



# **TECHNICAL ASSISTANCE REPORT**

## **SOMALIA**

### **Prudential Classification and Provisioning of Credit Operations**

**March 2026**

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# Glossary

|      |                                                                            |
|------|----------------------------------------------------------------------------|
| BCBS | Basel Committee on Banking Supervision                                     |
| CBS  | Central Bank of Somalia                                                    |
| FSSF | Financial Sector Stability Fund                                            |
| FSSR | Financial Sector Stability Review                                          |
| IFRS | International Financial Reporting Standards                                |
| IMF  | International Monetary Fund                                                |
| LSD  | Licensing and Supervision Department                                       |
| MCM  | Monetary and Capital Markets Department of the International Monetary Fund |
| TA   | Technical Assistance                                                       |

# Preface

At the request of Central Bank of Somalia (CBS), the Monetary and Capital Markets (MCM) Department mission visited Nairobi from October 26 to 30, 2025 to (i) review the current regulation on asset classification and provisioning of credit operations, published in 2018, updating its concepts, definitions, and criteria with those from standard-setting bodies, and also promoting the alignment with the regulation on capital adequacy, and (ii) deliver training on best practices on how banks are expected to manage credit risk and on how the supervision is expected to assess banks' credit risk management. The mission also included three preparatory online sessions, scheduled for the period between September 29 to October 5, 2025, conducted for understanding the current framework and supervisory practices.

The mission met in Nairobi with Mr. Mohamed Abdullahi, head of the Bank Supervision Division, and other supervisors of the CBS's Licensing and Supervision Department (LSD). Prior to the in-person meetings, the mission held virtual meetings with the LSD team, in order to understand the main objectives envisaged for the revision of the current regulation, request additional information about banks' current practices and exposures, and also agree on the content for the training on credit risk management.

The mission wishes to thank the CBS and the LSD, particularly Mr. Mohamed Abdullahi and the supervision team for their valuable collaboration, openness and willingness to engage in discussions throughout the whole mission. The mission also thanks the Somali IMF Resident Representative Office in Kenya, for all the support provided.

# Executive Summary

**The TA had the objectives of reviewing the CBS 2018 regulation on asset classification and provisioning, and of delivering training on credit risk management.** The mission reviewed the regulation jointly with the banking supervisors, focusing on alignment with international standards and best practices. The training focused on clarifying definitions and their application, and on providing a sound basis for supervisors to identify and assess credit risk.

**The proposed revision of the asset classification and provisioning regulation incorporates several modifications:**

- a) Clear delineation and differentiation of the minimum requirements on prudential classification of credit operations and provisioning from the qualitative requirements applicable to banks' internal credit risk management framework;
- b) Extensive review of definitions, particularly those considered as criteria for the prudential classification and provisioning requirements, adding additional definitions and adjusting those currently used, ensuring their consistency with documents published by standard setting bodies, such as the Basel Committee and Banking Supervision (BCBS);
- c) Inclusion of equity-like transactions in the scope of the regulation, allowed under Islamic banking and comparable to conventional credit operations, such as *Musharakah* and *Mudarabah*;
- d) Enhanced requirements on the credit risk management framework of financial institutions, highlighting its forward-looking nature and Board's responsibilities;
- e) Redesign of the prudential asset classification into six categories. A new category for performing transactions past-due up to 30 days was added to the five categories currently in use. Classification criteria for all categories were aligned with BCBS performing and non-performing definitions and with IFRS9's three stages of impairment, and the concept of forbearance was introduced;
- f) Inclusion of minimum levels of provisioning for prudential categories related to performing transactions, ranging from 0.1 percent to 1 percent, also requiring the overall prudential provisioning to not be below the consolidated amount of expected credit losses, in case they are above the prudential provisioning levels;
- g) Addition of a specific hard limit on large exposures corresponding to 25 percent of core capital; and
- h) Inclusion of explicit CBS powers to apply sanctions and prescribe corrective measures and adjustments when a financial institution is not in compliance with the regulation.

