MAS 612

11 March 2005

NOTICE TO BANKS
BANKING ACT, CAP 19

(MAS Notice 612 dated 30 December 2004 is cancelled.)

Credit Files, Grading and Provisioning

This notice is issued pursuant to section 55 of the Banking Act (Cap. 19) and applies to all banks in Singapore.

2 Definitions

2.1 The expressions used in this Notice shall, except where expressly defined in this Notice or where the context otherwise requires, have the same meanings as in the Act.

3 Credit Files

3.1 Every bank in Singapore shall maintain credit files whether in electronic, print or other form, on all its borrowers which shall contain adequate and timely information on the credit-worthiness of the borrowers:

(a) to enable the proper and effective monitoring of credit facilities extended by the bank; and

(b) to enable examiners from the Authority, as well as the bank's internal and external auditors, to have immediate and complete factual information from which they can form an objective appraisal of the quality of the credit facilities.

3.2 A bank shall maintain basic information (including those set out in the Appendix, where applicable) on:

(a) the borrower;

(b) the credit facility;

(c) the appraisal of the credit application; and

(d) the conduct of the account,

to enable an objective evaluation of the quality of each facility.

3.3 A bank shall also maintain in its credit files, documents which support such basic information. For consumer loans where credit risk is managed on a portfolio basis, a bank shall maintain information on at least the borrower, credit facility and its appraisal of the credit application.

3.4 The information in the credit files shall be made available in English.

4 Grading of Credit Facilities

4.1 A bank in Singapore shall conduct regular and systematic reviews of all credit facilities (including off balance-sheet items) that it has extended to its borrowers. A bank shall exercise its judgment in deciding the frequency of reviews for the various types of credit facilities. In general, facilities deemed to be of higher risk or showing signs of deterioration should be placed on a shorter review cycle. For consumer loans with homogeneous characteristics, a bank may perform credit reviews on a portfolio basis.

4.2 A bank shall categorise the credit facilities based on its assessment of the ability of the borrower to repay from the normal sources of income of that borrower. At a minimum, a bank shall categorise the credit facilities into five credit grades, namely (a) pass, (b) special mention, (c) substandard, (d) doubtful and (e) loss. The last three credit grades are considered as classified grades. The description of each of the credit grades is as follows:

(a) **Pass:** this indicates that timely repayment of the outstanding credit facility is not in doubt. Repayment is prompt and the credit facility does not exhibit any potential weakness in repayment capability, business, cash flow or financial position of the borrower.

(b) **Special Mention:** This indicates that the credit facility exhibits potential weaknesses that, if not corrected in a timely manner, may adversely affect repayment by the borrower at a future date, and warrant close attention by a bank.

Characteristics of "special mention" credit facilities include the following:

(i) a declining trend in the operations of the borrower that signals a potential weakness in the financial position of the borrower, but not to the point that repayment is jeopardised;

(ii) economic and market conditions that may unfavourably affect the profitability and business of the borrower in the future.

(c) **Substandard:** this indicates that the credit facility exhibits definable weaknesses, either in respect of the business, cash flow or financial position of the borrower that may jeopardise repayment on existing terms.

Characteristics of "substandard" credit facilities include the following:

(i) inability of the borrower to meet contractual repayment terms of the credit facility;

(ii) unfavourable economic and market conditions or operating problems that would affect the profitability and business of the borrower in the future;

(iii) weak financial condition or the inability of the borrower to generate sufficient cash flow to service the payments;

(iv) difficulties experienced by the borrower in repaying other credit facilities granted by the same bank, or by other financial institutions (where such information is available);

(v) breach of any key financial covenants by the borrower.

A bank shall assess the severity of each weakness exhibited by the credit facility and consider whether the weakness, when considered singly and in combination with other weaknesses, would adversely affect the repayment ability of the borrower.

(d) **Doubtful:** this indicates that the outstanding credit facility exhibits more severe weaknesses than those in a "substandard" credit facility, such that the prospect of full recovery of the outstanding credit facility is questionable and the prospect of a loss is high, but the exact amount remains undeterminable as yet. Consumer loans past due for 120 days or more, but less than 180 days fall under this classification.

