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TECHNICAL REPORT

REPUBLIC OF BELARUS

Asset Classification and Nonperforming Loan Regulation

August 2020

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GLOSSARY

Basel II	International Convergence of Capital Measurement and Capital Standards (BCBS, June 2006)
BCBS	Basel Committee on Banking Supervision
BYN	Belarusian Ruble
CL	Contingent Liabilities
CS	Concessions
DPD	Days Past Due
FD	Financial Difficulty
FI	Financial Imbalance
FSI	Financial Soundness Indicators
IMF	International Monetary Fund
LLP	Loan Loss Provisioning
LTV	Loan-to-Value
MCM	Monetary and Capital Markets Department, IMF
NBRB	National Bank of the Republic of Belarus
NI	Negative Information
NPL	Nonperforming Loan (nonperforming exposures in a broader sense)
Regulation	NBRB Instruction 138 on the Procedure for Building Up and Use of Special Reserves for Covering Probable Losses on Assets and Transactions Not Reported on the Balance Sheet by the Banks, Development Bank of the Republic of Belarus JSC, and Nonbank Financial Institutions
RG	Risk Group
RR	Right of Recourse
TA	Technical Assistance
UFR	Unlikely Full Repayment

PREFACE

At the request of the National Bank of the Republic of Belarus (NBRB), the IMF Monetary and Capital Markets Department (MCM) evaluated the latest revision of NBRB's regulation on asset classification and provisioning, Instruction 138, against international prudential benchmarks. The evaluation included a qualitative discussion of the current version of Instruction 138 in comparison with the previous one and produced quantitative estimates of the impact of the regulatory changes and potential shortcomings that need to be addressed. Particular attention was paid to the former category of "problem assets" versus the newly introduced category of nonperforming loans (NPLs).

The work was conducted by Mr. Javier de la Cruz, MCM short-term expert, who visited Minsk during November 4–6, 2019, to discuss onsite the conclusions of the report. He met with Ms. Alena Mashnina, member of the NBRB Board and Head of Banking Supervision, and her senior staff. He presented the conclusions to Governor Kallaur and discussed with him the way forward. During this closing visit, Mr. de la Cruz also met with private sector participants.

The mission wishes to thank the NBRB management and staff for their cooperation during the evaluation.

EXECUTIVE SUMMARY

The NBRB revised in 2018 its regulation on asset classification and provisioning (the Regulation). One of the main changes was the introduction of a new definition for NPLs based on the current framework of risk groups (RGs). This definition substitutes the previous term "problem assets." One of the intentions of the replacement is to promote international comparability by using it as a financial soundness indicator (FSI).

The reported levels of this new NPLs indicator are, however, relatively low and, more important, much lower than the previous indicator, based on problem assets. The new NPL indicator levels are relatively stable, around 4 percent. The previous indicator was also stable, but the levels were more than three times higher, about 13 percent.

One of the main objectives of this report is to evaluate the alignment of the new Regulation with the relevant international prudential benchmarks. Even though asset classification and loan-loss provisioning (LLP) have always been sensitive and important areas for banking management and supervision, international benchmarks in this context are limited to the guidelines issued in April 2017 by the Basel Committee on Banking Supervision (BCBS). The guidelines cover two key concepts, NPLs and forbearance, where the BCBS found enough international communalities.

The methodological approach mimics those used to evaluate the implementation of key BCBS standards. In order to be both objective and structured, the evaluation criteria followed in this report have been the main harmonization features determined by the BCBS in its guidelines on NPLs and forbearance. The BCBS states six main harmonization features for the NPL international prudential benchmark. The NPL criteria are: (1) scope; (2) recognition criteria; (3) role of collateralization; (4) level of application; (5) upgrading NPLs to performing loans; and (6) interaction with forbearance. The BCBS states seven main harmonization criteria for the forbearance international prudential benchmark. The forbearance the harmonization features are: (1) scope; (2) level of application; (3) concept of forbearance; (4) financial difficulty (FD) and concessions (CS) examples; (5) categorization of forbearance exposures; (6) discontinuation of the forbearance categorization; and (7) interaction of forbearance with NPLs. The results of the evaluation are expressed in terms of four degrees: aligned, largely aligned, materially non-aligned, and non-aligned.

The Regulation is materially non-aligned with the BCBS Guidelines on NPLs, and therefore falls short of facilitating the international benchmarking of local banks. The Regulation is largely aligned with the BCBS Guidelines on the scope, materially non-aligned on harmonized recognition criteria, non-aligned on the role of collateralization, non-aligned on the level of application, materially non-aligned on upgrading NPLs to performing loans, and aligned on interaction with forbearance. This would place the simple average around materially non-aligned, a situation that is confirmed considering the relative importance of each of these

criteria, especially the harmonized recognition criteria (materially non-aligned) and, to a lesser extent, the scope and the role of collateralization (non-aligned).

The Regulation is also largely aligned with the BCBS Guidelines on forbearance. The Regulation is largely aligned with the international benchmarks on the scope for forbearance, as in the case of NPLs; aligned on the forbearance's level of application; materially non-aligned on the forbearance's concept; materially non-aligned regarding FD and CS examples; aligned concerning categorization of forbearance's exposures; aligned considering discontinuation of the forbearance categorization; and largely aligned as to interaction of forbearance with NPLs. This would place the simple average on largely aligned, a situation that is confirmed, taking into account the relative importance of each of these criteria, especially the two related to the categorization of forbearance's exposures and the discontinuation of the forbearance categorization on the one hand, which are both rated as aligned, and the other one related to the forbearance's concept on the other hand, evaluated as materially non-aligned.

The qualitative comparison with the previous version shows that the Regulation has made significant progress regarding alignment with the BCBS Guidelines. Even though there is still substantial room for further alignment with the BCBS Guidelines, it must be noted that the current version of the Regulation has made significant progress compared to the previous version, especially the introduction of the NPL and forbearance concepts and frameworks. However, advances made regarding asset classification and LLP should be further structured and integrated with the NPLs concept into a robust related framework.

Qualitative and quantitative analyses suggest that the new Regulation may be a "lighter" requirement than the previous one; however, it has to be considered that the "prolonged debt" approach was not effective in practice. The previous Regulation was more conservative, as the detailed criteria used for the RGs definition implied that the RGs with higher risk levels received more exposures in relative terms. However, the substitution of the prolonged debt should have produced the opposite effect, so an educated guess based on professional knowledge and experience suggests that the application of this approach was quite limited in practice.

The quantitative analysis, even though the available data was limited in this regard, also shows that NPL estimates that were aligned with the BCBS Guidelines would be somewhere in the middle of former concept of problem asset levels and the currently reported NPLs. Both in quantitative and qualitative terms, it seems that problem assets would be more conservative, while NPLs, according to the current Regulation, would fall quite short of what would be NPLs for international comparisons. The mission has made a number of detailed recommendations for further improvement, which are summarized in Table 1.

