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

مصرف لبنان
BANQUE DU LIBAN

Basic Decision No. 12713

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:

Banks and financial institutions are required, as of 1 January 2018, 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 individual 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 should be exceptional and infrequent, and should meet all the selling requirements specified in IFRS 9. Besides, the reasons behind each exceptional sale 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 sale operations have led to the effective transfer of all the risks and revenues pertaining to the sold financial instruments.
2- Perform the sale 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 swap operations and sale and purchase operations of financial instruments, over the life of the purchased instruments, by amortizing premiums over the life of the purchased financial instruments, provided such operations aim at realizing immediate profits. Such amortization is required, 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[1]: Banks and financial institutions must record the profits resulting from swap operations or sale and purchase operations of financial instruments performed with Banque du Liban, over the life of the exchanged instruments, and must not record any immediate profits thereon.

Banks and financial institutions may record immediate profits on their current and prospective operations and financial engineering with Banque du Liban, on condition that:

- These operations are executed after 1 January 2019.
- The funds invested in these operations are either specifically transferred from funds other than their funds at Banque du Liban, or result from foreign exchange operations.
- The surplus resulting from these operations is recorded in the Profit or Loss Statement, then transferred at the end of the fiscal year to the "Undistributable General Reserve" item.

The Banking Control Commission of Lebanon shall control the sound implementation of the provisions of this Paragraph.

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.

[1]- This Paragraph was amended by Intermediate Decision No. 13076 of 1 July 2019 (Intermediate Circular No. 519).

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.

Banks and financial institutions must, exceptionally, implement as a minimum the mechanism below in order to build up provisions against their sovereign investments portfolio[1]:

1- Adopt the Ratios for Regulatory Expected Credit Losses (Annex 6 of Basic Decision No. 6939 of 25 March 1998) on the portfolio of investments at BDL in Lebanese pound and foreign currency (including CDs) and on the portfolio of investments in TBs issued in Lebanese pound and foreign currency, in order to build up provisions in the Profit or Loss Statement against these portfolios.
   The BDL Central Council shall periodically revise the imposed ratios in light of any development in the prevailing situation.
2- Build up the above-mentioned provisions gradually over a five-year period. The Central Council may approve to extend this period to 10 years, once the concerned bank has increased its Tier One Capital, as specified in Article 6 bis of Basic Decision No. 6939 of 25 March 1998.
3- Disclose in the financial statements to be published, as mentioned in Basic Decision No. 6574 of 24 April 1997, the total provisions to be gradually built up and the timeline set to that effect.

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.

[1]- This paragraph was added pursuant to Intermediate Decision No. 13188 of 3 February 2020 (Intermediate Circular No. 542), then amended pursuant to Article 1 of Intermediate Decision No. 13259 of 26 August 2020 (Intermediate Circular No. 567).

Article 7 bis[1]:

First: Without prejudice to Paragraph Second of this Article, and for the period from 1 February 2020 to 31 December 2020, banks and financial institutions operating in Lebanon must neither downgrade the debts of customers negatively affected due to the Covid-19 pandemic (hereinafter the "emerging situation") whenever the repayment of their debt (principal and interest) was delayed and/or the ceiling of the facilities approved and granted to them was exceeded, nor consider this as an indicator of a significant increase in credit risk or credit-impairment or a default.

In such a case, the instalments due but unpaid because of the said situation alone, may be rescheduled, without entailing any debt reclassification.

Second: In exceptional circumstances, and if the "emerging situation" has significantly impacted the customer's credit capacity, causing the latter to stop doing business permanently and to stop operating as a going concern, banks and financial institutions operating in Lebanon must promptly downgrade the concerned customer's debt to Stage 3.

Third: Banks and financial institutions operating in Lebanon must continue to implement the mechanism adopted pursuant to BDL regulations for the classification of customers that were not impacted by the "emerging situation".

Fourth: Banks and financial institutions must continue the assessment of the customers' upcoming financial situation, provided this assessment is completed by 31 December 2020.
Without prejudice to Paragraph Second of this Article, the provision against expected credit losses shall be calculated according to the categories determined by this assessment, and only after the aforementioned date, and shall be fully recorded in the Profit or Loss Statement for the year 2020.

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.

[1]- This Article was added pursuant to Article 2 of Intermediate Decision No. 13259 of 26 August 2020 (Intermediate Circular No. 567).

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.
- Computing 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 sheet financial 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 computing 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 to build 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 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; and 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 impairment 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 Profit or Loss 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 Profit or Loss 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, to build 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 Decision 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 of 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 an impairment 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 exchange positions resulting from net interests, commissions and other revenues in foreign currencies, 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 balance sheet models, pursuant to the provisions of this Decision. The Banking Control Commission of Lebanon shall issue the related application guidance, 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