

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

RBAP National Convention

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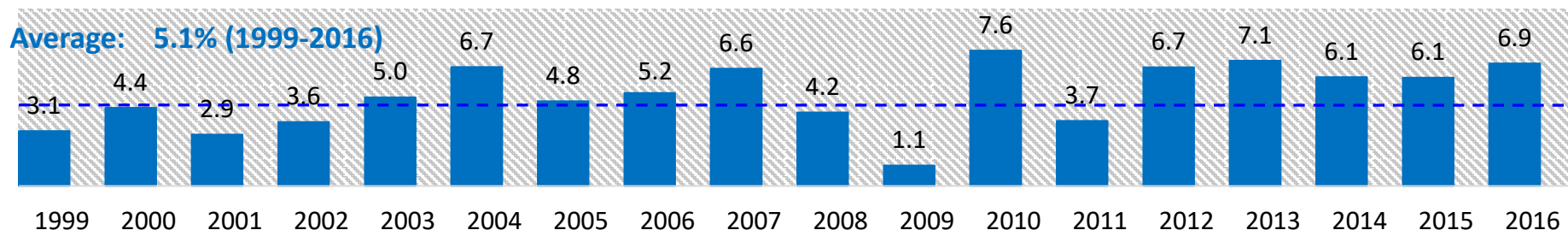
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Snapshot of Macroeconomic Environment

Positive economic growth for 73 consecutive quarters

Real GDP Growth (%)

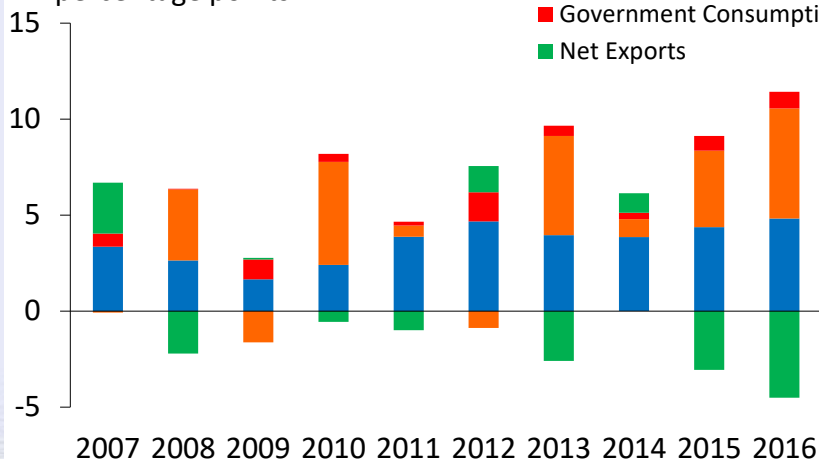
Average: 5.1% (1999-2016)



*Demand-side drivers:
Private consumption and investment*

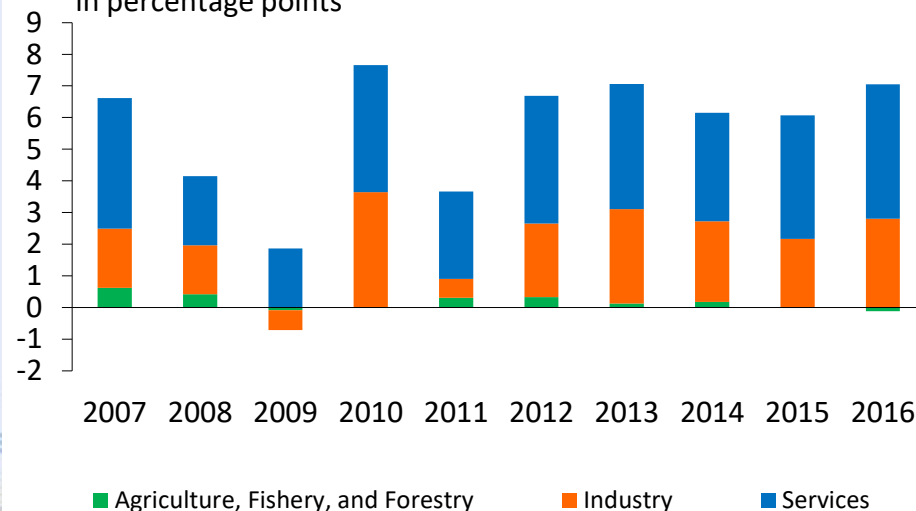
Contribution to Growth: Demand
in percentage points