Table 1. Key Recommendations

Recommendation	Priority 1/
NPLs' Alignment with the BCBS Guidelines	
Only trading book assets should be excluded from the scope of the Regulation; high-credit quality should be always included.	High
The definition of NPLs should be directly based on the time past due and the unlikely full repayment criteria (or on RGs defined under these criteria).	High
The definition of NPLs should explicitly consider CL.	Medium
The definition of NPLs should include exposures that are defaulted under the Basel framework and exposures that are impaired under the accounting framework.	High
Time past due for NPLs should be based on 90 DPDs.	High
Negative information (NI) should be eliminated, and its components added to the time past due or to the financial imbalance (FI)/unlikely full repayment (UFR) criterion according to their nature.	High
Related parties consideration should not be limited to NI.	High
FI should be reviewed in depth, incorporating contents from the BCBS Guidelines, especially those related to UFR and financial analysis.	High
FI/UFR should also include natural persons, based on personal wealth and income analysis.	High
FI/UFR should be evaluated according to severity; different grades of FI/UFR should lead to classification into different RGs.	High
Time past due and FI/UFR criteria should be applied separately on a parallel basis for asset classification purposes.	High
Collateral should not be directly considered for asset classification purposes; high-quality collateral should not be included in RG-I.	High
The Regulation should be applied at the transaction level for retail exposures.	Medium
The Regulation should be applied at the individual level for economic groups, but should consider the situation of group members.	Medium
The Regulation should contain provisions related to NPL reclassification, especially for the probation period and for checking that exposures are not defaulted or impaired.	High
Forbearance Alignment with the BCBS Guidelines	
As in the case of NPLs, no other exclusions apart from assets included in the trading book should be made from the forbearance's scope.	High
The Regulation should explicitly consider in formal terms the two main components of forbearance, that is, CS and FD.	Medium
CS should include changes to other terms and conditions such as interest rates and collateral; other options should be considered.	High
The FD concept should be explicitly reflected in the regulation.	Medium
The list of examples for CS should be significantly expanded; a list of examples for FD should be produced (for example, based on the FI list).	Medium
The Regulation should not wait until the third time forbearance is granted; some considerations should be made for the second time.	High

1/ These recommendations are advised to be implemented within 24 months.

I. INTRODUCTION

1. **This report evaluates the alignment of the NBRB's regulation on asset classification and loan-loss provisioning with international prudential benchmarks.** The international prudential benchmark used for evaluation purposes is the BCBC Guidelines: "Prudential treatment of problem assets—definitions of nonperforming exposures and forbearance," issued in April 2017 (the BCBS Guidelines). The methodology used to evaluate the alignment of NBRB Instruction 138 with the BCBS Guidelines is conceptually similar to the one used internationally to evaluate the implementation of key BCBS standards—namely, the methodology to conduct assessments of compliance with the Basel Core Principles and the methodology to conduct the Regulatory Consistency Assessment Program (RCAP). One of the main advantages of this approach is that it allows identifying and evaluating the existing shortcomings in such a way that clear indications are made on how to make progress and improve the alignment.

2. **This report also compares in qualitative and quantitative terms the current Instruction 138 to its previous version.** Two versions have been considered: the current version, of December 2017, and a previous version enacted in June 2016. The qualitative evaluation seeks to determine if progress has been made regarding alignment with the BCBS Guidelines and, on the other hand, if the current regulation is more or less conservative than the previous one. The quantitative evaluation seeks to identify not only the main impact of the regulatory changes, but also potential shortcomings that need to be addressed. Particular attention has been paid in this regard to the former category of problem assets and the current one of NPLs, including the links between them.

3. **The rest of the report is structured in five sections.** Section II is devoted to the main aspects of the evaluation to be performed, including the scope and the methodological approach. The next two sections focus on the evaluation of the alignment with the regulation to the NPLs, and the forbearance with the BCBS Guidelines. The last two sections deal with the qualitative and then the quantitative evaluation of the Regulation. These evaluations are focused on the identification of progress made in the alignment with the BCBS Guidelines on the one hand and on the evaluation of the appropriateness and conservatism of the Regulation on the other hand.

4. **The report also contains five appendixes.** The first appendix includes some specific recommendations for asset classification and LLP. The next two appendixes contain the detailed evaluation of the alignment of the regulation to the NPLs, and then the forbearance to the BCBS Guidelines, with the purpose of facilitating not only the identification of the main observed differences, but also the implementation of the amendments needed to overcome them. Finally, the last two appendixes contain the detailed qualitative and then quantitative evaluation of the Regulation.

II. METHODOLOGY AND SCOPE

A. Current Regulation

5. **The current relevant regulation is Instruction 138_505 (the Regulation).** The official name is "Instruction 138 on the Procedure for Building Up and Use of Special Reserves for Covering Probable Losses on Assets and Transactions Not Reported on the Balance Sheet by the Banks, Development Bank of the Republic of Belarus JSC, and Nonbank Financial Institutions."

6. **This Regulation covers both asset classification and loan-loss provisioning (LLP).** Although the official name induces to think that this Regulation only covers LLP, the fact is that it also includes asset classification in full detail.[1] More specifically, the main parts of this Regulation are: (1) general provisions; (2) general requirements for credit risk assessment; (3) credit risk assessment of the collateral; (4) classification of assets exposed to the credit risk and building up the special reserve on assets exposed to the credit risk; (5) special aspects of building up the special reserve for covering probable losses on assets exposed to the credit risk; (6) procedure for use of the special reserve for covering probable losses on assets exposed to the credit risk; (7) procedure of building up and use of the special reserve for covering probable losses on portfolios of homogeneous loans; (8) special aspects of building up the reserve for covering probable losses on special portfolios of homogeneous loans; and (9) procedure for building up and use of special reserves for covering probable losses on CL.

7. **The latest version of this Regulation was issued in December 2017, entering into force on April 1, 2018.** It is an updated version of the Regulation originally issued in September 2006, which has been partially amended and updated numerous times since then.[2] Suffix 505 corresponds to this latest amendment.

B. International Prudential Benchmarks

8. **Although asset classification and LLP are concepts and tools that have been widely used in different contexts, there are no commonly accepted international standards that can be used as a common reference.** In practice, this means that different banks and supervisors in different countries usually employ the same technical terms, but in many cases with significantly different qualitative meanings and, consequently, different quantitative implications and amounts.

9. **Furthermore, there are significant differences depending on the context where the related terms are used.** More specifically, this is the case regarding: (1) asset quality supervisory monitoring; (2) regulatory capital adequacy; (3) banks' internal credit risk

[1] The term "asset classification" is used here for the sake of simplicity, considering as well that it is the traditional term used in this context. It must be noted that asset classification refers to assets in broad terms, including off-balance sheet items such as contingent liabilities as well.

[2] Twenty-three times, including this latest one.

management; (4) accounting frameworks;[3] (5) financial reporting (public disclosure) frameworks, including FSIs; (6) commercial law and insolvency procedures schemes; and (7) taxation.