**The training on credit risk management covered best practices on the design and implementation of banks' credit risk management framework, and on supervisory assessments of these frameworks.** The training was based on documents published by the BCBS, World Bank and the Toronto Centre, mixed with practical discussions connected to the local reality in Somalia.

**The CBS is tasked with performing two tasks in the following months:** (i) conduct an impact study on how financial institutions would distribute their credit transactions under the new proposed six categories; and (ii) collect answers to a short questionnaire on the financial institutions' internal credit classification and provisioning framework. The data collection will allow to estimate potential impacts of the new prudential provisions and provide an understanding of the materiality of performing operations past-due up to 90 days, which currently are informed together with the operations that are not past-due. The answers to the questionnaire will allow CBS to identify financial institutions that use an internal framework for credit classification into different categories, including the classification criteria for each internal category and their provision levels. This is important information for supervisory assessment and will also provide inputs to assess the adequacy of the new qualitative requirements included in the revised regulation.

**A follow-up TA is planned** for (i) a final review of the proposed regulation, considering the results of the impact study and the answers to the questionnaire; (ii) updating the current template to collect data on credit transactions from banks on a monthly basis, and (iii) developing written instructions for banks on filling out the credit transactions template.

# Recommendations

**Table 1. Recommendations**

| Description                                                                                                                                                                                                                                        | Priority | Timeframe <sup>1</sup> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|------------------------|
| Collect data from Somalian FIs on the estimated amounts of credit operations distributed between the six new proposed categories for the classification of credit operations                                                                       | High     | Near term              |
| Collect answers from Somalian FIs to a short questionnaire, which gathers information on their internal grids for credit operation classifications, and, for each internal category, the classification criteria and respective provisioning level | High     | Near term              |
| Conduct an impact study, by estimating the new minimum prudential provisioning requirements under the revised regulation, discussing if adjustments to the minimum provisioning floors or other corrections are necessary or advisable             | High     | Near term              |
| Discuss within LSD the applicability of the regulation on financial institutions that are not banks (e.g., microcredit entities that perform banking activities)                                                                                   | High     | Near term              |
| Adjust the draft for the revised regulation on credit classification and provisioning                                                                                                                                                              | High     | Near term              |
| Upgrade the current credit risk data template and develop instructions for the financial institutions on how to fill it out                                                                                                                        | High     | Medium term            |
| Adjust supervision practices for all financial entities, not only banks, ensuring a coherent implementation of the new regulation within the LSD                                                                                                   | Medium   | Medium term            |
| Develop data analysis procedures for the information gathered monthly on credit operations, based on robust systems and processes                                                                                                                  | High     | Long term              |

1/ Near term: < 12 months; Medium term: 12 to 24 months; Long term: 24+ months

# Introduction

1. **This TA aims to support the CBS on improving the quality of data submitted by banks, for which an action plan was approved by the CBA board in July 2024.** An MCM TA conducted in April 2024 a diagnostic assessment of data collected by banking supervision in Somalia, which helped the LSD develop the mentioned an action plan. The first step of the action plan is focused on reviewing reporting templates used by banks to send data to the CBS and on elaborating instructions for the banks to fill the templates out. Importantly, complementary activities for this review include delivering training to supervisors and reviewing the corresponding regulations, to ensure that the requirements and the data request are appropriate and in accordance with international standards and best practices.
2. **The templates and corresponding regulations that fall under the purview of prudential supervision and are, therefore, under the action plan consist of Capital Requirements, Liquidity Requirements (Liquidity Coverage Ratio - LCR), Related Party Transactions and Assets Classification and Provisions.** The regulations on capital and liquidity were object of MCM TAs delivered in February and June of 2023, and the corresponding templates and instructions were object of an MCM TA in April 2025. In coordination with the Director of LSD, it was agreed that asset classification and provisioning, including broader aspects related to credit risk, would be the next priority for the regulatory and template review and corresponding elaboration of template instructions.
3. **Therefore, at the request of the CBS, the TA** (i) reviewed the current regulation on asset classification and provisioning of credit operations, published in 2018, updating its definitions and criteria with those from standard-setting bodies, and also promoting the alignment with the CBS regulation on Capital Adequacy (CBS/BS/REG/02), amended in 2023; and (ii) delivered training on best practices related to credit risk management and supervisory assessment of banks' practices. Following the Somalia 2024 Financial Sector Stability Review (FSSR) that covered among other topics, financial supervision and regulation, capacity development activities to Somalia in financial supervision and regulation are funded by the Financial Sector Stability Fund (FSSF).

