BANK FOR INTERNATIONAL SETTLEMENTS

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Prudential treatment of problem assets – Executive Summary

Supervisors and banks around the world have very different ways of categorising assets based on their perceived credit risk features. This has implications for the comparability of banks' provisioning and capital across jurisdictions. This lack of comparability was highlighted during the Great Financial Crisis and frustrated supervisors and investors who tried to assess and compare banks' performance and riskiness.

The inconsistencies reflected the absence of a consistent international framework. Hence, in 2016, the Basel Committee on Banking Supervision (BCBS) embarked on a project that analysed the definitions of terms commonly used in credit categorisation schemes in different jurisdictions and how they were applied in practice. The result was the BCBS guidelines on Prudential treatment of problem assets – definitions of non-performing exposures and forbearance, published in April 2017. The guidelines provide common definitions for two of the important terms used in credit categorisation: "non-performing exposures" and "forbearance".

In the common definitions, supervisors and banks now have a more harmonised way of monitoring asset quality. The definitions can also be useful benchmarks in: (1) the disclosure on asset quality by banks and (2) the dissemination of data for asset quality indicators and international assessments of financial systems (for example, through the International Monetary Fund's Financial Soundness Indicators and Financial Sector Assessment Program (FSAP)). Moreover, the definitions can also serve as a foundation for jurisdictions that currently lack definitions of non-performing exposures and forbearance.

Definition of non-performing exposures

The following exposures, which could be on- or off-balance sheet items, are considered as non-performing:

- all exposures that are "defaulted" under the Basel framework, where applicable; or
- all exposures that are credit-impaired according to the applicable accounting framework; or
- all other exposures that are not defaulted or impaired but nevertheless:
  - are material exposures* that are more than 90 days past due; or
  - where there is evidence that full repayment based on the contractual terms is unlikely without the bank's realisation of collateral.

Definition of forbearance

Forbearance occurs when:

- a counterparty is experiencing financial difficulty in meeting its financial commitments; and
- a bank grants a concession that it would not otherwise consider, whether or not the concession is at the discretion of the bank and/or the counterparty, to allow the counterparty in financial difficulty to sufficiently service its debt.

* Material exposures are those that hit a given jurisdiction's materiality threshold as defined by supervisors.

Interaction between the two terms

The granting of forbearance measures on a non-performing exposure will not automatically alter its status. However, granting forbearance can be an additional factor to consider when deciding whether a performing exposure should be moved to non-performing status.

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