10. **The BCBS has performed a limited harmonization on the concepts of NPLs and forbearance.** Conscious of the significant negative implications of not having international standards for asset classification and LLP,[4] the BCBS decided to initiate a harmonization process.[5] A detailed review of relevant literature as well as of the regulatory frameworks and supervisory practices across 28 jurisdictions (all the members of the BCBS plus Thailand) was performed; the main conclusion was that there were no consistent international standards for asset classification and LLP. Only significant commonalities could be found in two concepts: NPLs and forbearance (or restructuring). Commonalities in the case of other relevant terms such as "weakened," "loss," and "write-off" were limited, while homogeneity among asset categories and related provisions was quite scarce. At the same time, the BCBS clarified that these guidelines do not substitute or replace other standards, but complement them, especially those related to accounting and capital adequacy. Regarding accounting, it must be noted that the term "nonperforming loans" is not used as such in the International Financial Reporting Standards (IFRS) framework, while in the capital adequacy context, the relevant current categories in the Basel framework are "past due" and "defaulted" (paragraphs 75 and 452, respectively).

11. **The BCBS Guidelines on NPLs and forbearance are not international standards, but can be considered the relevant international prudential benchmarks in practical terms, especially for comparison purposes.** While the Basel Committee guidelines are not binding on its members as are its standards, they are nevertheless relevant to the international community as a common language for supervisory purposes.

C. Scope of the Evaluation

12. **The evaluation of the alignment of the current Regulation to the BCBS Guidelines is consequently limited to NPLs and forbearance.** Even though there are some commonalities in other concepts related to asset classification and LLP, these commonalities are not significant enough to use them as references for comparison purposes.

13. **Notwithstanding this limited scope, some specific recommendations are made about other concepts related to asset classification and LLP.** Although a full and deep analysis of other concepts related to asset classification and LLP would be out of scope, the chance is taken

[3] Especially in those cases where IFRS has been adopted as the accounting framework for banks.

[4] The BCBS uses the term "asset categorization" instead of "asset classification" to prevent confusion with the use in some countries of "classified assets" as low credit risk quality assets.

[5] The European Union (EU) has also made progress toward harmonization as part of the general regulatory convergence process. However, the scope is obviously limited to the member states. Therefore, EU standards are not as representative as those of the BCBS in international terms.

to formulate some specific recommendations that could improve the current Regulation considering international best practices. These recommendations are contained in Appendix I.

III. Alignment of the Regulation to the BCBS Guidelines on NPLs

14. **The six main harmonization features put forth by the BCBS in the NPLs context will be used as the evaluation criteria in order to facilitate an objective, complete, and structured evaluation.** The harmonization features proposed in the BCBS Guidelines about NPLs are the following: (1) scope; (2) harmonized recognition criteria; (3) role of collateralization; (4) level of application (nonretail and retail counterparties, banks, and groups); (5) upgrading NPLs to performing; and (6) interaction of forbearance with NPLs.

15. **Appendix II contains the full details of this evaluation.** Appendix II contains the detailed evaluation of the alignment of the current Regulation to the NPLs in the BCBS Guidelines, with the purpose of facilitating not only the identification of the main observed differences, but also the implementation of the amendments needed to overcome them.

A. Scope

16. **The Regulation is largely aligned with the BCBS Guidelines on the scope for NPLs.** The BCBS scope for NPLs is not limited to loans, as it includes all credit risk-related exposures except those forming part of the trading book. The Regulation scope is broader than loans as well, as it includes securities and contingent liabilities (CL). There are, however, some differences, with the most important ones being those related to securities; high-credit quality assets in general and securities in particular should not be excluded from the asset classification/LLP framework, but classified into the group(s) with the lowest risk and subjected to the standard rules for NPL and LLP purposes. Furthermore, securities to be excluded should not be those recorded at fair value, but those included in the trading book.

B. Harmonized Recognition Criteria

17. **Both the BCBS and the Regulation use the same recognition criteria, time past due and UFR, although the Regulation does not do it in a particularly clear or direct way.** The evaluation of the alignment of the Regulation to the BCBS Guidelines is quite complex, as NPLs are not defined in terms of the recognition criteria, but of the RGs. NPLs can be defined, directly or indirectly, in terms of the two recognition criteria: time past due and UFR. The definition made in the Regulation of NPLs, based on RGs, seems too restrictive in principle, as some RGs subject to high provisions are excluded.

18. **Ninety days is the usual number of days of the time-past-due criterion by the BCBS and defined in the Regulation.** However, different days past due (DPD) figures are used in some cases for NPLs and LLP purposes considering the type of debts and the related delinquency rates in terms of DPD. The BCBS Guidelines consider 90 days the standard DPD for NPLs. Due to the indirect way in which NPLs are defined, the Regulation does not have a

standard DPD for NPLs; however, 90 days is the usual reference. The Regulation uses another concept, "negative information" (NI), whose minimum cases are mostly based on DPD, but does not seem can play a significant role regarding the two NPLs international recognition criteria. Furthermore, in order to prevent the current overlaps and inconsistencies, the NI concept should be eliminated, and its concepts distributed according to its nature between DPD and UFR.

19. **The Regulation uses the FI concept, which is similar to UFR, but should be reviewed in depth.** UFR is an independent criterion that complements the time past due criterion and is mostly based on the analysis of the financial situation of the debtor, although no specific guidance is provided by the BCBS. The Regulation uses a relatively similar concept, FI, whose minimum cases are mostly related to the financial situation of the debtor, especially for banks[6]. Given the list of minimum factors and the focus placed on banks, it does not seem that FI can play a significant role regarding the NPLs definition in international terms unless this concept is reviewed in depth. The review of FI should follow the related content of the BCBS Guidelines, especially where it refers to UFR and financial analysis. There are other factors from the legal side that are usually and traditionally considered in international terms, although the BCBS Guidelines only mention them tangentially. The Regulation considers two legal situations related to the financial situation of the debtor, used to classify debts in the group with the highest risk (RG-VI) and provision (100 percent).

20. **There are six RGs in the Regulation, from "standard" to "bad," although three of them receive the common generic "supervised."** The Regulation devotes Chapter 4 to the detailed application to assets of the recognition criteria to be used for RGs definition purposes. Appendix II shows the RG framework.

21. **While the RG scheme is largely in line with common international practices, this is not so much the case of the NPLs definition.** Even though there are no international benchmarks in a strict sense regarding RG types and related provisions, it seems that the RGs scheme is largely in line with common international practices, even though the distribution of provisions is somewhat concentrated in the higher extreme. However, the definition of NPLs does not seem to be so aligned, as most of the RGs are not considered NPLs, including some of those with significant related provision levels.

22. **Even though there are no international benchmarks in a strict sense regarding asset types that should be used for RG classification, one could review and streamline the current asset types being used.** More specifically, the mission suggests using a single asset type classification for all RGs, based on the relative importance of each type of asset, easily linkable to the balance sheet or business categories. Appendix II shows the types of assets used in the Regulation for RG classification purposes.

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[6] As in the case of assets, "debtor" is used here in a broad sense, including counterparties of CL.

23. **Appendix II provides a detailed table that summarizes the application of the recognition criteria to define the different RGs.** Colors have been used to facilitate a quick understanding of how NPLs, according to the BCBS Guidelines, are reflected in terms of the RGs. Green is used to denote performing assets, while yellow is reserved for NPLs. Considering comments already made, NI is not taken into account in this regard, while FI, even with its limitations, is considered equivalent to UFR.