■ Private Consumption
■ Investment
■ Government Consumption
■ Net Exports



*Supply-side drivers:
Industry and services*

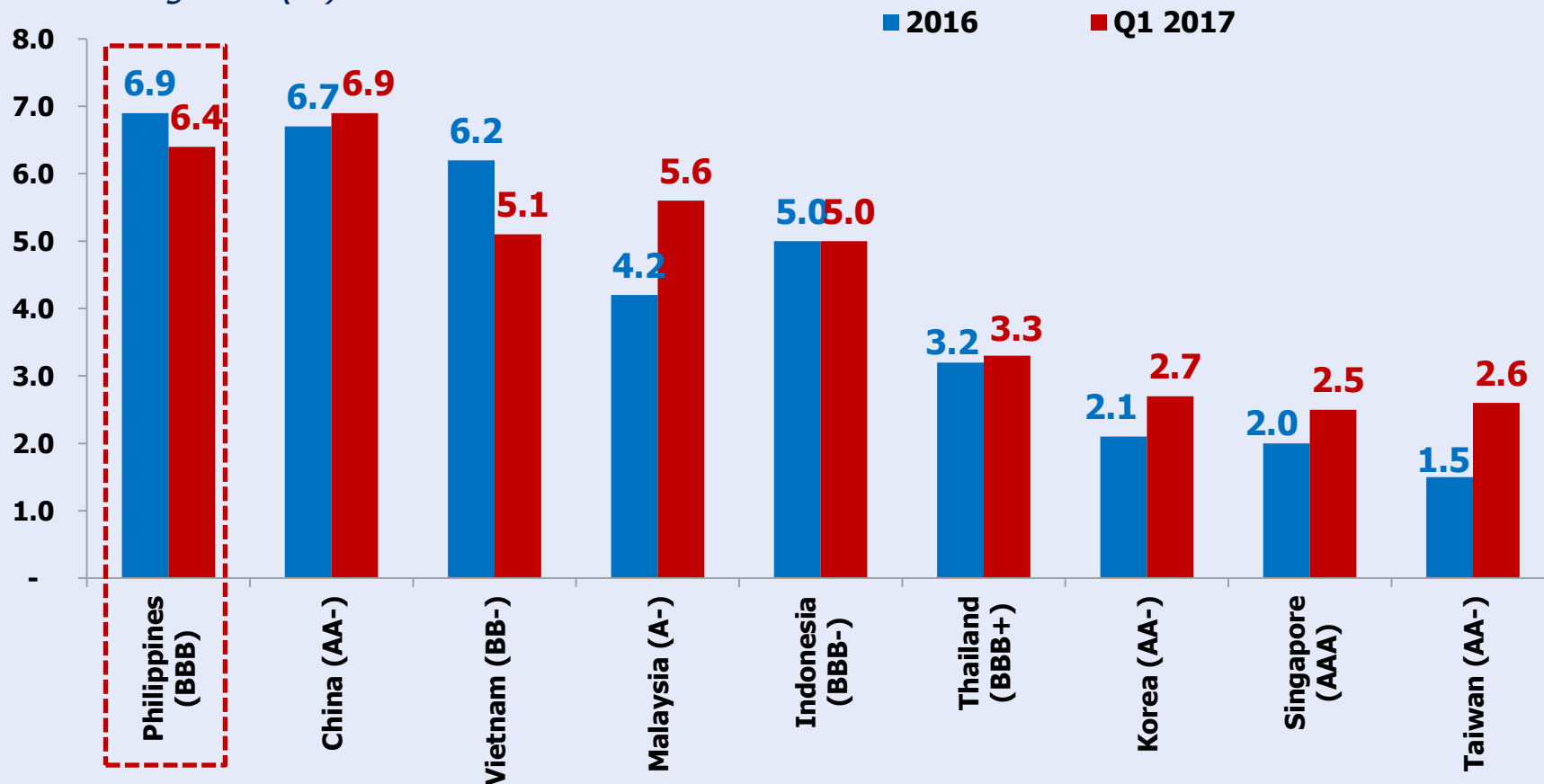
Contributions to GDP Growth: Supply Side
in percentage points



