



South African Reserve Bank
From the Office of
the Registrar of Banks

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To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Directive 7/2015 issued in terms of section 6(6) of the Banks Act 94 of 1990

Restructured credit exposures

Executive summary

It has come to the attention of this Office that banks treat restructured credit exposures differently, which creates uneven playing fields for banks conducting business in South Africa. In order to ensure that banks determine their regulatory capital requirements with regard to restructured credit exposures correctly and to improve the reporting of such exposures, this directive specifies requirements relating to the identification of restructured credit exposures and how such exposures should be treated for the purposes of the definition of default as well as various other matters relating to reporting.

This directive replaces Directive 9/2014 dated 1 December 2014.

1. Purpose

- 1.1 The definition of default as defined in regulation 67 of the Regulations relating to Banks (the Regulations) includes the distressed restructuring of a credit obligation, which restructuring is likely to result in a reduced financial obligation.
- 1.2 In order to gain a better understanding of the South African banking sector's practices with regard to restructured credit exposures, this Office issued a questionnaire relating to restructured credit exposures to all banks in February 2013.
- 1.3 From the responses received from participating banks and following further discussions held between this Office and the banks at various meetings throughout the year, it has become apparent that banks treat restructured credit exposures differently, especially with regard to the definition of default in the case of the banks that adopted the internal ratings-based (IRB) approach (hereafter referred to as IRB banks) to calculate their exposure to credit risk.

- 1.4 The purpose of this directive therefore is firstly to provide clarity on how banks should identify restructured credit exposures and secondly how to treat them for purposes of the definition of default. Furthermore, the directive addresses reporting of restructured credit exposures as well as the rehabilitation of non-performing loans using restructuring.
- 1.5 The directive should result in greater comparability of data and promote the correct application of the definition of default for purposes of regulatory capital calculation.
- 1.6 It should be noted that the contents of this directive does not remove or alter any of the provisions on restructured credit exposures currently contained in the Regulations. It is only intended to provide further direction and clarification on interpretive issues relating to restructured credit exposures.

2. Definition of a restructured credit exposure

- 2.1 A key element of the definition of a restructured credit exposure contained in regulation 67 of the Regulations is the question of financial distress. The following paragraphs provide direction on what factors banks should take into account when determining whether the restructure was performed due to the financial distress of the obligor. Such a restructure will, for the purposes of this directive, be referred to as a 'distressed restructure'.
- 2.2 In all cases, if the loan is in arrears¹ (excluding technical arrears²) at the time of the restructure, the restructure should be regarded as a distressed restructure.
- 2.3 If a loan has been in arrears at any point during the past six months prior to the restructure, the restructure should be regarded as a distressed restructure.
- 2.4 Where the loan is not in arrears at the time of the restructure and the terms and conditions were changed in order to prevent the obligor from going into arrears, this should also be regarded as an indication of financial distress of the obligor and the restructure should be classified as a distressed restructure.
- 2.5 In order to determine whether the terms and conditions were changed for the purposes of preventing the obligor from going into arrears, paragraphs 2.6 to 2.12 should be considered.

Wholesale credit exposures³

- 2.6 For wholesale exposures, the decision to classify a restructure as distressed should be made on a loan-by-loan basis, taking into account the information available to the bank. Evidence in support of the decision should be retained.

¹ 'In arrears' for purposes of this directive will mean a payment or portion of a payment is one day past the contractual due date.

² 'Technical arrears' for purposes of this directive will mean any account that is classified as being "in arrears" because of technical reasons such as operational errors or the bank's information technology system not updating the relevant information on time.

³ Wholesale credit exposures include all asset classes under the Basel Accord with the exception of the retail asset class.

- 2.7 Indicators of financial distress (other than the arrears status of a loan or advance) include, but are not limited to:
- 2.7.1 bankruptcy or application for bankruptcy by the obligor;
 - 2.7.2 application for business rescue⁴ by the obligor;
 - 2.7.3 analysis of the information available indicates that the cash flows will be insufficient to service the existing agreement; and
 - 2.7.4 any other information that comes to the banks attention that indicates that the obligor is experiencing financial difficulty.

Retail credit exposures:

- 2.8 The same provisions as for wholesale credit exposures (paragraphs 2.6 and 2.7 above) will be applicable to retail portfolios. However, instead of the business rescue referred to in 2.7.2 above, the application by a retail obligor for debt counselling⁵ would be considered a sign of financial distress.
- 2.9 In the retail book, banks' systems should be sufficiently granular to ensure that restructures of a similar nature, that is, those which are indicative of financial distress and those which are not, can be separated accurately.
- 2.10 Sufficient policy documentation should be in place to support the criteria which are used in the classification referred to in paragraph 2.9. above. These criteria must be in line with the requirements of this directive.

Exclusions:

- 2.11 Unless the loan is in arrears, the following will not in itself be considered as distressed restructures, even if they appear in the retail portfolio:
- 2.11.1 change in payment frequency;
 - 2.11.2 change in pay date; or
 - 2.11.3 reduction of term with a commensurate increase in the agreed instalment.
- 2.12 Where an arrears loan remains on the books of the bank after the original maturity and the bank continues to collect outstanding amounts this will not be considered a restructure and should not be reported as such. The loan should be classified as non-performing in line with the bank's credit and write-off policy.

3. Reporting

- 3.1 Once financial distress of the obligor has been established and the remaining requirements of the definition of a restructured credit exposure have been met, the exposure must be reported as having been restructured in columns 1 to 3 of the form BA 210 (lines 22 to 42 for banks on the standardised approach (STA banks) or lines 257 to 284 for IRB banks).
- 3.2 Whereas column 1 and 2 relate to restructures within the reporting quarter only, column 3 requires cumulative figures.

