

# ***Redefining NPL: Helping Banks Make Better Credit Decisions (Updates on Credit Risk Management)***

***RBAP National Convention***

*by: Mary Jane T. Chiong, CFA*

*29 May 2017*

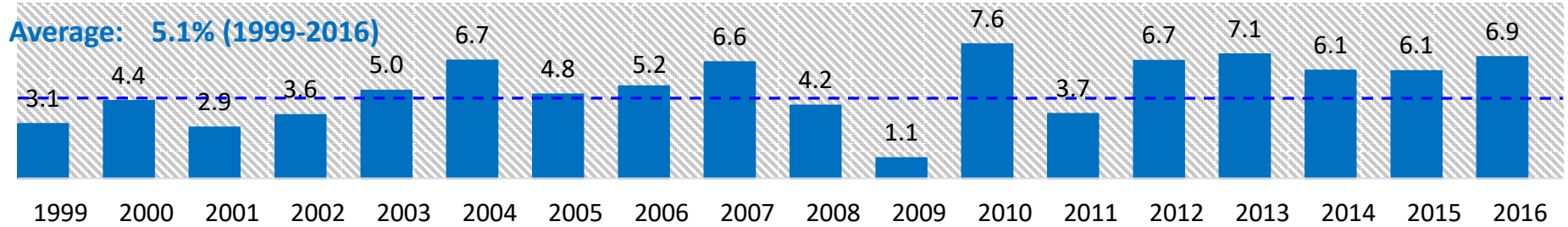


**BANGKO SENTRAL NG PILIPINAS**

# Snapshot of Macroeconomic Environment

*Positive economic growth for 73 consecutive quarters*

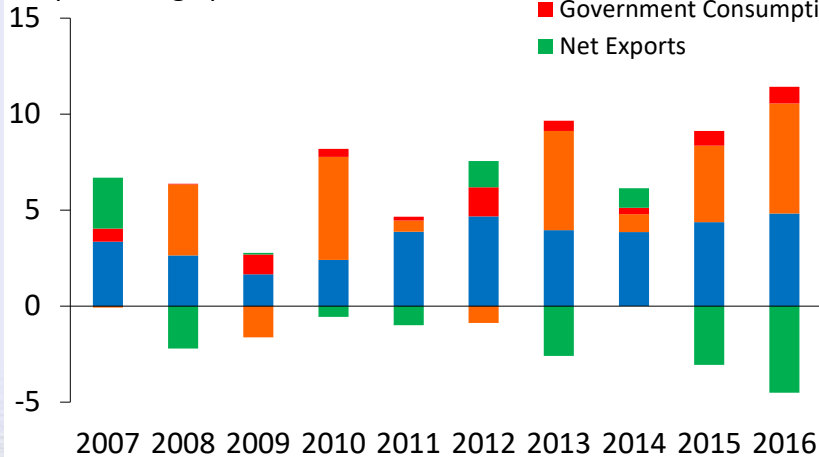
**Real GDP Growth (%)**



**Demand-side drivers:  
Private consumption and investment**

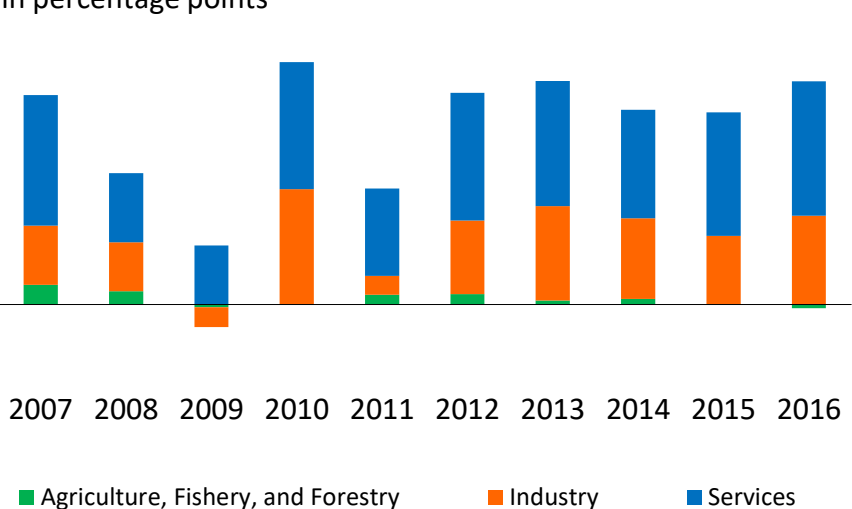
**Contribution to Growth: Demand**  
in percentage points