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

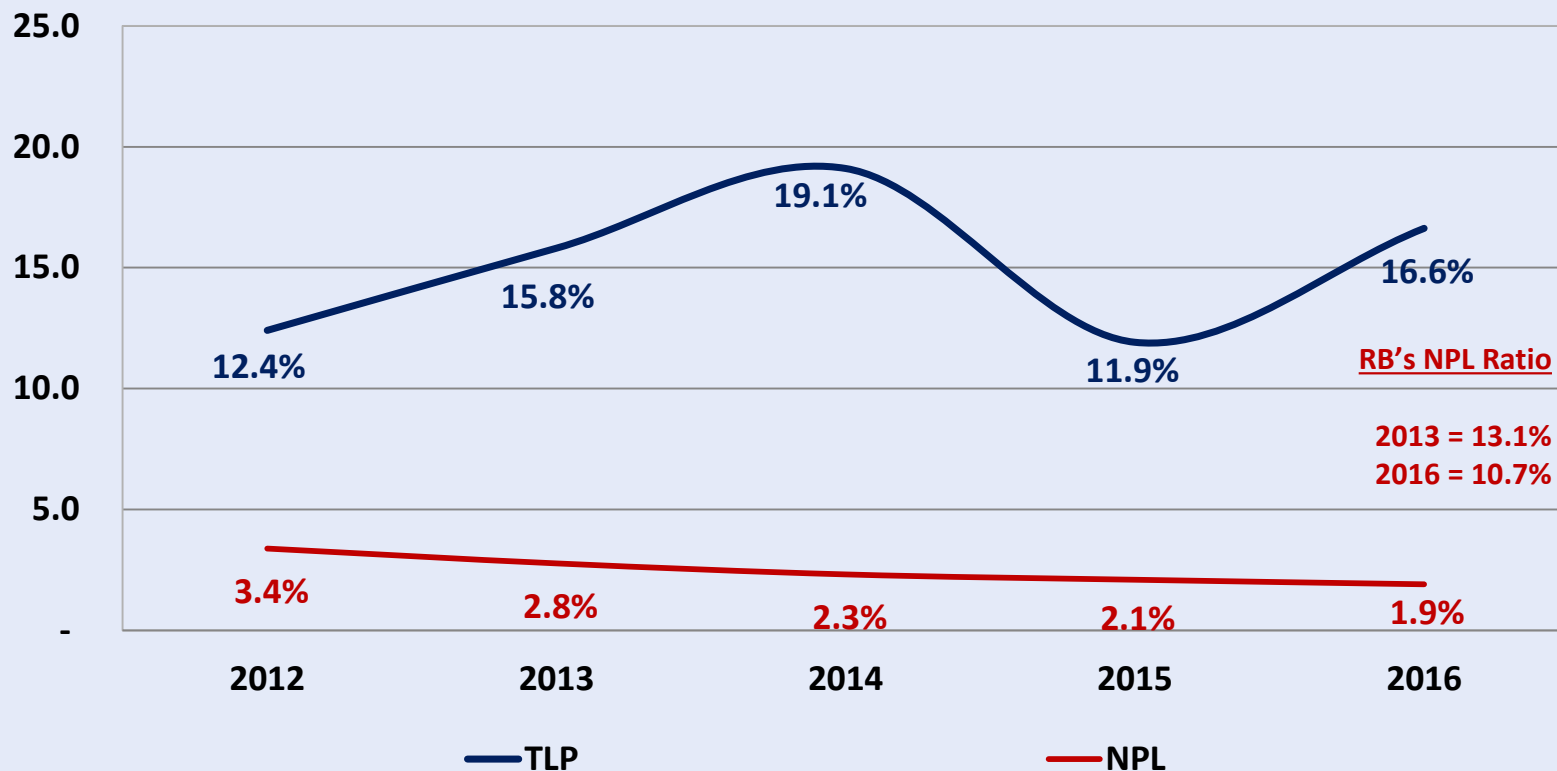


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Reshaping the NPL Story

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

(Growth Rates/Ratios in Percent)



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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



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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