24. **Although there are significant exceptions, NPLs, according to the BCBS Guidelines, are mostly included in RGs-V and -VI, with RG-IV a transitional category.** The contents of RG-V and -VI practically correspond to NPLs, according to the BCBS Guidelines, in most cases due to the application of the time past due criterion. The rest of NPLs, according to the BCBS Guidelines, are due to the existence of FI and are classified into RG-II to -IV, which are not considered NPLs under the Regulation, apart from RG-IV restructured debt. It must be noted that FI is only used for banks and other legal persons, but not for natural persons. There is no clear separation between time past due and FI criteria in terms of their application; FI is considered in practice as an intermediate situation between short and long DPD. The simultaneous consideration of NI and collateral overcomplicates the framework to the point of producing inconsistencies. One could consider only DPD and FI for all assets types, on a separate and parallel basis for the sake of clarity and consistency.

25. **CL is on a parallel basis to assets for asset classification and LLP purposes, but no mention is made, directly or indirectly, of its potential as NPLs.** The Regulation devotes Chapter 9 to the detailed application to CL of the recognition criteria to be used for RGs definition purposes. Classification of assets into RG-III to -VI due to the DPD criterion determines the classification of the CL of the same counterparty, although the wording is somewhat unclear. Classification of assets into RG-III to -VI not due to the DPD criterion determines the classification of CL according to the counterparty and CL characteristics, although surprisingly in RG-I to -III. As in the case of assets, there is a specific article for each RG, including both the criteria for classification and the related reserves for LLP purposes.

26. **Even though there are no international benchmarks in a strict sense regarding types of contingent liabilities that should be used for RG classification, the current types could be reviewed.** Appendix II shows the type of assets being used for RG classification purposes.

27. **As in the case of assets, the mission recommends using a single CL-type classification for all RGs, based on their basic nature and the ease of linking them to the balance sheet or business categories.** Appendix II summarizes in a table the application of the recognition criteria to define the different RGs in the same way as has been done for assets. Colors have been used in the same manner to facilitate quick understanding of how NPLs, according to the BCBS Guidelines, are reflected in terms of the RGs. As in the case of assets, NI is not taken into account in this regard, while FI, even with its limitations, is considered equivalent to UFR.

28. **As it can be observed, the contents of RG-V and RG-VI practically correspond to NPLs, according to the BCBS Guidelines**. In most cases, this is due to the application of the time past due criterion to the related assets. There are several cases where no evaluation can be made due to their generic contents. The rest of NPLs, according to the BCBS Guidelines, are due to the existence of FI and are classified into RG-III, which are not NPLs, according to the Regulation; furthermore, natural persons are not considered in this regard.

29. **One could consider UFR alone for all CL types, but consistent with and parallel to the way it is done for assets of the same counterparty.** The simultaneous consideration of intrinsic aspects of CL and the way the assets of the same counterparty are classified into RGs overcomplicate the framework to the point of producing inconsistencies and dubious interpretations.

30. **Considering all the comments made above, the conclusion is that the Regulation is materially non-aligned to the BCBS Guidelines on harmonized recognition criteria for NPLs.** The Regulation uses time past due and UFR, although not in a particularly clear, complete, or direct way. Furthermore, the definition of NPLs is not based on the recognition criteria, but on RGs, and seems to be too restrictive on the one hand, as RGs subject to high provisions are not NPLs (RG-III and -IV at least, even though restructured debt of RG-IV is thought of as a NPL). On the other hand, while the application of the time past due criterion seems to determine NPLs in line with the BCBS Guidelines, this is not usually the case for UFR. Given the importance of these shortcomings, it is believed that the Regulation is materially non-aligned with harmonized recognition criteria for NPLs.

C. Role of Collateralization

31. **The Regulation is non-aligned with the BCBS Guidelines on the role of collateralization for NPLs.** According to the BCBS Guidelines, collateral should not be taken into account as a direct factor for NPLs determination, although it can have an indirect impact on UFR. However, in the case of legal entities, the Regulation considers collateral for asset classification and LLP purposes. The Regulation's definition of "high-quality collateral" is somewhat confusing. The Regulation includes all debt related to high-quality collateral in the group with the lowest risk if it is not overdue more than seven days. Collateral is also used to divide transactions into "secured," "under-secured (partially secured)," and "unsecured," applying different requirements to each of these types to classify them in the RGs. The Regulation does not consider indirect effects of collateral on UFR, although collateral can be used, according to the BCBS, to calculate UFR.

D. Level of Application

32. **The Regulation is non-aligned with the BCBS Guidelines on the level of application for NPLs.** According to the BCBS, the Guidelines should be applied at the total exposures level for nonretail exposures, while allowing this at the transaction level for retail exposures. The Regulation states that the criteria for RGs classification should be applied at the total exposure

level when the time past due criterion is applied, without differentiating between retail and nonretail exposures. In the case of economic groups, the BCBS Guidelines should be applied at the individual level, although considering the other group members' status. The Regulation is silent with respect to economic groups in itself, although some considerations are made for related parties in the NI context.

E. Upgrading NPLs to Performing

33. **The Regulation is non-aligned with the BCBS Guidelines on upgrading NPLs to performing loans.** The Regulation does not contain any provision related to NPLs reclassification, so it can be assumed that reclassification is automatic and does not consider the previous classification. Automatic reclassification implies that at least one condition (the probation period) and probably two conditions (exposures not being defaulted or impaired) of the four conditions established in the BCBS Guidelines are not considered. However, automatic reclassification implies on the other hand that reclassifications are made at the level required by the BCBS Guidelines.

F. Interaction with Forbearance

34. **The Regulation is aligned with the BCBS Guidelines on interaction with forbearance.** According to the BCBS, banks should not use forbearance practices to avoid classifying loans as NPLs. The Regulation is not explicit in this regard but establishes some specific backstops on a just-in-case basis.

G. Evaluation Summary of NPLs

35. **The summary evaluation regarding alignment of NPLs with the BCBS Guidelines is materially non-aligned.** As it can be observed, two criteria are evaluated as mostly non-aligned, another two as non-aligned, one as largely aligned, and another one as aligned. This places the simple average on materially non-aligned, a situation that is confirmed when one takes into account the relative importance of each of these criteria, especially the harmonized recognition criteria and, to a lesser extent, the scope and the role of collateralization. Appendix II provides a summary table showing the evaluation of NPLs against the BCBS Guidelines.

IV. Alignment of the Regulation with the BCBS Guidelines on Forbearance

36. **The seven main harmonization criteria established by the BCBS in the context of forbearance will be used here for evaluation purposes in order to facilitate an objective, complete, and structured evaluation.** The main harmonization criteria proposed in the BCBS Guidelines for forbearance are: (1) scope; (2) level of application; (3) concept of forbearance; (4) examples of financial difficulty and concessions; (5) classification of forbearance exposures; (6) discontinuation of the forbearance classification; and (7) interaction of forbearance with NPLs.

37. **The terminology used in the Regulation is somewhat different than the BCBS Guidelines, but is common in many countries.** The Regulation does not use the term "forbearance," but "debt restructuring" or "restructured indebtedness." "Restructuring" is considered a synonym of forbearance by the BCBS, apart from being a traditional term used in many countries. Accordingly, for the sake of simplicity and ease of comparison, the term "forbearance" is used in this report when discussing the BCBS Guidelines and the Regulation.

