

Basel Committee on Banking Supervision

Bank for International Settlements

CH-4002 Basel, Switzerland

July 12, 2016

**Re: BCBS Consultation on Prudential treatment of problem
assets – definitions of non-performing exposures and forbearances**

Dear Sir/Madam,

China Banking Association (“CBA”) appreciates the opportunity to comment on the Basel Committee on Banking Supervision Consultative Document: **Prudential treatment of problem assets – definitions of non-performing exposures and forbearance** dated April 2016.

China Banking Association (CBA) is a nationwide non-profit self-discipline organization of China’s banking sector. CBA serves for the common interest of its members through the functions of self-discipline, rights protection, coordination and service so as to

safeguard lawful rights and maintain market order of the banking sector, and promote the healthy and sustainable development of the industry. By April 2016, CBA has 585 members and 4 observers.

We sincerely appreciate the great endeavors you have made on the Consultative Document: **Prudential treatment of problem assets – definitions of non-performing exposures and forbearance**, as well as the opportunities you have provided to solicit the industry's comments on it.

On this important topic, we therefore have solicited our member banks' main comments as below for your reference, which we hope can be helpful. And we sincerely appreciate the great endeavors you have made in the global financial regulatory reforms.

Yours sincerely,

A handwritten signature in black ink, reading "Yang Zaiping". The signature is written in a cursive, flowing style with some loops and flourishes.

Yang Zaiping

Executive Vice President

China Banking Association

Specific Comments

1. Comments on Section 24: “the following exposures are considered as non-performing: (i) all exposures ‘defaulted’ under the Basel framework; ...(iii) - (b) where there is evidence that full repayment of principal and interest without realization of collateral is unlikely, regardless of the number of days past due”:

In our opinion, non-performing exposures are defined only based on the probability of default (PD) without considering the risk mitigation role of collateral. The standard is too strict.

Suggestion: We suggest that the definition of non-performing exposures could additionally include the exceptional handling principles for specific risk mitigation measures, so that exposures secured by pledge of financial assets as collaterals that are highly liquid and easily realizable or by financial institution guarantee that is lawful, valid and highly risk-mitigating may not be classified as non-performing.

2. Comments on interpretation of “unlikely full repayment” in the non-performing exposure section and interpretation of “financial difficulty” in the forbearance section.

In our opinion, the specific circumstances of “unlikely full repayment” and “financial difficulty” listed in the Consultative Document mainly

take into account financial factors of the borrower at the time of classification, but do not reflect the differences in performance of the same customer in different stages of the economic cycle. For example, an enterprise that faces temporary financial difficulties during economic downturn can eventually survive such difficulties by adjusting product structure, controlling financial costs and tapping into market, having the capability of counter-cyclical operation.

Suggestion: While specifying minimum requirements, the definition of non-performing exposures is suggested to provide some cyclical flexibility that enables more stable reflection of the borrower's risks other than reflect the cyclical risk inherent in the economy too much. It is suggested that the exposures might not be classified as non-performing if the borrower that it is unable to fully repay the loan within a short period of time due to unfavorable economic conditions can restore its ability to pay in the foreseeable future taking into account its subsequent operation arrangements.

3. Comments on the interpretation of “financial difficulty” in “4.1. Identification of forbearance”: “(a) a counterparty is currently past due on any of its material exposures. (b) a counterparty is not currently past due, but it is probable that the counterparty will be past due on any of its material exposures in the foreseeable future without the modification”:

In our opinion, it is too strict that the default or potential default on loans is identified as a character of the borrower's financial difficulty. The borrower's default on principal or interest might be a temporary default resulting from the mismatch between term of loan and period of operating cycle. For example, a school that has an obvious seasonal characteristic of tuition and fees temporarily defaults on the principal and interest on loan due to the bank's unreasonable repayment schedule. As another example, an enterprise that remains in normal operation is forced to change its normal product shipping methods and channels due to blocked roads resulting from unexpected natural disasters, which has led to a longer period of operation and a longer period of payment collection, and eventually a temporary default occurs.

Suggestion: If the borrower that shows a mismatch between term of loan and period of operating cycle can fully repay the loan principal and interest as long as the bank changes contract clauses (e.g. by extending the contract term and reasonably rescheduling principal repayment and interest payment), such circumstances should be excluded from the characteristics of the borrower's financial difficulty and the definition of forbearance.

4. Comments on Section 32: "An exposure ceases to be non-performing and can be reclassified as performing when all

the following criteria are simultaneously met: ... (ii) Repayments have been made when due over a continuous repayment period specified by the supervisor" and Section 33: "the following situations will not lead to the reclassification of a non-performing exposure as performing: ... (ii) Repossession of collateral on a non-performing exposure, until the collateral is actually disposed of and the bank realizes the proceeds (when the exposure is kept on balance sheet, it is deemed non-performing); or (iii) extension or granting of forbearance measures to an exposure that is already identified as non-performing":

In our opinion, the conditions on upgrading of non-performing exposures are too strict.

Suggestions:

1. Section 32.(ii) "repayments have been made when due over a continuous repayment period specified by the supervisor" is suggested to be changed to "repayments have been made over the period from classification of exposures as non-performing to reclassification";
2. After the principal or interest is repaid when due out of proceeds from disposal of collateral, reclassification of the remaining exposure as performing is suggested to be permitted if conditions on such reclassification are satisfied;

3. It is suggested to be made clear that non-performing exposures for which forbearance measures have been implemented can be reclassified as performing when relevant conditions on upgrade are met, so as to avoid any misunderstanding of Sections 33 and 43.

5. Comments on Section 41: “a forborne exposure will be identified as such until it meets both of the following exit criteria: (i) When repayments as per the revised terms have been made in a timely manner (principal and interest payments) over a continuous repayment period of not less than one year (minimum probation period for reporting)...”:

In our opinion, the probation period for the exit of exposures from forbearance is too long. It might be difficult for short-term loans with a term of shorter than one year to meet the exit criteria.

Suggestion: The minimum probation period is suggested to be changed from one year to six months. The probation period could be further extended if the borrower again defaults or shows other signs of loan repayment difficulties during the probation period.

6. Comments on Section 37: “forbearance occurs when: ...” and Section 42: “the definition of forbearance covers exposures of performing and non-performing status before the granting of forbearance measures”:

In our opinion, currently there are significant disparities in regulatory practices among different countries or regions. The term “forbearance” used in the Consultative Document should be distinguished from the term of “restructuring” used by China Banking Regulatory Commission in terms of specific criteria, scope of application and risk classification requirements.

Suggestion: We suggest that the Basel Committee could further clarify the relations between “forbearance” and “restructuring” and refine specific identification criteria and risk classification requirements for forborne exposures, so as to establish alignments or distinctions between the definition of forbearance and other terms used by national regulators and provide practical guidance and precise basis for risk classification by commercial banks.

7. Comments on Further Alignment between the Consultative Document and IFRS9 in terms of requirements on bank asset classification and provisioning.

According to consultative document on the International Financial Reporting Standard 9 - Financial Instruments: Impairment (IFRS9) issued by the International Accounting Standards Board in 2013, a bank should classify assets into three stages according to expected credit losses and set aside provisions accordingly. There are disparities between IFRS9 and the Consultative Document in the basis of

measurement models, asset classification criteria and provisioning methods. The two parallel systems will add to the credit risk management costs of banks.

Suggestion: We suggest the Basel Committee to take into full account the banks' costs of implementing the Consultative Document and IFRS9 and establish alignments with IFRS9 in terms of asset classification criteria, provisioning and other requirements.