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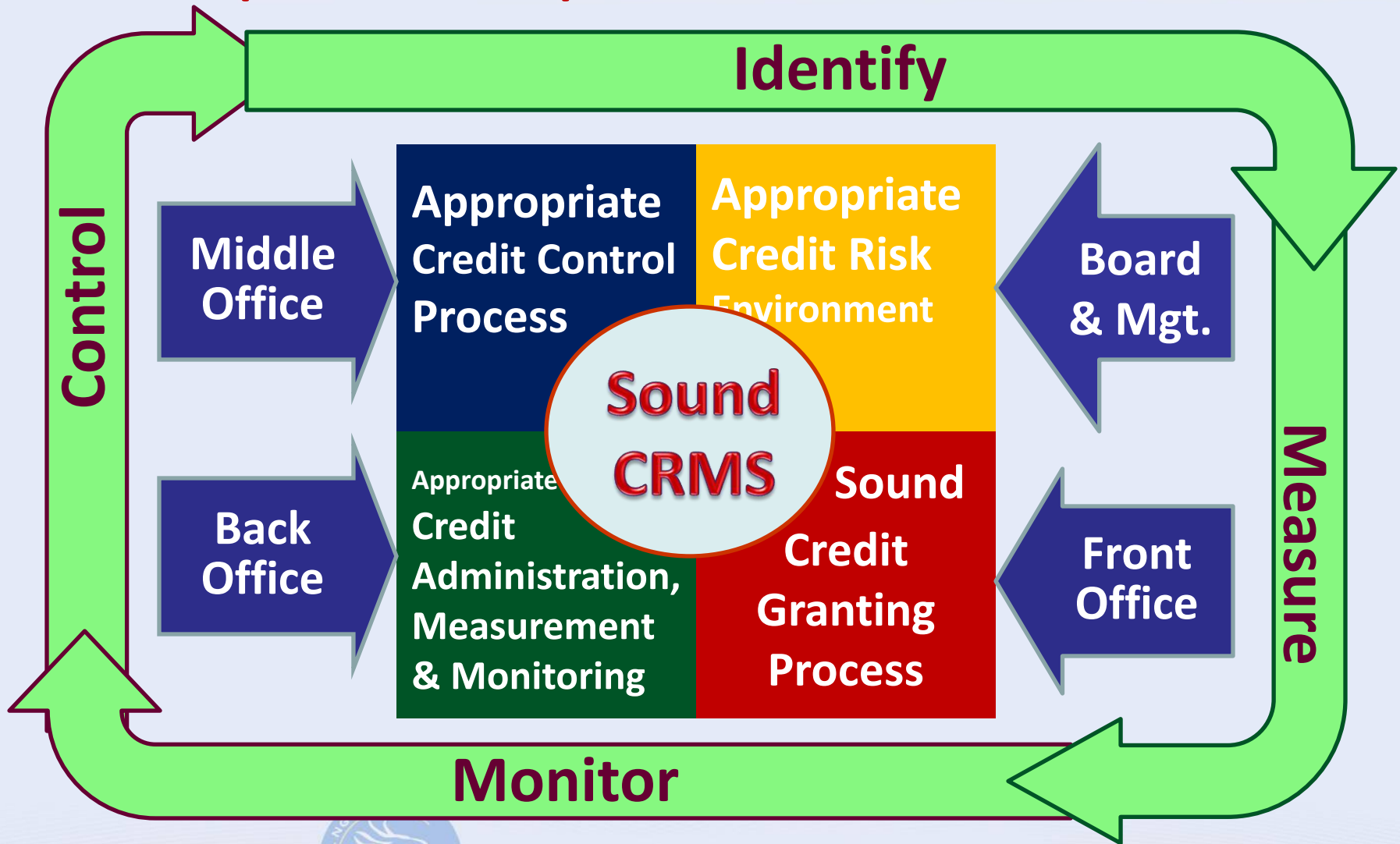
Circular No. 855

GUIDELINES ON SOUND CREDIT RISK MANAGEMENT PRACTICES



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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



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Credit Criteria and Credit Rating/Grading System