(e) **Loss:** this indicates that the outstanding credit facility is not collectable, and little or nothing can be done to recover the outstanding amount from any collateral or from the assets of the borrower generally. Consumer loans past due for 180 days or more fall under this classification.

4.3 Based on repayment conduct, a bank shall, at the minimum, classify every credit facility:

(a) where the principal or interest or both is past due for more than 90 days;

(b) in the case of a revolving credit facility (such as an overdraft), where the outstanding amount, including interest, has remained in excess of the approved limit for a period of more than 90 days; or

(c) where the amount is past due or the outstanding amount has been in excess of the approved limit for 90 days or less, if the credit facility exhibits weaknesses that render a classification appropriate according to the credit grading framework.

4.4 For credit facilities with repayments on a quarterly, semi-annual or longer basis, a bank shall classify such a credit facility as soon as a default occurs, unless the credit facility does not exhibit any weakness that would render it classified according to the credit grading framework set out in paragraph 4.2.

4.5 A credit facility is restructured when a bank grants concessions to a borrower because of a deterioration in the financial position of the borrower or the inability of the borrower to meet the original repayment schedule. The revised repayment terms relating to the interest or repayment period, are normally considered as non-commercial by a bank. A bank shall place a restructured credit facility on the appropriate classified grade depending on its' assessment of the financial condition of the borrower and the ability of the borrower to repay based on the restructured terms.

4.6 For any credit facility which has been classified according to the requirements set out in paragraph 4.2 ("classified credit facilities"), a bank may use split credit grades only if certain portions of a facility are likely to be recoverable from the realisation of collateral. If the amount recoverable is considered insufficient to cover the entire amount outstanding, the portion of the credit facility covered by the amount realisable shall be graded "substandard" and the remaining portion shall be graded "doubtful" or "loss", where appropriate.

4.7 Every bank in Singapore is encouraged to use internal credit rating systems to categorise its credit facilities. Such internal ratings should be an integral part of the credit risk management framework of the bank for assessing, monitoring and controlling the quality structure of the loan portfolios. Independent validation of the rating systems should also be performed to ascertain the accuracy and reliability of these systems in measuring the quality of the bank's loan portfolios. For the purpose of reporting to the Authority, the internal ratings from these systems shall be mapped to the 5 credit grades listed in paragraph 4.2.

5 Upgrading of Credit Facilities

5.1 Upgrading of any credit facility shall be supported by a credit assessment of repayment capability, cash flows and financial position of the borrower in line with the credit grading framework set out in paragraph 4.2. A bank shall exercise prudence in the upgrading of any credit facility and be satisfied that the credit facility that it intends to upgrade has exhibited a sustained trend of improvement to justify the improved credit grading.

5.2 A bank may restore a classified credit facility to unclassified status only when:

(a) the bank has received repayment of the past due principal and interest and the bank expects repayment of the remaining principal and interest in accordance with the terms of the credit facility; or

(b) in the case of a restructured credit facility, there are reasonable grounds for the bank to conclude that the borrower will be able to service all future principal and interest payments on the credit facility in accordance with the restructured terms.

A restructured credit facility shall, at the minimum, remain classified unless the borrower has complied fully with the restructured terms and has serviced all principal and interest payments continuously for either a period of 6 months, in the case of credit facilities with monthly repayments, or a period of 1 year, in the case of a credit facility with quarterly or semi-annual repayments. For a restructured credit facility with repayments of principal and interest on an annual or longer basis, a bank shall only upgrade that credit facility if the borrower has complied fully with the restructured terms and demonstrated the ability to repay after the end of one repayment period.

A restructured credit facility in respect of which a debt moratorium is given shall remain classified unless the same conditions required to upgrade a restructured credit facility with no debt moratorium set out in the paragraph above (save that the conditions apply only after the end of the period of the moratorium) are satisfied.

6 Requirements for Individual and Collective Impairment Provisions

6.1 Purpose and Background

6.1.1 This section of the Notice addresses provisioning requirements for loan impairment. Under Financial Reporting Standard ("FRS") 39 on Recognition and Measurement of Financial Instruments, a bank shall recognise an impairment loss by reducing the carrying amount of each loan or groups of similar loans that has been assessed by the bank to be impaired. The impairment loss for any individual loan or groups of similar loans is measured as the difference between the carrying amount of the loan or groups of similar loans and the present value of the estimated future cash flows that the bank would be able to recover on the loan or groups of similar loans.

