularly those adopted to calculate expected credit losses and determine the provisions in line with IFRS 9 requirements.

Article 12:

Banks and financial institutions must build up provisions in the currency of on-balance sheet financial assets and off-balance sheet financial liabilities, against each of the types of these assets and liabilities that is subject to IFRS 9.

Article 13:

First: Banks and financial institutions shall cease building up the collective provision specified in Article 3 bis, Paragraph Second, Subparagraph 4 of Basic Decision No. 7776 of 21 February 2001, as of the 2017 fiscal year.

Second: In order to build up provisions against the expected credit losses on 1 January 2018 in the portfolio of on-balance sheet financial assets and off-balance sheet financial liabilities involving a credit risk, across all three stages mentioned in Article 7, banks and financial institutions must use the balance, as on 31 December 2017, of:

- The general provisions, as specified in Article 9 of Basic Decision No 6939 of 25 March 1998.
- The special and collective provisions, including the collective provision in Lebanese Pound specified in Article 2 bis, Paragraph II of Basic Decision No 7776 of 21 February 2001, to be fully built up by the end of 2017; as well as all other provisions built up to implement IFRS 9, by using the surplus resulting from the selling of LBP - denominated sovereign financial instruments and the simultaneous and concurrent purchase of foreign-currency financial instruments.

Article 14:

In case the total available balance, as on 31 December 2017, of the special and collective provisions and the general provisions mentioned in Article 13, is below the value of expected credit losses on 1 January 2018, the lack in the provision shall be covered by using the general reserve mentioned in Article 16 below.

Article 15:

If, as on 31 December 2017, the total available balance of the special and collective provisions and the general provisions exceeds the value of expected credit losses on 1 January 2018, the surplus shall be recorded under the "General Provisions" item, and may be used in either case:

1- The surplus shall be used to build up any probable additional provisions against expected credit losses after 1 January 2018, by releasing an amount equivalent to any such additional provisions and transferring it to the Income Statement.
2- The surplus balance that is not used to build up the additional provisions mentioned in Paragraph 1 of this Article, shall be released and transferred to the Income Statement; then all the released provisions shall be transferred to the "General Reserve" item mentioned in Article 16.

Article 16:

First: Banks and financial institutions shall cease, as of the 2017 fiscal year, building up the general reserve computed on the basis of the portfolio of performing loans and credits (other than retail loans), and the general reserve computed on the basis of the portfolio of retail loans mentioned in Paragraph "Second" of this Article.

Second: Banks and financial institutions shall transfer to the "Undistributable General Reserve" item, the balances of the following items, as declared on 31 December 2017:
- Undistributable retained earnings.
- The reserve for unspecified banking risks, mentioned in Basic Circular No. 7129 of 15 October 1998.
- The general reserve computed on the basis of the portfolio of performing loans and credits (other than retail loans) as specified in Article 2 bis, Paragraph I, Subparagraph 3 of Basic Decision No 7776 of 21 February 2001.
- The general reserve computed on the basis of the portfolio of retail loans as specified in Article 3 bis, Paragraph II, Subparagraph 5 of Basic Decision No 7776 of 21 February 2001.

Third: The conversion of the balances of the aforementioned reserves from Lebanese Pound into foreign currencies is prohibited.

Article 17:

First: In order to build up foreign-currency provisions against the credit losses expected on 1 January 2018, banks and financial institutions must use, in the following order:

1- The balance, as on 31 December 2017, of the general provisions and the special and collective provisions previously set aside in foreign currencies.
2- The balance, as on 31 December 2017, of the foreign-currency general reserve.

Second: If a lack in foreign-currency provisions remains on or after 1 January 2018, banks and financial institutions must cover such deficit from the positive variances in foreign-currency trading positions resulting from foreign-currency net interests, commissions and other revenues, within the limits authorized for trading positions. In case of excess to the above-mentioned limits, the provisions of Article 8 of Basic Decision No. 6568 of 24 April 1997 shall apply.

Article 18:

When preparing the reports required by Decree No 1983 of 25 September 1971, the external auditors of banks and financial institutions are requested to express their opinion on banks and financial institutions' compliance with IFRS 9 requirements.

Article 19:

Banque du Liban shall prepare one or several balance sheet models, pursuant to the provisions of this Decision. The Banking Control Commission shall issue the related implementation directives, in a way to ensure banks and financial institutions' compliance with IFRS 9 requirements.

Article 20:

This Decision shall come into effect upon its issuance.

Article 21:

This Decision shall be published in the Official Gazette.

Beirut, 7 November 2017

The Governor of Banque du Liban

Riad Toufic Salamé