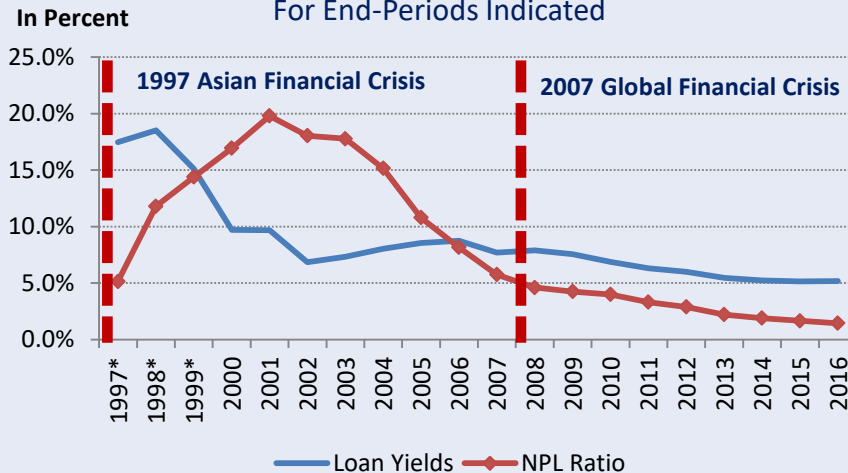
- Sets the range of “acceptable borrowers”
- Should cover both the assessment of ability and willingness to pay
 - Source of payment primarily anchored on cash flow analysis ; collateral only secondary consideration
 - However, cash flow analysis is not enough
- Banks are allowed and encouraged to innovate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



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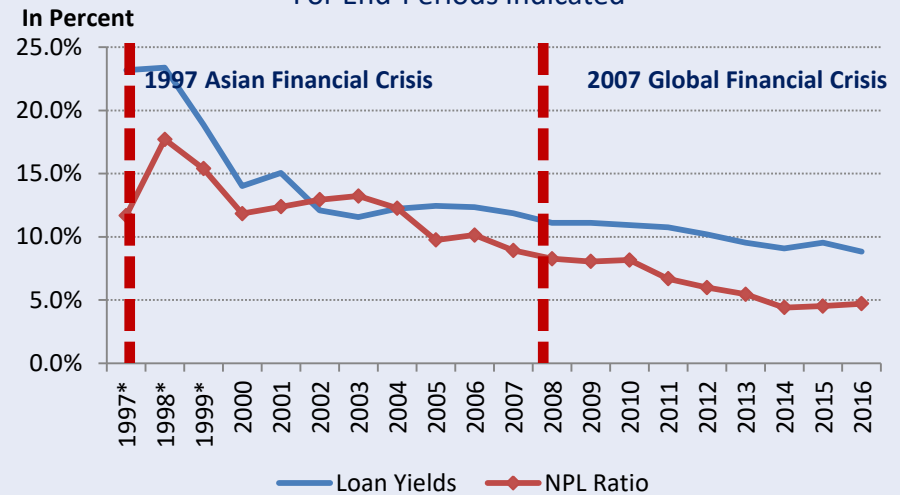
The Need for Credit Rating/Grading System

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

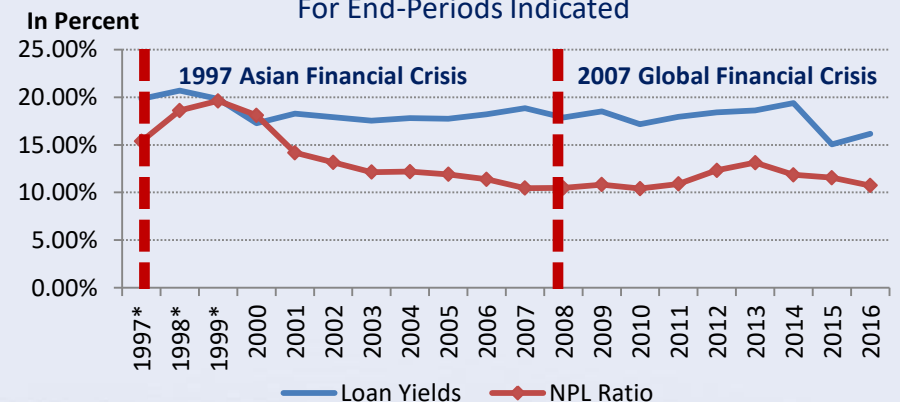


*Total interest income as proxy for loan yield

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



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



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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



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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



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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