# I. Regulation on classification and provisioning – New draft

## A. Purpose, scope, and definitions

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4. **The review promoted several significant changes in the first part of the regulation, beginning with a clear delineation of its purposes.** The previous regulation did not state its purpose, an omission that could create misunderstandings by the readers, since it covers not only prudential classification and provisioning aspects, but also requirements related to financial institutions' internal practices on credit risk management. The new version includes the 1.2 section describing the three distinct purposes of the regulation:

### ***“1.2. Purpose***

*The purpose of this regulation is to ensure financial institutions:*

*1.2.1. Assess the credit risk on their portfolios based on internal classification systems that accurately reflect differing levels of credit risk,*

*1.2.2. Grade the credit risk on their portfolios based on the standardized prudential classification included in this regulation, and*

*1.2.3. Account for identified and expected credit losses on their portfolio, estimating consistent provision amounts, including for prudential purposes.”*

5. **The section on definitions was enhanced, incorporating new items aligned with BCBS and IFRS standards.** These include terminology such as “credit risk”, “general provision”, “specific provision”, “non-accrued status”, “forbearance”, “concession” and “distressed restructuring”<sup>1, 2</sup> and, from the IFRS, “significant influence” and “joint control”<sup>3</sup>.

6. **Finally, the draft includes equity-like operations in the scope of the regulation, since these transactions, such as Musharakah and Mudarabah, are common at Somalian banks due to Islamic banking.** It also considers a potential distinction between equity-like operations where the financial institution has a significant interest or joint control – both concepts from IFRS IAS28, from the equity-like operations where that is not the case. This is for the case in which CBS decides, after consulting the Accounting and Auditing Organization for Islamic Financial Institutions, that only one of those two should be subject to the regulation, instead of both.

7. **Importantly, the effectiveness of the new credit classification and provisioning regulation will only be ensured if CBS improves its onsite and offsite supervisory practices.** Therefore, it is

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<sup>1</sup> For the BCBS, the main reference is Guidelines: [Prudential treatment of problem assets - definitions of non-performing exposures and forbearance](#).

<sup>2</sup> Another important reference is Hulster, K., Salomao-Garcia, V., & Letelier, R. (2014). *Loan classification and provisioning: Current practices in 26 ECA countries*. World Bank Publications, available at: [World Bank Document](#).

<sup>3</sup> For the IFRS, the main reference is [IFRS - IAS 28 Investments in Associates and Joint Ventures](#).

necessary to (i) improve supervisory procedures and make resources available to perform onsite evaluations of the financial institutions' adherence to the qualitative requirements on their credit risk management frameworks, (ii) enhance offsite supervision processes, including the information technology platform to receive, store and process data, the analysis of the data collected, the calculation of risk indicators, and the corresponding incorporation of findings in the onsite review and risk assessment.

## **B. Classification and provisioning requirements for financial institutions**

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8. **The draft prescribes financial institutions to have a credit risk classification and provisioning policy compliant with qualitative requirements based in BCBS standards, such as the “2024 Core principles for effective banking supervision”<sup>4</sup> and “Principles for the Management of Credit Risk”.<sup>5</sup>**

9. **The qualitative requirements are extensive, principles-based – allowing for proportional implementation depending on the financial institution, and cover several aspects, such as:**

- Clear definition of Board's responsibility, including formally approving the credit risk classification and provisioning policy, reviewing it annually, ensuring its consistency with the credit risk strategy, its integration with the overall risk management process, and that it has been properly implemented, maintained and monitored;
- Requirement for the prudential consolidated credit provisioning not to be below and to be consistent with expected losses calculated for the overall credit risk exposure, in case later are above total prudential provisions. This is important guidance because Somali financial institutions rely on incurred losses as a primary indicator of creditworthiness;
- The credit risk policy shall provide for a well-designed credit risk classification system that should comply with a series of conditions;
- Formal procedures for the treatment of operations with certain characteristics (large exposures, with related parties and deemed too complex), and for write-offs and redemptions;
- Critical role played by the three lines of defense, which should communicate their findings to the Board.