⁴ As provided for under the Companies Act, 2008 (Act No. 71 of 2008).

⁵ As provided for under the National Credit Act, 2005 (Act No. 34 of 2005).

3.3 The percentage to be reported in column 3, (Restructured credit exposure as percentage of asset class exposure), should be calculated by dividing the outstanding balances at the end of the reporting quarter for all exposures which had been restructured during the past 12 months and which are still included on the balance sheet of the bank by the total amount of the asset class at the end of the reporting quarter.

4. Derecognition of restructured credit exposures.

4.1 Banks shall not derecognise credit exposures upon restructure and subsequently recognise a new loan based on the new terms and conditions unless the requirements of IAS 39 with regard to derecognition of financial assets are complied with.

5. IRB approach

Definition of default:

5.1 The definition of default in regulation 67 of the Regulations includes a distressed restructuring of a credit obligation, which restructuring is likely to result in a reduced financial obligation.

5.2 In terms of International Accounting Standard (IAS) 39 paragraph 59(c), when the lender for economic or legal reasons relating to the borrower's financial difficulty, has granted to the borrower a concession that the lender would not otherwise have considered, and this concession has an impact on the estimated future cash flows of the asset or group of assets, this constitutes a loss event.

5.3 This Office therefore considers a distressed restructure, as defined in section 2 above, to be objective evidence of impairment as per IAS 39 paragraph 59(c).

5.4 Such exposures should be assessed for impairment at the time of the restructure and at appropriate intervals thereafter as per the requirements of IAS 39.

5.5 Where, subsequent to the impairment test, a specific impairment is raised against the exposure/portfolio or where there is any other reduction of the financial obligation, this should be regarded as a reduced financial obligation and the exposure/ portfolio shall consequently be classified as 'in default' and assigned a probability of default (PD) of 100 per cent for capital purposes as well as the appropriate loss given default (LGD).

5.6 No restructured credit exposure (as defined under section 2 above, that is, a distressed restructure) may be classified as not 'in default' unless it has been specifically assessed for impairment under IAS 39, either individually or on a portfolio basis.

5.7 Documentation of the impairment methodology and evidence of testing of restructured credit exposures for impairment shall be maintained by banks.

5.8 Where a bank is currently applying a more stringent policy for example by classifying all restructured exposures as in default, whether or not an impairment loss has been recognised, such treatment is acceptable for purposes of the calculation of the bank's required capital and reserve funds.

- 5.9 A restructured credit exposure which has been classified as in default should remain in default for as long as a specific impairment is raised against the exposure.
- 5.10 It should be noted that this directive is only intended to emphasise the requirements of IAS 39 with regard to impairment and not to contradict them in any way.

Rehabilitation/curing of non-performing loans through restructure:

- 5.11 Loans which are restructured should not be reclassified as performing until such time as the obligor's ability to meet the requirements of the revised terms and conditions has been established.
- 5.12 For this purpose, a minimum observation period of six months after restructure is required by this Office during which the obligor must comply with the revised terms and conditions, before the exposure can be reclassified as performing.
- 5.13 In most cases the requirement of paragraph 5.12 above will equate to six full consecutive monthly payments under the revised terms and conditions.
- 5.14 In the case of wholesale clients and clients with quarterly or longer dated repayment terms, the classification of a loan into a performing category from the non-performing category may be made subsequent to an evaluation by the bank's relevant credit or risk committee, which evaluation may take into account qualitative factors in addition to compliance with the revised payment terms and conditions of the agreement. Qualitative factors include compliance with loan covenants and compliance with other existing loan obligations.
- 5.15 In no case may a restructured credit exposure be reclassified as performing within six months after the restructure.
- 5.16 In addition, the bank should be able to demonstrate to the satisfaction of the Registrar of Banks that the revised terms and conditions of the loan will result in the amortisation of the principal loan amount over the remaining term of the loan. The amortisation of the loan shall be sufficiently documented.

6. Standardised approach

- 6.1 For reporting purposes, distressed restructures should be determined as for IRB banks (as specified in section 2 of this directive) and should as a minimum be classified as special mention for purposes of regulation 24(5)(c) of the Regulations.
- 6.2 Distressed restructures should also be assessed for impairment as described in section 5 above.
- 6.3 In order to determine whether a restructured credit exposure has rehabilitated sufficiently to be reclassified as performing, paragraphs 5.11 to 5.16 above should also be applied.

7. In writing

- 7.1 Paragraph (b)(iv) of the definition of a restructured credit exposure contained in regulation 67 of the Regulations requires that the modification of terms and conditions shall be made in writing. For this purpose, 'In writing' shall include:
- 7.1.1 paper-based or electronic documentation of the revised terms and conditions, signed physically or electronically by both parties;
 - 7.1.2 verbally agreed changes to the original terms and conditions, which are digitally recorded; and
 - 7.1.3 electronic communication of the revised terms and conditions to the client, (for example by electronic mail (e-mail) or short message service (SMS)).
- 7.2 This Office regards it as essential that the legal position of the bank is protected when the terms and conditions of an agreement are changed. It follows that where there is uncertainty regarding the legal enforceability of a particular method of communication, the bank should obtain a legal opinion to that effect.
- 7.3 When a bank decides not to formalise the concession or revised terms and conditions in writing as specified by this directive, footnote 1 to lines 22 to 42 (for STA banks) and lines 257 to 284 (for IRB banks) of the form BA 210 states that the relevant exposure or facility shall be regarded as impaired.

8. Acknowledgement of receipt

- 8.1 Two additional copies of this directive are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.



René van Wyk
Registrar of Banks

The previous directive issued was Directive 6/2015, dated 9 April 2015.