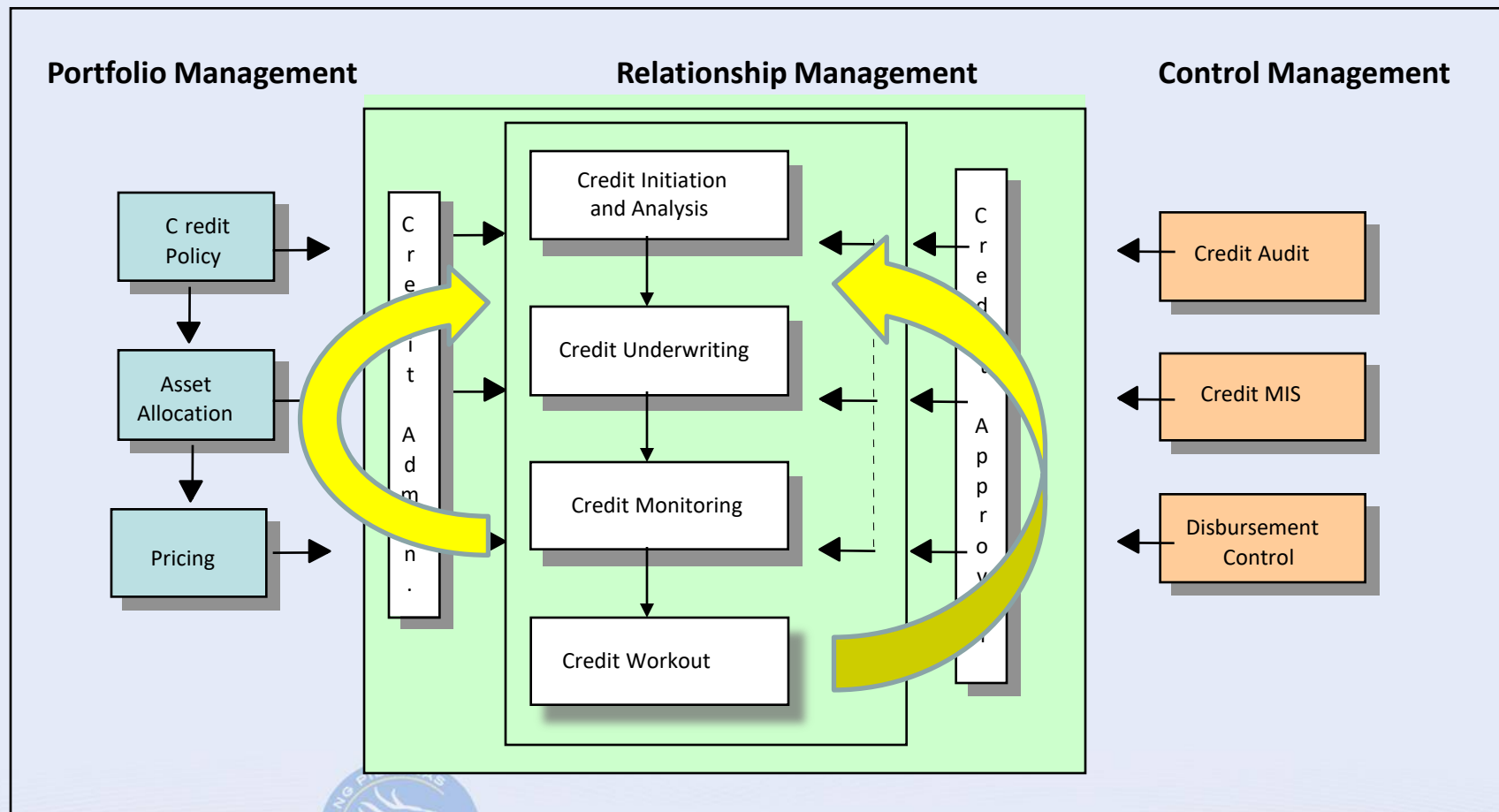
Mode of Payment	New Policy		Old Policy	
	Past Due (PD)	NPL	Past Due	NPL
Monthly Installment	1 day after contractual due date*	NPL if IMPAIRED, etc. whether past due or not**	3 installments missed	Installments unpaid for more than 90 days
Quarterly/ Semestral/ Annual			1 Installment missed	PD for more 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



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