- Private Consumption
- Investment
- Government Consumption
- Net Exports



**Supply-side drivers:  
Industry and services**

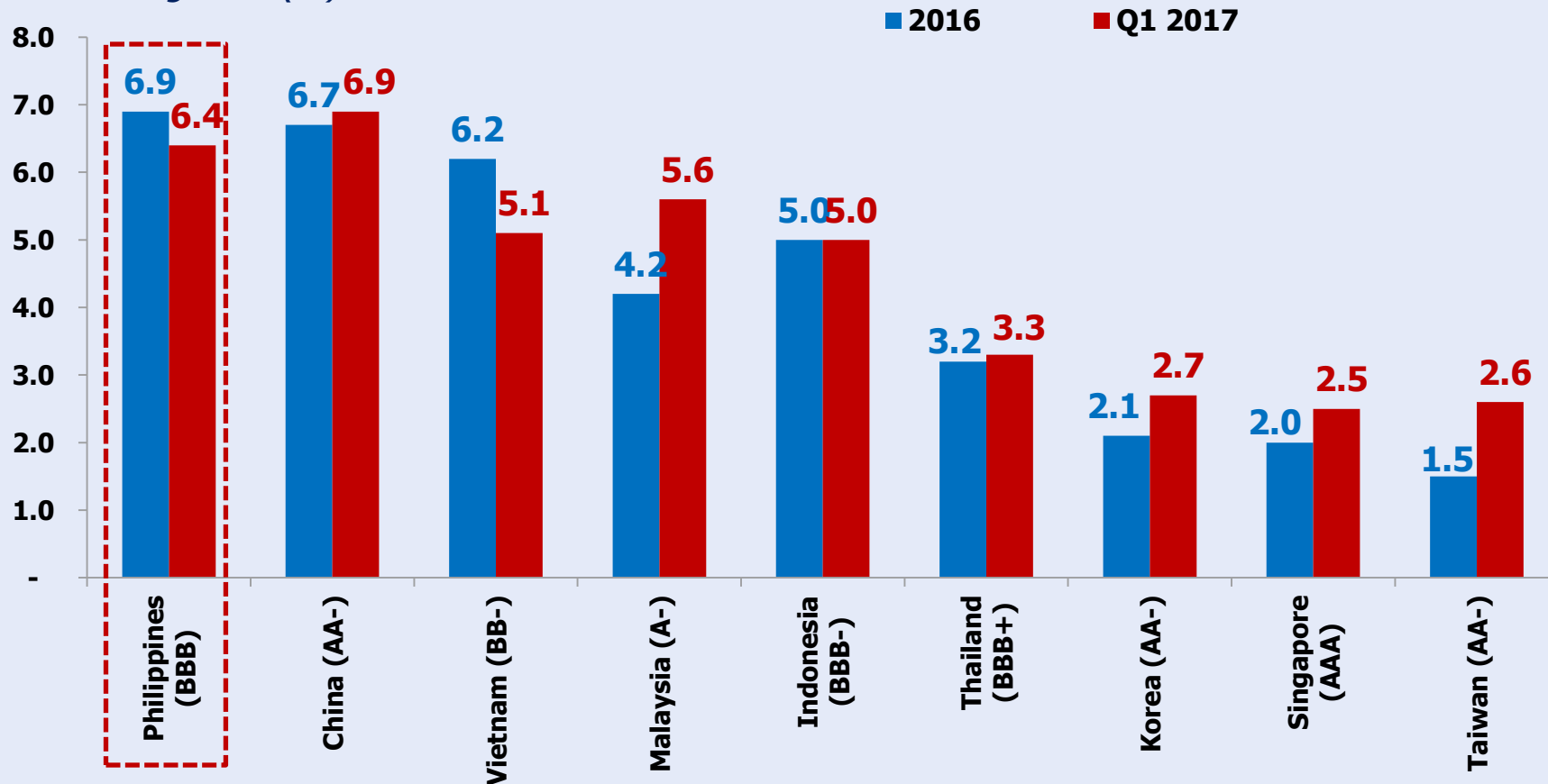
**Contributions to GDP Growth: Supply Side**  
in percentage points