38. **Appendix III contains the detailed evaluation of the alignment of the current Regulation with forbearance in the BCBS Guidelines.** This is intended not only to identify the main differences, but also to implement the amendments needed to overcome them.

A. Scope

39. **As in the case of NPLs, the Regulation is largely aligned with the BCBS Guidelines on the scope for forbearance.** The scope used for forbearance purposes in the BCBS Guidelines is the same as for NPL purposes. The same is the case in the Regulation. The conclusion for scope is that it is the same for NPLs as it is for forbearance.

B. Level of Application

40. **The Regulation is aligned with the BCBS Guidelines on the forbearance level of application.** Both the BCBS Guidelines and the Regulation, even if implicitly, establish that forbearance should be applied on a transaction basis.

C. Concept of Forbearance

41. **The definition of the Regulation contains the two main components of the BCBS Guidelines definition, concessions (CS) and financial difficulty (FD), although in an implicit form.** The BCBS defines forbearance as CS granted to a counterparty for reasons of FD that would not otherwise be considered by the lender. The Regulation defines "forbearance" as the modification of terms and conditions of a contract to facilitate full and due repayment of the debt that would not be possible under different circumstances.

42. **The Regulation is materially non-aligned with the BCBS Guidelines on the forbearance concept.** The Regulation should include in the case of CS, changes to terms and conditions other than dates and maturities, especially regarding interest rates and collateral. Furthermore, other possibilities, such as partially condoning the debt and conversion of debt into equity, are not considered at all.

D. Examples of Concessions and Financial Difficulty

43. **The Regulation is materially non-aligned with the BCBS Guidelines regarding forbearance examples.** The BCBS provides 11 detailed examples of CS; the Regulation contains four examples of CS, although all of them are focused on dates and maturities issues.

The BCBS provides seven detailed examples of FD, while the Regulation does not contain any example related to FD and those related to FI are too limited.

E. Classification of Forborne Exposures

44. **The Regulation is aligned with the BCBS Guidelines regarding categorization of forbearance exposures.** According to the BCBS Guidelines, forbearance exposures can be included in the performing or NPLs category. The Regulation establishes, even if in an indirect way, that forbearance exposures shall be initially classified as NPLs. The Regulation allows the reclassification of forbearance exposures as performing, implying that forbearance exposures can be classified as NPLs or performing exposures, depending on the circumstances.

F. Discontinuation of the Forbearance Classification

45. **The Regulation is aligned with the BCBS Guidelines regarding discontinuation of the forbearance categorization.** The BCBS requires two criteria to cease being used as forbearance: a probation period and a solvency test. The Regulation has similar requirements: a probation period and no NI or FI.

G. Interaction of Forbearance with NPLs

46. **The Regulation is largely aligned with the BCBS Guidelines regarding interaction of forbearance with NPLs.** Banks should not use forbearance practices to avoid classifying loans as NPLs according to the BCBS Guidelines. The Regulation is not explicit in this regard but establishes some specific backstops on a just-in-case basis. The BCBS states that forbearance may be granted on performing exposures or NPLs, and determines the outcomes depending on the circumstances. According to the Regulation, forbearance may be granted on a performing exposure or an NPL, but it has to be classified as an NPL in any case. The BCBS also states that banks should pay particular attention to the appropriate classification of exposures on which forbearance has been granted more than once; the Regulation prohibits the reclassification of forbearance exposures when forbearance has been granted more than twice, except in the case of natural persons and microloans. According to the BCBS Guidelines, the continuous repayment period for NPLs and the probation period for forbearance can run concurrently, while there is no probation period for NPLs in the Regulation, only for forbearance exposures.

H. Evaluation Summary of Forbearance

47. **The summary evaluation regarding alignment of forbearance with the BCBS Guidelines is largely aligned.** As it can be observed, three criteria are evaluated as aligned, two as largely aligned, and another two as materially non-aligned. This would place the simple average on largely aligned, a situation that is confirmed when taking into account the relative importance of each of these criteria, especially the two related to the classification of forbearance exposures and the discontinuation of the forbearance classification on the one hand, which are rated as aligned, and the other one related to the forbearance concept on the other hand,

evaluated as materially non-aligned. Appendix III provides a summary table on the evaluation of the Regulation against the BCBS Guidelines.

V. QUALITATIVE COMPARISON TO THE PREVIOUS REGULATION

A. Main Changes Regarding the Current Regulation

48. **There are many changes between the previous Regulation, issued in June 2016, and the current Regulation; although many of the changes are purely formal, some of them are substantial.** Even though neither NPLs or forbearance existed as such before, changes can be grouped in terms of the harmonization criteria for each of them. In general terms, it can be said that, compared to the previous version, the current Regulation has made significant progress regarding alignment with the BCBS Guidelines. Appendix IV provides the details of the qualitative comparison performed by the mission. In addition, Appendix IV provides summary tables that show the main changes made in the current regulation regarding NPLs, and the main changes made in the current regulation regarding forbearance.

49. **Appendix IV contains the full details of this qualitative evaluation.** The comprehensive qualitative evaluation is contained in Appendix IV, including all the details of the evaluation of the main types of assets and the related analytical tables.

B. Analysis of the Changes to the Detailed RGs Definitions

50. **A more in-depth analysis of the changes introduced in the current Regulation can be made through the comparison of the RGs detailed definitions for assets.** In order to allow a homogeneous comparison, it is necessary first to build the detailed RGs definition table for assets in the previous Regulation (until April 2018). This table is provided in Appendix IV.

51. **There are some elements that introduce heterogeneity in the framework and can significantly complicate the comparison.** The number of RGs, the term "prolonged debt," and the types of assets are the most relevant. The variation in the number of RGs is the easiest element to address, as the new RG is a subdivision of the former RG-II. The comparison of the use of the term "prolonged debt" versus the new forbearance concept is more complex, as prolonged debt is not defined on the one hand, and it is used on the other hand together with other time past due-related criteria.

52. **Problem assets were more representative of NPLs in international terms than the NPLs definition used in the current Regulation**. A global evaluation shows that NPLs, according to the BCBS Guidelines, would be represented primarily in the previous Regulation by RG-III to RG-V. There is not a definition of problem assets in the previous Regulation; problem assets were defined in another regulation as the aggregate of RG-III to RG-V.

53. **The types of assets used in the previous Regulation differ greatly from those used in the current Regulation.** In fact, there are only four cases where a direct comparison is possible.

There are four other cases where some aggregation/disaggregation is needed to perform comparisons. Finally, there are five cases where there is no correspondence at all between types of assets, so these situations cannot be compared. Appendix IV provides a summary table that shows this situation in full detail.

54. **A detailed comparison between the current and the previous regulations shows that the current Regulation is generally more benevolent than the previous one.** More specifically, the detailed comparison highlights the following: (1) legal persons are treated more benevolently in general terms now, as requirements have been lowered one grade for current RGs-III to -VI; (2) legal persons-financial leasing is treated in a slightly more benevolent way now; (3) natural persons are treated slightly more benevolently now, as situations with fewer than 60 DPD are now integrated into RG-III and therefore subject to lower provisions; (4) microloans are treated in a slightly more benevolent way now; (5) banks are treated in a slightly more benevolent way now; (6) securities are treated slightly more benevolently now, as situations with fewer than 30 DPD and/or FI are now integrated in RG-III and therefore subject to lower provisions; (7) other active transactions are treated more benevolently now; and (8) other circumstances are treated more benevolently now, as the number of cases to be included in the worst RG has been substantially reduced.