10. **It is important to highlight that governance deficiencies are a weakness commonly reiterated in CBS onsite supervision reports.**

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<sup>4</sup> Available at: [Core principles for effective banking supervision](#).

<sup>5</sup> Available at: [Principles for the Management of Credit Risk](#)

## C. Prudential classification and provisioning

11. **The prudential classification of credit operations in the current regulation is comprised of five categories, two of which related to performing operations.** Minimum levels of provision is required for all categories except for the category PASS, which contains the operations with the best creditworthiness. See Table 2 for more details.

**Table 2. Current CBS Classification Grid for Credit Operations**

| Prudential category | Quality        | Past-due criteria | Minimum provisioning levels |
|---------------------|----------------|-------------------|-----------------------------|
| PASS                | Performing     | 0 to 59 days      | -                           |
| SPECIAL MENTION     | Performing     | 60 to 89 days     | 5%                          |
| SUBSTANDARD         | Non-performing | 90 to 179 days    | 20%                         |
| DOUBTFUL            | Non-performing | 180 to 364 days   | 50%                         |
| LOSS                | Non-performing | Over 364 days     | 100%                        |

12. **Several gaps were identified in that 5-level classification grid:**

- The PASS category includes both operations not past-due and past-due up to 59 days, without requiring financial institutions to discriminate between those operations of different conditions, besides not permitting the collection of important information on those past-due operations to the supervision;
- The criteria for classification in the five categories do not align with BCBS definitions of performing and non-performing operations<sup>6</sup>, do not allow for a comparison with the IFRS9 stages, and are not forward-looking motivated;
- There is no minimum provisioning floor for the PASS category, and no requirement for prudential provisions to be at least equivalent to the consolidated incurred and expected losses;
- There is no obligation on financial institutions to have formal processes and procedures to reconcile internal and prudential categories.

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<sup>6</sup> The current criteria for non-performing categories does not include all those mentioned in BCBS [Prudential treatment of problem assets - definitions of non-performing exposures and forbearance](#), in particular for operations not yet defaulted or impaired.

13. **The proposed adjustments on the categories of the classification grid are highlighted in Table 3, in blue:**

**Table 3. Proposed Classification Grid for Credit Operations**

| Prudential category | Quality        | Past-due criteria | Minimum provisions levels | IFRS equivalence |
|---------------------|----------------|-------------------|---------------------------|------------------|
| PASS                | Performing     | 0 days            | 0.1%                      | Stage 1          |
| MENTION             | Performing     | 1 to 30 days      | 1%                        |                  |
| SPECIAL MENTION     | Performing     | 31 to 89 days     | 5%                        | Stage 2          |
| SUBSTANDARD         | Non-performing | 90 to 179 days    | 20%                       | Stage 3          |
| DOUBTFUL            | Non-performing | 180 to 364 days   | 50%                       |                  |
| LOSS                | Non-performing | Over 364 days     | 100%                      |                  |

14. **The inclusion of the MENTION category permits discriminating between operations recently past-due and applying distinct minimum provisions between that category and PASS.** Somalian financial institutions practice Islamic banking, which directly affects how banking operations are designed and implemented. Past due operations, under Islamic banking cannot be subject to interest charges and if there is a contractual penalty it should not be kept by the lender – and Somalian financial institutions, according to the discussions in Nairobi, usually do not include in their contracts any penalty. This creates an incentive for borrowers past due their obligations, and that was the main reason for the inclusion of the MENTION category, increasing the grid from five to six categories. That inclusion would allow for differentiating non-past due and past due performing operations in different categories, recognizing their potentially distinct credit risk levels.