# Domestic economy leading regional growth...

PH remains one of the fastest growing economies regionally and amongst similarly rated peers

Real GDP growth (%)



Source: Bloomberg, BSP website

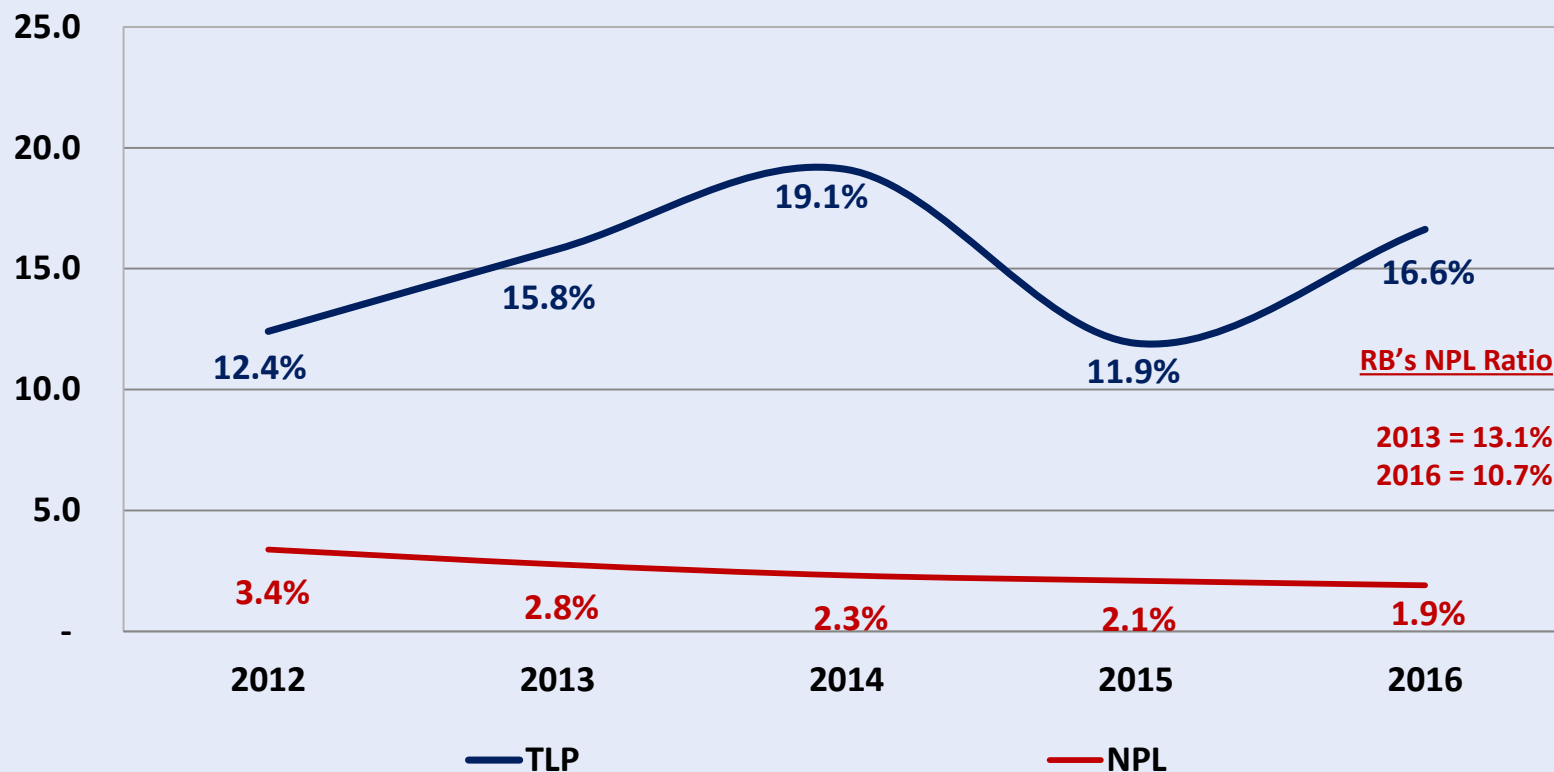


BANGKO SENTRAL NG PILIPINAS

# Reshaping the NPL Story

## Philippine Banking System: Lending Trends (As of End-Period Indicated)

(Growth Rates/Ratios in Percent)