55. **Two additional comments can be made in this context.** The replacement of the prolonged debt scheme with the debt restructuring framework has resulted in a more aligned regulation to the BCBS Guidelines on forbearance; this change has implied in practice moving forbearance exposures to RGs with higher risk and related provisions levels. On the other hand, it must be noted that it is not possible to perform the same kind of analysis for CL, as the types of CL defined in each version of the Regulation are totally different, making comparisons practically impossible.

VI. Quantitative Comparison to the Previous Regulation

56. **The main objective of this evaluation is to identify the most relevant quantitative changes, although this analysis is subject to significant limitations regarding data availability.** This quantitative comparison should be taken as a complement to the qualitative assessment. The provided data set is quite limited and does not allow precise conclusions. More specifically, no detailed information about the type of assets and CL and the way they have been used in the asset classification and LLP processes has been provided. That said, some analytical progress supported by professional judgment can be made in terms of identifying the most significant changes regarding asset classification and LLP in general and NPLs in particular.

57. **There are two important issues related to the scope that should be investigated: (1) assets have significantly increased even though the scope is the same; and (2) there is a relevant amount of assets not classified into any RG.** The first important difference that has been identified is that the total assets increased quite significantly (to 12.8 percent) once the regulatory change entered into force, even though no major changes were made in terms of

scope. The second identified difference is that there is a relevant amount of assets not classified into any RG. Maybe these figures correspond to CL, but even in this case, these figures should be distributed into the different RGs.

A. Composition in Terms of RGs

58. **The relative importance of each of the RGs is stable, both before and after the regulatory change.** The distribution of exposures between the different RGs only changed significantly when the current Regulation entered into force. A correct comparison of RGs requires some realignment of previous and current RGs because the main change was the division of the previous RG-II into the current RG-II and RG-III.

59. **The changes occurred when the current Regulation entered into force confirmed that the new Regulation is softer than the previous one.** The importance of the two RGs with the higher risk levels is relatively low, both before and after the regulatory change. However, the current RG-II and RG-III aggregate amount represents significantly more than the amount of the previous RG-II, confirming the landslide identified in the qualitative section. In a similar vein, the importance of RG-I also increases significantly, being these all these changes corresponded in the opposite sense by the decrease of the previous RG-III now transformed into the current RG-IV.

60. **The absence of changes in the opposite direction suggests that the prolonged debt approach of the previous Regulation was not effective in practice.** Even though there is no detailed information available that could fully confirm it, the absence of related opposite changes, supported by professional judgment, suggests that the prolonged debt approach was not effectively implemented in practice.

B. Problem Assets Versus NPLs

61. **Problem assets were about 13 percent, while NPLs levels are now much lower, about 4 percent.** Given the quantitative values reflected here and the qualitative comments made before, it seems that NPLs aligned with the BCBS Guidelines can be somewhat in the middle of problem assets and NPLs. A significant part of NPLs comes from restructured debt classified into RG-IV; this restructured debt represents on its turn a significant and increasing part of RG-IV.

C. Provisions

62. **The provisioning percentages are stable and have not been affected by the regulatory changes, representing an average 6.4 percent of the total assets.** As in the case of the assets, there is a relevant amount of provisions not classified into any RG. The provisioning levels per RGs are also stable and close to the minimum regulatory values, both before and after the regulatory changes.

63. **The average provisioning for total assets remains coincidentally stable after the regulatory change due to the emergence of the new provisioning percentage of 30 percent for RG-III.** However, the average provisioning levels of problem assets were stable, around 34 percent, while the average provisions for NPLs are higher but significantly decreasing, from more than 53 percent to almost 42 percent. From that point on, it can be said that current NPLs are a kind of problem assets with higher credit risk and provisioning.

64. **Appendix V contains the full details of this quantitative evaluation.** The comprehensive quantitative evaluation is contained in Appendix V, including all the details of the evaluation of the main types of assets and the related analytical tables.

Appendix I. Additional Recommendations

Table 1. Additional Recommendations for Asset Classification Purposes

Topic	Priority 1/
The asset types used for RG classification purposes (Chapter 4, articles 30–38) should be more representative in terms of quantitative relevance (types should be first selected according to their quantitative importance, not to the specifics of their LLP treatment).	High
The asset types used in the general provisions section (article 5.1) should be exactly the same as those used for RG classification purposes (Chapter 4, articles 30–38).	Medium
The CL types used for RG classification purposes (Chapter 9, articles 69–74) should be reviewed; the division into financing obligations, guarantees, and other CL made in 5.8 could be used in this regard, followed by subdivisions of the main types of counterparties (as for asset types).	Medium
The NPLs definition and the RG classification should be more aligned in terms of most of the RGs being devoted to NPLs and having so significant provisions levels related to them.	High
There are some other issues where materiality could be introduced, especially when a part of the total exposure is reclassified according to the time past due criterion: (1) to determine in which cases the full loan should be reclassified when part of it (e.g., some installments of a residential mortgage loan) should be reclassified; (2) to determine in which cases a reclassified exposure of a customer should force the reclassification of his/her other exposures; and (3) to determine in which cases a bad classification of the exposures of a member of an economic group should force the reclassification of the exposures of other members of the group (including, in this case, considerations about the financial situation and the contagion risk).	High

1/ These recommendations are advised to be implemented within 12 months.

Table 2. Additional Recommendations for LLP Purposes

Topic	Priority 1/
Special reserves should be always calculated in the same currency as the related asset or contingent liability, but can be expressed in terms of its counter value in local currency; reserves are not built on any currency in itself, as article 10 states.	Medium
Change article 16 so banks are obliged to specify the criteria in local regulatory legal acts to provide detailed risk level assessment for assets and CL. This will build up the special reserves in a more complete way (that is, build provisions over the minimum value of the provided intervals).	High
It should be reviewed and further clarified which items are acceptable as collateral and to what extent (haircuts), including the need to have independent appraisals updated on a regular basis.	High
The division of collateral into “secured,” “under-secured,” and “unsecured” should be reviewed; “secured” and “under-secured” should be integrated, considering the collateral’s acceptable value just for LLP purposes.	High
The definition of “high-quality collateral” should be reviewed in order to clarify the current confusing aspects. High-quality collateral should be used just for LLP purposes (not asset classification purposes).	High

1/ These recommendations are advised to be implemented within 12 months.

Appendix II. Alignment to the BCBS Guidelines on NPLs

1. **The six harmonization features established by the BCBS for NPLs are**: (1) scope; (2) harmonized recognition criteria; (3) role of collateralization; (4) level of application (nonretail and retail counterparties, banks, and groups); (5) upgrading to performing loans; and (6) interaction of forbearance with NPLs.