15. **The SPECIAL MENTION category had its past-due threshold reduced from 60 to 31 days.** The objective is aligning that category with IFRS9 Stage 2, which has among its criteria the more-than-30 days past-due event. An additional benefit is allowing the alignment of PASS and MENTION categories with IFRS9 Stage 1.

16. **All suggested categories include in their classification criteria forward-looking indicators of creditworthiness, complemented by metrics based on past-due behavior.** The inclusion of minimum level of prudential provisioning for the two performing categories, PASS and MENTION, indicates that those operations should not be assumed as exempted from credit risk. It also provides a backstop for supervision in case financial institutions internally assume this, as it seems to be the case according to discussions with TA participants.

17. **The draft also requires:**

- That once a credit operation with a customer has been classified as non-performing, all other operations with that same customer should be reclassified as such;

- Special treatments for operations subject to forbearance and that were initially past-due and subsequently fully paid, with cure periods being required before they can be reclassified in a performing category;
- Financial institutions to have conversion tables between internal and prudential provisioning levels, a critical input for supervision activities, specially onsite supervision;
- Financial institutions to follow specific conditions that trigger the non-accrued status and the mandatory write-off of credit operations;
- That prudential provisions should be solely calculated based on gross amounts, disregarding any compensation by collaterals or mitigants, and that their consolidated amounts must not be limited to those calculated solely based on the minimum provisioning levels of the category mentioned in the regulation, but instead it should be adequate to absorb the identified and expected losses associated with the entire portfolio of credit operations;
- That the aggregate amount of prudential provisions must be approved at least monthly by the Chief Financial Officer.

18. **The draft took into consideration potential relationships between the new requirements on credit classification and provisioning procedures and the qualitative requirements for credit risk management embedded in the regulation on Capital Adequacy.** Special attention was paid to avoid inconsistencies or overlaps between the two regulations. Also, interactions between the reviewed regulation and the calculation of capital requirements – for instance, when selecting the risk weight applicable to a defaulted operation in accordance with its provisions – were identified, with potential misalignments and misinterpretations addressed.

#### **D. Hard limit on large exposures**

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19. **The reviewed regulation introduced a specific hard limit to individual large exposures, which cannot surpass the threshold of 25 percent of the financial institution's core capital.** This is in addition to the current definition of a large exposure as representing at least 10 percent of core capital. The addition of the hard limit is in accordance with the Basel Core principles for effective banking supervision (sections 40.44.6 and 40.45. b), and it was suggested by the CBS during the discussions in Nairobi.

#### **E. Reporting, sanctions and penalties**

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20. **The draft also includes improvements in the requirements related to providing a monthly report on credit risk to the CBS.** The improvements include informing the data on gross amounts in the prudential categories, together with specific data on forborne operations and large exposures.

21. **Finally, a new section expressly determines the ability of CBS to apply sanctions and penalties whenever a financial institution is deemed not compliant with the regulation.** This replicates a similar command included in the regulations on Capital Adequacy and Liquidity Requirements.

## II. Credit risk management training

22. **The mission delivered extensive training on credit risk, covering critical definitions, best practices expected from banks on their credit risk management framework, and guidelines for supervisory practices.** The material strongly reflects the principles described in the Basel Core Principles for Effective Banking Supervision”, and other BCBS documents such as “Principles for the Management of Credit Risk” and “Guidance on credit risk and accounting of expected losses”<sup>7</sup>, complemented by materials published by the Toronto Centre.<sup>8</sup>

23. **The covered points were requested by the CBS staff during the online sessions, before the in-person mission.** They included the different manifestations of credit risk (e.g., default, counterparty and wrong-way risk), critical definitions (e.g., performing, nonperforming, forbearance), points of contact and attrition between prudential and accounting frameworks, and an extended discussion centered on the concept of expected credit losses.

24. **The training also shared best practices on how banks are expected to develop and implement their internal classification practices and how supervision is expected to assess its consistency and quality.** Strong emphasis was given to structural issues related to governance, a finding frequently mentioned in onsite supervision reports shared by the CBS staff in preparation for the mission.