**RB's NPL Ratio**

**2013 = 13.1%**

**2016 = 10.7%**



BANGKO SENTRAL NG PILIPINAS

# Reshaping the NPL Story

- 1997 Asian Financial Crisis – relaxed underwriting standards led to mounting credit losses in the real estate sector
- Extraordinary intervention
  - New definition of NPL in 1999
  - Enactment of SPV laws
    - P154.5 billion unloaded



# Sustaining the Credit Reform Agenda

- NPL definition, monitoring, reporting of its movement and aging
- Guidelines on Sound Credit Risk Management Practices
- Redefining Past Due Loans and Non-Performing Exposures



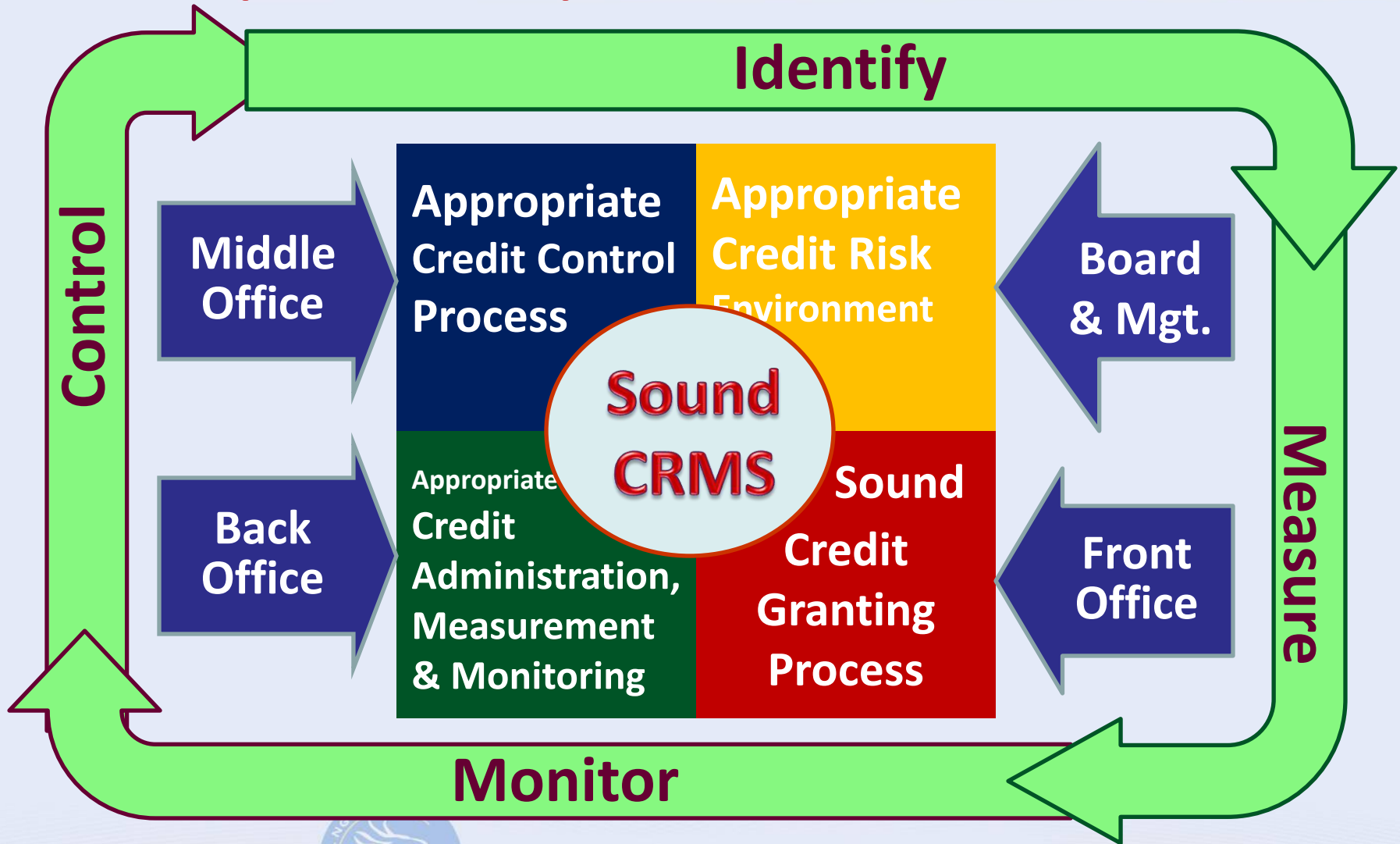
*Circular No. 855*

# **GUIDELINES ON SOUND CREDIT RISK MANAGEMENT PRACTICES**



BANGKO SENTRAL NG PILIPINAS

# Guidelines on Sound Credit Risk Management Practices (Circular 855)





# Key Highlights

- Credit Risk Strategy