Scope

2. **The BCBS scope for NPLs is not limited to loans, including all credit risk-related exposures except those forming part of the trading book**. According to the BCBS Guidelines, the definition for NPLs will be applied not only to on-balance sheet loans, but also to: (1) debt securities; (2) other amounts due included in the banking book for Basel II capital adequacy purposes such as interest and fees; and (3) off-balance sheet items such as loan commitments and financial guarantees. Consequently, exposures included in the trading book are not in the NPLs scope.[1]

3. **The Regulation scope is broader than loans as well, as it also includes securities and contingent liabilities (CL).** Even though the wording used to define the scope of the Regulation is mostly focused on LLP and not so much on asset classification, there is no doubt that the scope is not limited to loans. First of all, article 2 of the Regulation mentions two main types of items: "assets exposed to the credit risks" and "CL.[2]" Securities are defined as one of the types of "assets exposed to the credit risks" in article 5.1[3] and classified in Chapter 4 on "classification of assets exposed to the credit risk and building up the special reserve on assets exposed to the credit risk" into the RGs. Finally, article 5.8 contains the definition for "CL," stating that they are obligations not reported on balance sheet accounts and classifying them into three groups (financing obligations, guarantees, and other CL).[4]

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[1] The literal definition is as follows: "The definition will be applied to on-balance sheet loans, debt securities, and other amounts due (e.g., interest and fees) that a bank includes in its banking book for the purpose of computing its capital requirements under the June 2006 international convergence of capital measurements and capital standards ("Basel II"), regardless of their measurement basis under the accounting standards. The definition will also be applied to off-balance sheet items (e.g., loan commitments and financial guarantees). Exposures that a bank includes in its trading book under Basel II, or that are treated as derivatives, are not in the scope of the definition of nonperforming exposures.

[2] "The instruction specifies the procedure for building up and use, by the Banks, of the following special reserves for covering probable losses (hereinafter referred to as "special reserves" unless otherwise specified): special reserve for covering probable losses on assets exposed to the credit risks, including the reserve for covering probable losses on portfolio of homogeneous loans; and special reserve for covering probable losses on transactions not reported on the balance sheet (hereinafter referred to as "contingent liabilities")."

[3] "Indebtedness on securities held by the Bank before redemption, and securities available for selling, where fair value cannot be found (hereinafter referred to as "securities exposed to the credit risk")."

[4] "Contingent Liabilities: Bank's obligations not reported on balance sheet accounts, such that the fulfillment of these liabilities will result in formation of Bank's assets exposed to the credit risk, include: a) Bank's obligations to provide money on a repayable basis including the letters of credit where payments shall be made by way of a loan given to the ordering customer (hereinafter referred to as the "financing obligations"); b) Bank's obligations to make payments if the principal, the ordering customer, or other liable party fails to fulfill its obligations to the Bank and (or) to other lenders, including the obligations under guarantees and suretyships, obligations resulting from accepts, avals, endorsements, obligations under the letters of credit if

(continued)

4. **There are however some differences, the most important ones being those related to securities.** Article 3 states that the Regulation shall not be applied to: (1) obligations to provide money as loans; (2) redeemed securities issued by the bank; (3) securities of the Government of the Republic of Belarus, the NBRB, governments and central banks of countries of the group A, banks of the group A, international financial institutions, and development banks (except when securities are classified as encumbered assets); (4) funds allocated to the NBRB; (5) shares; (6) securities recorded at fair value; and (7) CL related to the activities for provision of own needs.[5] Article 15 states that asset classification and LLP shall not be carried out in five other particular cases, none of which is relevant enough to be detailed here.[6]

5. **High-credit quality assets in general and securities in particular should not be excluded from the asset classification/LLP framework, but classified into the group(s) with the lowest risk and subjected to the standard rules for NPLs and LLP purposes.** It seems that the exception made in article 3 (c) is based on the assumption that these securities have such a high-credit quality that no provisions are needed for them under any circumstances. While it can be the case that these securities have a high-credit quality[7], this is not the point. It is ensuring that the scope for asset classification and LLP purposes is complete enough and covers all the items subject to credit risk. From this point on, the Regulation should be applied to these securities due to their specific characteristics, which would probably lead to their classification into the group(s) with the lowest risk in principle, but subject as well to potential deterioration and classification into other RGs with higher risk, especially in terms of the time past due criterion.

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related payments are made from the ordering customer's money or if the bank acts as a confirming bank, and other obligations; and c) other contingent liabilities."

[5] "The requirements of this Instruction shall not be applied to: a) obligations to provide money as loans, and loans given by the bank (except for commercial loans); b) redeemed securities issued by the entity itself; c) governmental securities of the Republic of Belarus, securities of the NBRB (hereinafter referred to as "the National Bank"), securities of governments and central (national) banks of countries of the group A, banks of the group A, international financial institutions, and development banks; d) funds allocated in the National Bank; e) shares; f) securities recorded at fair value; and g) contingent liabilities related to the activities for provision of own needs."

[6] "Classification shall not be carried out and special reserves shall not be built up for: a) Bank's assets recognized as interrelated claims and as Bank's obligations in accordance with the terms and conditions of the contract(s) and (or) the legislation; b) future indebtedness or the indebtedness overdue for the period not longer than 7 days as a result of provision of an advance, prepayment, deferment and (or) installment in payment for goods, works and services (the commercial loan); c) contingent liabilities that, if fulfilled, result in arising interrelated claims and obligations of the Bank; d) contingent liabilities (or part thereof) fulfilled at the expense of money provided by the counterparty or the third party to the Bank (except for the guarantee deposit and other tools of the collateral for fulfillment of obligations by the counterparty, guarantor or surety); and e) contingent liabilities for financing, if the contract terms and conditions allow the Bank to refuse to fulfill these liabilities if a counterparty demonstrates the signs of financial imbalance and (or) negative information becomes available concerning the counterparty's capability to fulfill its obligations to the Bank, and the counterparty has no indebtedness to the Bank on assets exposed to the credit risk or the existing indebtedness on assets exposed to the credit risk has been assigned to the risk group I and (or) II or included into the portfolio of heterogeneous loans in accordance with Chapter 7 of this Instruction or included into the special portfolio of heterogeneous loans in accordance with Chapter 8 of this Instruction."

[7] This high credit quality consideration can be made for the Government of the Republic of Belarus and the NBRB for local purposes, regardless of their international rating or consideration, being a usual practice in most countries.

6. **Securities to be excluded should not be those recorded at fair value but those included in the trading book.** While it can be assumed that valuation at fair value excludes current significant losses by definition, and therefore provisions are not needed,[8] this assumption should not lead to excluding these securities from the Regulation scope. As in the previous case and for similar reasons, these securities should be classified into the group(s) with the lowest risk and subjected to the standard rules for NLP and LLP purposes (for example, low provisions could be required to cover potential evaluation errors). On the other hand, securities included in the trading book should be excluded from the scope of the Regulation in order to be aligned with the applicable BCBS Guidelines.[9]

7. **Based on the discussion above, the conclusion is that the Regulation is largely aligned with the BCBS Guidelines within the scope for NPLs.** While there are some differences that should be eliminated to ensure full alignment with the BCBS Guidelines within the scope for NPLs, these differences are not important enough to qualify the situation worse than largely aligned. Not only loans are examined in the Regulation, but also securities and CL.