6.1.2 As the identification of impairment losses inherent in each loan or groups of similar loans and the making of appropriate individual or collective impairment provisions to cover such losses is critical to the safety and soundness of a bank, this section of the Notice sets out the requirements that all banks shall adhere to in their credit review processes and the basis for establishing appropriate individual or collective impairment provisions in conjunction with the impairment and provisioning requirements under FRS 39.

6.1.3 In conducting its credit review, a bank shall assess all the loans in its portfolio to ascertain the degree of impairment inherent in each loan that points to a reduced ability or an inability of the bank to collect all contractual interest or principal payments due on that loan. A bank shall include in its assessment all loans, including those that have been graded as "pass" or "special mention", to ensure that any adverse developments that may affect such loans are duly taken into account.

6.1.4 A bank shall conduct the assessment on a loan-by-loan basis except for homogeneous loans below a certain materiality threshold (e.g. housing loans, consumer loans, credit card receivables) where such loans may be pooled together with all other loans that have not been considered or provided for on an individual basis (e.g., "pass" and "special mention" loans) according to their risk characteristics, and assessed and provided for collectively as a group[1]

[1] The assessment and provisioning on a group basis is a common industry practice.

according to the degree of impairment, taking into account the historical loss experience on such loans.

6.1.5 A bank shall be circumspect and prudent, and maintain a level of impairment provisions that is sufficient to absorb all credit losses inherent in its entire loan portfolio. In particular, the bank shall ensure that the provisions contain an amount that is adequate to cover losses that may already exist but have not been identified or attributed to specific loans or groups of loans in the portfolio. This is important as a normal credit review process usually covers the assessment of all loans over a 12-month or longer timeframe such that a loan assessment may not necessarily identify a credit event on a loan that occurs after the review is completed but before the date to which the financial statements are made up. A bank shall establish a level of impairment provisions that is sufficiently prudent to reflect the best estimate of the bank of all the inherent losses in its loan portfolio.

6.2 Specific Provisions for Individual Loans (also known as "Individual Impairment Provisions")

6.2.1 A bank that adopts the impaired loan measurement basis specified in FRS 39 shall have in place:

(a) a systematic, comprehensive and consistently applied process to identify on a timely basis, all loans that are impaired (please refer to the requirement in paragraph 6.3.1(a) that also applies to a bank that adopts the impaired loan measurement basis specified in FRS 39 for determining the appropriate level of collective impairment provisions required on groups of similar loans); and

(b) sound loan loss estimation methodologies that will yield timely and <u>prudent</u> estimates of the amount of impairment provision required for each loan that is assessed by the bank to be impaired.

6.2.2 For practical reasons, a bank may establish a certain materiality threshold for loans to be subject to an individual assessment, in order to identify the degree to which the loan is considered to be impaired. Where such a threshold is used, a bank shall clearly establish, as part of its systematic credit review process, the size of the loan that will warrant an individual assessment such that loans whose individual values fal below the threshold may be grouped based on similar loan characteristics, in order to ensure that all loans are subject to an impairment review either on an individual or group basis.

6.2.3 Subject to the requirements set out in paragraph 6.2.1, a bank may use its own internal rating system to ascertain the degree of impairment for each loan where the rating of the loan reflects the best judgement of the bank about the level of default and the loss associated with the loan.

6.2.4 A bank shall make provisions on a loan when existing facts, conditions or valuations indicate that the bank is not likely to collect some or all of the principal and interest due contractually on the loan from the borrower.

6.2.5 A bank shall ensure that any provision for individually assessed loans is based on a reasonable and well-documented estimate of the net present value of the future cash flows that the bank determines will be recoverable from the borrower based on the historical loss experience of the bank for similar loans. Any decision by the bank to deviate from an estimate that is based on the historical loss experience of the bank shall be supported by assessments of the nature of the collateral or other circumstances that distinguish the loan from similarly rated loans.

6.2.6 In cases where there is limited historical loss experience or where such loan loss data is no longer relevant to the current circumstances, a bank shall draw on its experience and exercise its expert judgement to derive a best estimate of the future cash flows that it expects to recover on that loan.