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<sup>7</sup> Available at: [Guidance on credit risk and accounting for expected credit losses](#)

<sup>8</sup> [Credit Review by Supervisors](#) and [Loan classification & Loss provisioning: A Primer](#)

### III. List of activities to be performed by the CBS before the next TA

25. **CBS staff has been left with tasks to be performed in the following months:**

- Collect data from Somalian FIs on the estimated amounts of credit operations distributed between the six new proposed categories for the classification of credit operations;
- Collect answers from Somalian FIs to a short questionnaire, which gathers information on their internal grids for credit operation classifications, and, for each internal category, the classification criteria and respective provisioning level;
- Conduct an impact study, by estimating the new minimum prudential provisioning requirements and capital ratios under the reviewed regulation, discussing if adjustments to the categories, its minimum provisioning floors or other corrections, such as a phased approach for implementation, are necessary or advisable. In particular, assess the impact for the categories "PASS" (0.1 percent in the current draft) and "MENTION" (1% in the current draft);
- Based on the answers received from the questionnaire, and a peer-review on similar regulations in the region, evaluate if the requirements for internal classification and provisioning of the reviewed regulation need adjustments or corrections;
- Define if the scope of the reviewed regulation should include equity-like investments where the FI has a significant interest or joint control of that investment, an important issue considering the materiality of Islamic banking operations in the portfolio of Somalian FIs;
- Agree on the specific time threshold that triggers the automatic write-off of an operation subject to credit risk classified in the prudential category "LOSS" - in the current draft that threshold is 365 days after its initial classification;
- Suggest wording for paragraphs 1.1, 3.5, and 9.2.1 of the draft regulation;
- Prepare for a final round of discussion of the reviewed regulation, taking into consideration the items described above and the results of a planned consultation with Somalian financial institutions;
- Suggest a date for the regulation to enter into force, which will depend on the results of the impact study.

## Annex I. TA Mission Agenda

| Day                               | Topic                                                                                                                                 |
|-----------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|
| Oct 26 – Morning: 9h00 – 12h30    | Previous TA – developments ever since<br>Credit risk - typology                                                                       |
| Oct 26 – Afternoon: 14h00 – 17h00 | Credit risk - typology<br>Key definitions                                                                                             |
| Oct 27 – Morning: 9h00 – 12h30    | Discussion of reviewed regulation                                                                                                     |
| Oct 27 – Afternoon: 14h00 – 17h00 | Discussion of reviewed regulation                                                                                                     |
| Oct 28 – Morning: 9h00 – 12h30    | Discussion of reviewed regulation                                                                                                     |
| Oct 28 – Afternoon: 1400 – 17h00  | Discussion of reviewed regulation                                                                                                     |
| Oct 29 – Morning: 9h00 – 12h30    | Training – what are banks expected to do in credit risk management?                                                                   |
| Oct 29 – Afternoon: 14h00 – 17h00 | Training – what are supervisors expected to do when assessing a bank's credit risk management?                                        |
| Oct 30 – Morning: 9h00 – 12h30    | Training – what are supervisors expected to do when assessing a bank's credit risk management?<br>Brief discussion on data collection |
| Oct 30 – Afternoon: 14h00 – 16h00 | Next steps<br>Conclusion                                                                                                              |

## Annex II - Training material and draft regulation



TA SOM IV Credit risk classific and train and provis v4 clean



CBS Asset classific



Comparative grid - Asset Classification  
'CBS Asset classific aiand Provisioning Re



## Annex III – CBS participants in the TA

|                              |                          |
|------------------------------|--------------------------|
| Mohamed Abdirahman Abdullahi | Head of Banking Division |
| Abdiaziz Mohamed Awad        | Bank Supervisor          |
| Abdishakur Mohamed Sheikh    | Bank Supervisor          |
| Abdullahi Ali Dhuhulow       | Bank Supervisor          |
| Asha Omar Mohamud            | Bank Supervisor          |
| Mukhtar Hassan Osman         | Bank Supervisor          |