  - Articulation of desired market segments and types of credit exposures
- Credit Risk Structure
- Credit Granting Criteria
- Credit Risk Rating
- Loan Loss methodology

Processes designed to:

Understand client behavior in order to make sound credit decisions



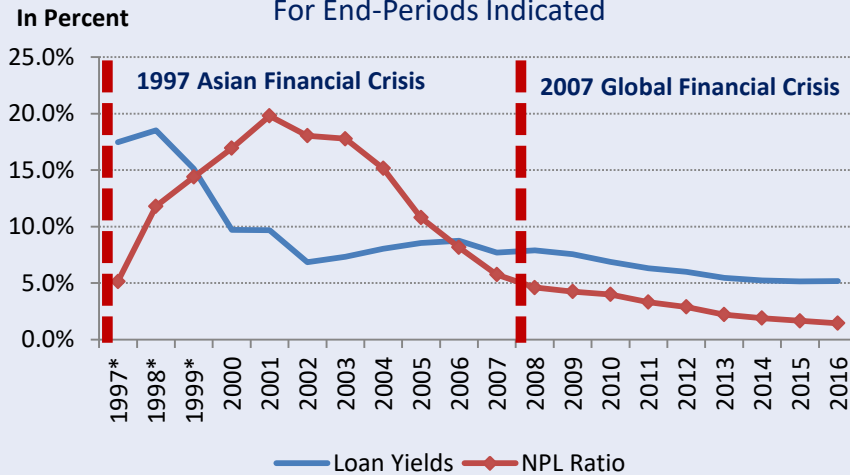
# Credit Criteria and Credit Rating/Grading System

- Sets the range of “acceptable borrowers”
- Should cover both the assessment of ability and willingness to pay
  - Source of payment primarily anchored on cash flow analysis ; collateral only secondary consideration
  - However, cash flow analysis is not enough
- Banks are allowed and encouraged to innovate credit criteria and may use various sources of information to assess creditworthiness
- Credit rating important to differentiate risk and properly price loans



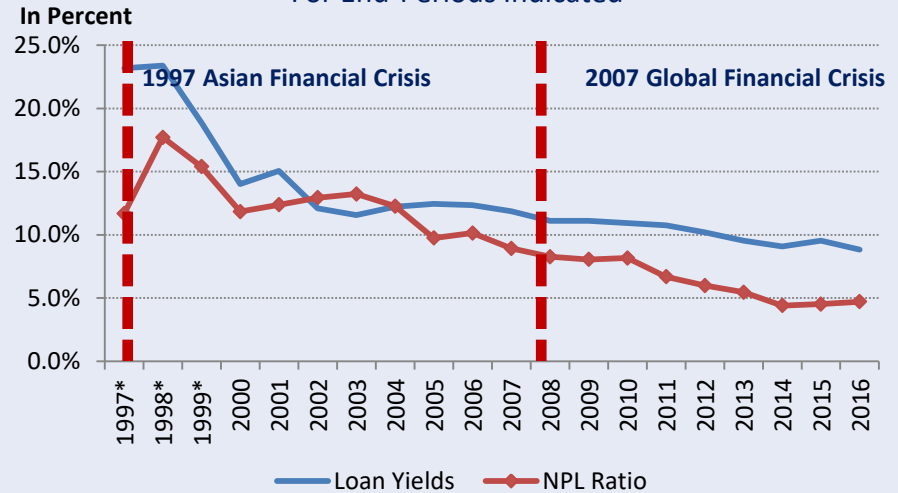
# The Need for Credit Rating/Grading System