6.3 Collective Impairment Provisions for Groups of Similar Loans (also known as "General Provisions")

6.3.1 In adopting the impaired loan measurement basis specified in FRS 39 for determining the appropriate level of collective impairment provisions required on groups of similar loans, a bank shall have in place:

(a) a systematic, comprehensive and consistently applied process to identify on a timely basis a group of similar loans that is impaired, and

(b) sound loan loss estimation methodologies that will yield timely and <u>prudent</u> estimates of the amount of collective impairment provision required for each group of similar loans assessed to be impaired.

(A) <u>Systematic process to identify loan impairment on a timely basis</u>

6.3.2 In developing a sufficiently robust process to identify loans or groups of loans that have become impaired and the degree of impairment, a bank shall institute and maintain an effective credit review system and controls that identify, monitor, and manage asset quality problems in an accurate, systematic and timely manner.

6.3.3 As part of the credit review process, a bank shall have in place a mechanism to establish and regularly assess the adequacy of the level of provisions required to absorb all estimated losses inherent in its loan portfolio, taking into account all factors that would point to a reduced ability by the bank to collect any of the principal or interest that are due from the borrowers.

Factors to consider in identifying when a loan or a group of similar loans is impaired and the extent of impairment

6.3.3.1 In assessing whether objective evidence of impairment exists for a loan or a group of similar loans, an effective credit review system should examine not just common default indicators such as delinquency but consider all indicators (both internal and external factors) that may point to a bank's reduced ability or inability to collect all interest or principal payments that are contractually due from the borrower or group of borrowers. Such events or factors should not be restricted to an event of default. Instead, they should include the following:

(a) deterioration in the payment status of a borrower or group of borrowers (e.g. increased number of credit card borrowers who have reached their credit limits and are servicing only the minimum monthly payments; loans that are placed under workout programs or have been restructured);

(b) local economic conditions or indicators that correlate with defaults in the group of credits, such as an increase in unemployment rates, a decrease in property prices, an increase in bankruptcies or other industry indicators that would affect the ability of borrowers in a particular industry to repay. For example, a bank may find that a decline in occupancy rates is a good indicator of estimated losses on commercial real estate loans and has documented the relationship between occupancy rates and its loss experience. A decline in commercial building occupancy rates beyond a certain threshold can therefore be considered as an event that affects the collectibility of such loans;

(c) any information about significant changes that would have an adverse impact on the technological, economic, market or legal environment in which the borrower or group of borrowers operate;

(d) adverse country risk indicators that have an impact on the borrower or group of borrowers (e.g. imposition of exchange controls, significant downgrade in the rating of a sovereign, deterioration in the balance of payments position of a country, substantial decline in the level of foreign reserves in the country, deterioration in the established payment performance of a country and its future debt servicing prospects, unstable socio-political situation in the country and uncertainty in the adoption or implementation of economic reforms, in particular those affecting debt servicing capacity, deterioration in the relationship of the country with its creditors and any recent adverse country evaluations performed by recognised external credit rating agencies).

(B) <u>Sound loan loss estimation methodologies to establish collective</u> impairment provisions for a group of similar loans

6.3.4 For the purpose of determining an appropriate level of collective impairment provisions, a bank shall segment its loan portfolios into as many groups as practical based on common characteristics, such as risk classification, past due status, loan types, industry types or collateral.

6.3.5 For each group of similar loans, the historical rate of net losses[2] provides a starting point for a bank's analysis. Such historical loss rate on each group of similar loans is not, by itself, an adequate basis for determining an appropriate level of collective impairment provisions unless it has been adjusted to reflect current trends and conditions.

Adjusting historical loss experience

6.3.5.1 The factors that a bank shall consider in adjusting the historical loss rates include the following:

(a) the levels of and trends in, delinquencies and classified loans;
(b) the levels of and trends in, charge-offs and recoveries;
(c) the existence and effects of any concentrations of credit, and changes in the level of such credit concentrations;

[2] Net losses are losses that are attributable to the year in which the loss event occurred.

