BANGKO SENTRAL NG PILIPINAS

MEMORANDUM NO. M-[2021]-056

OFFICE OF THE DEPUTY GOVERNOR

To : **ALL BSP-Supervised Financial Institutions (BSFIs)**

Subject : **Regulatory Treatment of Restructured Loans for Purposes of Measuring Expected Credit Losses**

The Monetary Board (MB), in its Resolution No. 1401 dated 14 October 2021, approved the attached guidelines on the Regulatory Treatment of Restructured Loans for Purposes of Measuring Expected Credit Losses (ECL) amid the pandemic.

BSFIs are expected to take a more flexible and systematic approach in modifying terms and conditions of loan agreements of borrowers significantly affected by the pandemic. Loan modification should be targeted at providing sustainable support measures to creditworthy borrowers experiencing financial difficulty to help promote overall loan quality and contribute to broader economic recovery. In this respect, BSFIs should establish prudent criteria in assessing and modifying the loan terms and conditions.

The classification of modified loans under Stage 1, 2, or 3 for purposes of determining the ECL shall be based on the assessment of the extent of financial difficulty of the borrowers and their ability to fully pay the loan based on the revised terms.

The guidelines on the regulatory treatment of restructured loans for purposes of measuring expected credit losses shall be effective until 31 December 2022.

For information and guidance.

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CHUCHI G. FONACIER
Deputy Governor

21 October 2021

Regulatory Treatment of Restructured Loans for Purposes of Measuring Expected Credit Losses Amid the Pandemic

The continuing uncertainty in the economic environment because of the COVID-19 health crisis has adversely affected the income, cashflows, and financial position of households and businesses. In this respect, the BSP expects its supervised financial institutions (BSFIs) to grant relief measures to their borrowers to reduce their debt burden and ultimately contribute to economic recovery. These relief measures include, among others, modifying the terms and conditions of the loan agreements to reflect the change in the borrowers' projected cash flows and improve the probability of full collection.

The BSP is issuing this Memorandum to provide guidance on the regulatory treatment of loans with terms and conditions that have been modified due to the impact of the pandemic, especially consumption loans[1], for purposes of measuring expected credit losses (ECL) and classifying the accounts as non-performing.

Section 1. Assessment of Significant Increase in Credit Risk

BSFIs have modified or changed the original terms and conditions of the loan agreements in response to the application of the mandatory grace period under the Bayanihan to Heal as One Act and the Bayanihan to Recover as One Act, and to grant relief to their borrowers who have been affected by the pandemic. The modifications in the terms and conditions of the loan agreement include repayment deferrals or holidays, extension of loan terms, changes in the principal and or interest payments, interest rates, fees, charges, or collaterals, among others.

a. Modifying contractual terms of the loans

BSFIs are expected to take a more flexible and systematic approach in modifying terms and conditions of loan agreements with borrowers significantly affected by the pandemic. Loan modification should be targeted at providing sustainable support measures to creditworthy borrowers experiencing financial difficulty to help promote overall loan quality and contribute to broader economic recovery. In this respect, BSFIs should establish prudent criteria in assessing and modifying the loan terms and conditions. BSFIs should also monitor the changes of the risk of default of the concerned borrowers at both the portfolio and individual levels as new information emerges, as well as evaluate the effectiveness of the relief measure extended.

[1] Section 2 (b) of the Memorandum No. 2020-61 dated 3 August 2020 on the Supervisory Expectations on the Measurement of ECL and the Treatment of Regulatory Relief Measures Granted Amid COVID-19 Pandemic.

b. Classifying modified loans into stages to determine ECL

Modified loans may be classified under Stage 1, 2, or 3 for purposes of determining the ECL. The classification shall be based on the assessment of the extent of financial difficulty of the borrowers and their ability to fully pay the loan based on the revised terms.

- Grant of payment deferral or extension of the term of the loan shall: (i) not automatically be considered an indicator of significant increase in credit risk, hence should not result in the loan automatically being classified under Stage 2 or 3, and (ii) not warrant the classification of the account as a "restructured loan": *Provided*, That prior to the grant of payment deferral or extension of the term of the loan, the borrower has continuously paid the account on schedule and the borrower exhibits the capacity to repay the loan under the modified terms.

- Other forms of modification of the terms and conditions of the loan **in view of the financial difficulty of the borrower**, shall warrant the classification of the account as either under Stage 2 or 3, depending on the severity of the financial difficulty of the borrower. These accounts shall be reported as restructured in the prudential reports.

Section 2. Treatment of Restructured Loans

Loans that have been restructured to support borrowers that are experiencing financial difficulties due to the pandemic should not automatically be considered as credit-impaired[2] that will warrant the classification of the accounts as non-performing[3]. BSFIs are expected to holistically assess the borrower's repayment capacity, revised cash flows, and financial position.

BSFIs that have established that the borrowers' financial difficulty is temporary or whose paying capacity can reasonably be expected to return to levels allowing full payment once COVID-19 restrictions are lifted and that said borrowers are expected to fully pay the loan under the modified terms, shall classify the restructured loan accounts under Stage 2 for purposes of determining ECL: *Provided*, That the restructured loan accounts are not more than 90 days past due on principal and or interest payments. Stage 2 restructured loans shall be reported as restructured-performing in the prudential reports. The transfer of

[2] As defined under PFRS 9, a financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit impaired include observable data, which include among others, significant financial difficulty of the issuer or the borrowers; the lender(s) of the borrower, for economic or contractual reason relating to the borrower's financial difficulty, having granted to the borrower a concession(s), etc.

[3] Under Section 304 of the Manual of Regulations for Banks.

restructured loans from Stage 2 to Stage 1 shall follow the six (6)-month observation period[4].

Restructured loans that are classified under Stage 2 shall be considered as credit-impaired (Stage 3) if there is evidence that full repayment of the loan under the modified terms is unlikely without foreclosure of collateral, if any; or if any principal and/or interest are unpaid for more than ninety (90) days from contractual due date under the terms of the restructured loan. All credit-impaired restructured loans shall be reported as non-performing in the prudential reports.

BSFIs should establish sound criteria in assessing the borrower's repayment capacity, and institute appropriate controls to ensure that the assessment is consistently applied across all borrowers.

In cases when the modification of the terms of the loan would involve capitalization of interest, the resulting amount should not be more than the original principal amount of the loan.

Section 3. Regulatory Reporting

BSFIs shall maintain an updated record of all borrowers whose loans have been modified due to the COVID-19 pandemic, including risk classification, staging, and provisioning, to closely monitor, manage, and report the changes in the risk of default of these loans at both the portfolio and individual levels.

BSFIs shall report the level of restructured loans based on the provisions of this issuance in the Financial Reporting Package beginning the immediately succeeding reporting period after the issuance of this Memorandum. The BSP shall issue separate guidelines on the submission of a supplemental report that captures the details of these restructured accounts.

Section 4. Effectivity

The guidelines on the regulatory treatment of restructured loans for purposes of measuring expected credit losses shall be effective until 31 December 2022.

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[4] Under Appendix 100/N-16 of the MORB/MORNBFI – Guidelines on the Adoption of PFRS 9 – Financial Instruments-Impairment