**Universal and Commercial Banks:  
Loan Yield vs. NPL Trends  
For End-Periods Indicated**

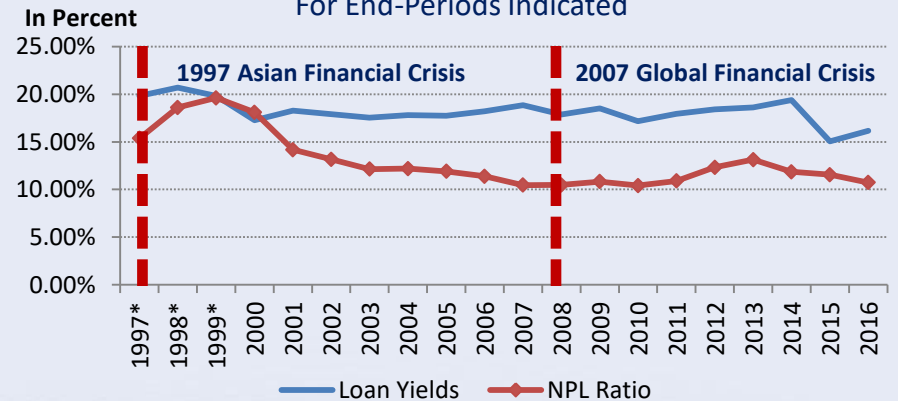


\*Total interest income as proxy for loan yield

**Thrift Banks: Loan Yields vs. NPL Trends  
For End-Periods Indicated**



**Rural and Cooperative Banks:  
Loan Yields vs. NPL Trends  
For End-Periods Indicated**



# Provisioning and Allowance for Credit Losses

- How do banks measure credit risk?
- Allowance for Credit Losses – estimation of expected credit losses (forward looking)
- Provisioning process is a key risk management tool that can help banks make better credit decisions:
  - Understanding credit behavior
  - Identifying target market
  - Define credit criteria including “acceptable borrowers”
  - pricing
- Recognizing appropriate provisions in a timely manner ensures true earnings and capital position
- Banks are required to develop own loan loss methodologies to measure expected losses

Circular No. 941

# **REDEFINING PAST DUE AND NON- PERFORMING EXPOSURES**



BANGKO SENTRAL NG PILIPINAS

# Purpose and Use of Common Definitions (BCBS Prudential Treatment of Problem Assets)

- Help banks properly assess credit risk and enhances early detection of deterioration of asset quality
- Enhances comparability and enables BSP and banks to better understand asset quality issues
- Provides benchmarks for use in supervisory asset quality monitoring and bank's internal credit ratings/classification



## Past Due Loans

- Any principal/interest not paid on due date, total outstanding balance shall be past due the following day;
- Regardless of type of loan/credit or mode of payment



# Cure Period

- Time period allowed borrowers to catch up on late payment without being considered past due
- Cure period recognizes late payments may not necessarily be due to financial difficulty and reflects management's tolerance of occasional payment delays
- Cure period policy must be credit-specific, based on verifiable collection experience and reasonable judgment
- Does not preclude timely adverse classification when material credit weaknesses developed
- Maximum of 30 days (rebuttable presumption of significant increase in credit risk)
- Subject to regular review





## Non-Performing Loans - Criteria

- Considered impaired under existing accounting standards,
- Classified as doubtful or loss or in litigation; or
- There is evidence that full repayment of principal and interest is unlikely without foreclosure of collateral, if any



# Non-Performing Loans - Criteria

- When any principal and/or interest are unpaid for more than ninety (90) days from contractual due date or accrued interests for more than ninety (90) days have been capitalized, refinanced, or delayed by agreement;
- When restructured, except if prior to restructuring, the loans were categorized as performing,



# Comparison Old vs. New

Mode of Payment	New Policy		Old Policy		
	Past Due (PD)	NPL	Past Due	NPL	
Monthly Installment	1 day after contractual due date*	NPL if IMPAIRED, etc. whether past due or not**	3 installments missed	Installments unpaid for more than 90 days	
Quarterly/ Semestral/ Annual			1 Installment missed		PD for more than 30 days
At Maturity			Day after maturity		
Daily/weekly/ semi-monthly	1 day after contractual due date*		Arrears is 10% of O/S balance	Upon past due	
Microfinance			1 installment	Upon past due	

\*Bank has option to provide cure period, if warranted.

\*\*All loans that are past due for more than 90 days are considered NPL.

# Helping Banks Make Better Credit Decisions

## CREDIT MANAGEMENT FRAMEWORK