(d) changes in the volume of troubled debt restructurings and other loan modifications;
(e) national and local economic trends and conditions;
(f) the experience and ability of the management of the bank and other relevant staff involved in managing credit risks;
(g) the effects of any changes in risk selection, lending or underwriting standards, or other lending policies, procedures or practices;
(h) the effects of external factors such as competition and legal requirements on the level of estimated credit losses in the bank's current portfolo.

Loan loss methodologies for analysing groups of similar loans

6.3.6 No single approach or loan loss methodology has been determined to be the best or most appropriate for use by all banks. A bank should use the methodology that is commensurate with the nature and complexities of its lending business as well as the capabilities of its information systems. Commonly accepted methodologies range from a simple average of the historical loss experience of a bank over a period of years or credit cycle, to more complex "migration" analysis techniques.

6.3.7 A bank shall exercise its expert judgement to determine what would be an acceptable period that will yield sensible historical loss rates. A bank should not restrict itself to the use of a fixed time period to determine the average historical loss experience for any group of loans. For example, during a period of economic stability, it may be appropriate to use a relatively longer period of historical loss experience (e.g. 5 to 10 years), whereas during a period of significant economic volatility, using a shorter period of historical loss experience may be more appropriate.

Historical loan loss data requirement

6.3.8 To meet the requirements in paragraph 6.3.1(b), a bank shall maintain sufficient historical loan loss data over a full credit cycle to provide a robust and meaningful statistical loan loss estimate in establishing the level of collective impairment provisions required for each group of similar loans.

6.4 Transitional arrangement for banks adopting the impaired loan measurement basis specified in FRS 39 on 1 January 2005

6.4.1 As a transitional arrangement, where a bank that adopts the impaired loan measurement basis specified in FRS 39 from 1 January 2005 does not have a loss estimation process that is sufficiently robust or sufficient quality historical loan loss data, over a full credit cycle, that is relevant to current circumstances, it shall remain circumspect and prudent by drawing on its own credit experiences and exercise its own expert judgment to ensure that the level of collective impairment provisions is sufficient to cover all the estimated losses inherent (but not currently identifiable in each individual loan) in each group of similar loans.

6.4.2 For the purposes of paragraph 6.4.1, a bank which does not have a loss estimation process that is sufficiently robust or sufficient quality historical loan loss data, over a full credit cycle, that is relevant to current circumstances shall maintain a level of collective impairment provisions that is not less than 1% of the loans and receivables[3] net of collaterals and after deducting any individual impairment provisions that have been made.

6.5 Default Minimum Provisioning Requirements

Specific Provisions for Individual Loans (also known as "Individual Impairment Provisions")

6.5.1 Any bank that is temporarily exempted by the Accounting & Corporate Regulatory Authority ("ACRA") from complying with the requirements in FRS 39 on 1 January 2005 shall, for the period of the exemption, maintain individual impairment provisions of not less than 10%, 50% and 100% for loans graded "substandard", "doubtful" and "loss", respectively, on the portion not covered by amounts realisable from collateral.

6.5.2 Any bank that does not meet the requirements set out in paragraphs 6.2.1 to 6.2.6, shall maintain individual impairment provisions of not less than 10%, 50% and 100% for loans graded "substandard", "doubtful" and "loss", respectively, on the portion not covered by amounts realisable from collateral.

Collective Impairment Provisions for Groups of Similar Loans (also known as "General Provisions")

6.5.3 Any bank that is given temporary exemption by ACRA from complying with the requirements in FRS 39 on 1 January 2005:

(a) shall, for the period of the exemption, maintain collective impairment provisions of not less than 1% of the loans and receivables net of collaterals and after deducting any individual impairment provisions that have been made; and

(b) should consider its historical loan loss data or other relevant information and exercise its expert judgment in determining if

[3] Loans and receivables include debt securities held and off-balance sheet exposures as determined by the bank's credit measurement framework and expert judgment.

higher collective provisions, over and above the minimum requirements, are warranted.

6.6 Banks incorporated outside Singapore

6.6.1 Notwithstanding paragraphs 6.3, 6.4 and 6.5.3, in the case of a bank incorporated outside Singapore, the collective impairment provisions to cover all the estimated losses inherent (but not currently identifiable in each individual loan) in groups of similar loans that are booked in Singapore may be determined and carried at the head office. Where such collective impairment provisions are determined and carried at the head office, the bank incorporated outside Singapore shall submit to the Authority, on a semi-annual basis, a report indicating the level of collective impairment provisions maintained at head office to cover the estimated losses inherent in groups of similar loans that are booked in Singapore.

7 Commencement Date of Notice

7.1 This Notice shall take effect on 14 March 2005.

7.2 MAS Notice 612 dated 30 December 2004 is cancelled with effect from 14 March 2005.

INFORMATION TO BE MAINTAINED IN CREDIT FILE

(I) INFORMATION ON BORROWER

(a) Natural Persons – Occupation, Employer, Salary/Income, Financial position/net worth and any other relevant information.

(b) Others – Constitution (proprietorship, partnership, private company, public company, society, club, co-operative, statutory board), Business background and history, Organisation structure, Management team/Directors, Shareholders/proprietor/partners, Financial position and performance, and any other relevant information.

(II) INFORMATION ON CREDIT FACILITY

(a) Description of facility type
(b) Purpose of facility
(c) Terms of facility – limits, interest rates, repayment schedules, expiry dates
(d) Collateral – types, valuation amount, valuation date and where applicable, name of the valuer
(e) Guarantors – names, financial position and net worth

(III) INFORMATION FOR APPRAISAL OF CREDIT APPLICATION

(Certain information would not be applicable for borrowers who are natural persons.)

(a) Assessment and recommendations of account officer/manager
(b) Approval and basis of approval by management/credit committee
(c) Qualitative analyses based on:
  (i) Borrower Information
  (ii) History of relationship with customer
  (iii) Information on the banking relationship of other related groups of the borrower with the bank
  (iv) Information obtained on the borrower from other institutions and sources, including related offices of the bank

(v) Analysis of industry and business risk
(vi) Single customer concentration (if appropriate)

(d) Quantitative analyses based on:
  (i) Financial position and performance (previous, current and projected)
  (ii) Business plans, sources and cash flow forecast for meeting repayment requirements

(e) Capital resources

(f) Other commitments

(g) Collateral appraisal and value

(IV) INFORMATION FOR PERIODIC CREDIT REVIEW

(Certain information would not be applicable for borrowers who are natural persons.)

(a) Assessment and recommendations of credit review officer, including:
  (i) Credit grading/rating accorded
  (ii) Provision for losses
  (iii) Suspension of interest

(b) Approval and basis of approval for renewals; revision in terms and conditions; and changes in credit grading

(c) Latest available information on:-
  (i) Outstanding facilities utilised, including contingent liabilities, commitments and other off-balance sheet transactions
  (ii) Conduct and servicing of a ccount
  (iii) Correspondences and call reports from meetings with borrowers and site visits
  (iv) Current qualitative analyses based on latest updated information on borrower, including review comments from internal and external auditors where available

(d) Current quantitative analyses based on latest updated financial information, appraisals and valuations

(e) Information on the account conduct of other related groups of the borrower

(f) Analysis of industry and business risk

Guidance Notes:

1 For the purpose of paragraph 4.2, banks should assess whether the problems faced by borrowers in any particular industry are in the nature of temporary or seasonal cash -flow difficulties or represent a broader deterioration in their financial condition. A bank should classify any loan that exhibits any definable weakness which may jeopardize repayment on existing credit terms. Classification serves to signal that the loan should be carefully monitored, and that the bank should set aside a provision to buffer against the possibility that the loan may not be repaid.

2 The requirements for individual and collective impairment provisions stated in paragraph 6 of the Notice are also applicable to contingent and off-balance sheet items. The rule that a bank should use to determine the specific provision to make for a product or instrument is the amount which the bank could stand to lose should its borrower default, i.e. the replacement cost of asset.

3 For syndicated loans, each participating bank has the responsibility to maintain credit information on the borrower, and to grade and make provision for its portion of the syndicated loan in accordance with the requirements of this Notice. The lead manager has the responsibility to provide any participating financial institution with the credit information on the borrower upon request by the participating financial institution. Where information has come to the attention of a participating bank that the lead manager or any other participating financial institution has classified the loan, the participating bank should likewise classify the loan.