Harmonized Recognition Criteria

8. **The BCBS has two harmonized recognition criteria: time past due and UFR.** Time past due is the most traditional as well as the most objective criterion for NPL determination, while UFR is relatively more modern as well as more subjective.[10] It must also be noted that the application of the time past due criterion tends to be more homogeneous in practice than the UFR criterion.

9. **The Regulation certainly uses these two criteria, although not in a particularly clear or direct way.** Banks are required to evaluate the debtor's capability of repayment through the analysis of cash flows, indicators characterizing their activities, and other factors (article 18).[11] The Regulation mentions NI and FI in this context, but does not define any of them, leaving in both cases its specific definition to the banks. However, minimum contents as a kind of floor for

[8] Potential future losses and capital requirements is a different issue.

[9] At least regarding the NPL part that is the real international prudential benchmark.

[10] The literal reference is as follows: "A uniform 90 days past due criterion is applied to all types of exposure within the scope, including those secured by real estate and public-sector exposures. The 90 days past due criterion is supplemented by considerations for analyzing a counterparty's unlikeliness to pay, for which the definition emphasizes the importance of financial analysis."

[11] "The capability of a debtor or counterparty under contingent liabilities to fulfill their obligations to the Bank shall be assessed through the analysis of cash flows, indicators characterizing their activities, and other factors impacting the capability to fulfill obligations to the Bank. The set of quantitative and qualitative indicators used of reassessment of capability of a debtor or counterparty under contingent liabilities to fulfill their obligations to the Bank and the procedure for calculation and evaluation of these indictors shall be specified by the Bank at its own discretion. The Bank must define, in its local regulatory legal acts, the set of indicators of the financial imbalance and negative information concerning the capability of a debtor or counterparty under contingent liabilities to fulfill their obligations to the Bank, taking into consideration the Bank's business model and risk profile including the attitude towards risk (the risk appetite)."

these definitions are established for each of them (in article 19 for NI and in article 20 for FI). As it is explained in more detail below, NI is mostly based on time past due, while FI is related to the evaluation of the financial situation, and from this point on, to UFR. Finally, DPD are extensively used to classify assets into the different RGs.

10. **The evaluation of the alignment to the BCBS Guidelines is even more complex, as NPLs are not defined in terms of the recognition criteria, but of the RGs.** The Regulation does not contain a definition of NPLs in terms of direct criteria, but indirectly in terms of the RGs. More specifically, the Regulation defines NPLs in article 31, just before the composition of the different RGs is discussed. The definition is as follows: "assets exposed to the credit risk and assigned to the risk groups V and VI as well as the restructured indebtedness assigned to the risk groups IV–VI shall be considered as nonperforming assets." It seems that this definition was incorporated on top of the framework, without really integrating it conceptually; in fact, the term NPL is mentioned just once in the Regulation and there is no equivalent definition of CL in the correspondent section (although it seems that in practice, reported NPLs include both assets and CL, as most probably NPL amounts are calculated using the RG totals).

11. **It is suggested to define NPLs, directly or indirectly, in terms of the two recognition criteria: time past due and UFR.** NPLs should be directly defined in terms of the two recognition criteria or, indirectly, in terms of RGs directly defined on its turn on the two recognition criteria (for example, RGs defined in terms of DPD>90 days and UFR).

12. **The definition of NPLs based on RGs made in the Regulation seems to be too restrictive in principle, as some RGs subject to high provisions are excluded.** Not considering yet the specific criteria used to define the composition of the different RGs, the first impression is that the definition of NPLs is too narrow, as RGs with quite significant provisioning levels are excluded. More specifically, RG-III's range of provisions is 20 percent to 30 percent, while RG-IV's range is 30–50 percent. This impression does not change even if only the lowest values of each of the ranges (which are the ones used in practice) are considered, as 20 percent and 30 percent are provisioning levels typical of NPLs. The fact that a component of RG-IV, its restructured indebtedness, is defined as part of NPLs does not seem enough to change this impression.

Time Past-Due Criterion

13. **Ninety days is the usual number of days considered for the time past due criterion.** In general terms, it is considered that debts overdue for periods shorter than 90 days[12] are almost fully recoverable and that the main issue in these cases is just payment delays but not repayment, so there are no grounds to consider those debts as nonperforming. From this point on, at the other extreme, it is thought that after a certain number of overdue days (usually 180 or 365 days), debts are practically irrecoverable and should be so fully provisioned and even written off. The

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[12] Ninety days is the traditional period considered for default purposes in most commercial laws, so the origin of this figure is clearly previous to any financial supervision framework.

usual technical term used to evaluate time past due is Days Past Due (DPD), and LLP under this criterion tends to be quantified from 0 percent for performing assets (0–89 DPD) to 25 percent to 100 percent for NPLs (from 90 DPD to 180 or 365 DPD, graduating provisions in terms of the observed DPD).

14. **However, different DPD figures are used in some cases for NPL and LLP purposes, because of the type of debts and the related delinquency rates in terms of DPD.** Apart from specific country-based qualifications, experience shows that certain types of debts should be defined as NPLs with lower or higher DPD than the standard 90 days. This is especially clear in the case of retail transactions, where 90 DPD can be too late to begin to consider consumer credits as NPLs, but too early for first residence mortgages.

15. **The BCBS Guidelines consider 90 days the standard DPD for NPLs.** Based on commonalities and tradition and in order to keep things as simple as possible, the BCBS establishes 90 days as the standard DPD for NPLs, regardless of the type of debts and the related delinquency rates. As noted below, this standard is not necessarily applicable to other contexts, as it is the case of the Basel II definition of "default," where DPD can be 180 days in some particular cases.

16. **Due to the indirect way NPLs are defined, the Regulation does not have a standard DPD for NPLs; however, 90 days is the usual reference.** As NPLs are defined in terms of RGs, there is not a direct link between DPD and NPLs. However, the minimum DPD required for RG-V, the RG with the lowest risk classified as NPLs, is 90 in eight out of 12 cases.

17. **The Regulation uses another concept, negative information (NI), whose minimum cases are mostly based on DPD, but does not seem to play a significant role in the NPLs definition in international terms.** Banks must define NI internally in detail , but article 19 of the Regulation establishes the following minimum cases: (1) overdue interests and fees from a legal entity (including a bank)[13] for a period of 8–30 days; (2) overdue interests and fees from a natural person (including a bank) for a period longer than 30 days; (3) overdue debt from related parties during the same periods; (4) decisions made by competent agencies to suspend transactions with debtors' accounts; and (5) banks of the group C according to their credit ratings.[14] As it can be observed, most of the cases, especially in terms of the number of potential

[13] It seems strange to include banks as natural persons, but this is what the Regulation says here.

[14] "The negative information concerning the capability of a debtor or counterparty under contingent liabilities to fulfill their obligations to the Bank includes, unconditionally and irrespective of whether any other negative information listed (or not listed) in Bank's local regulatory legal acts: a) overdue payments of remunerations (interests, commissions and other similar remunerations) to the Bank from a legal entity (including a bank) for the period from 8 to 30 days; b) overdue payments of remunerations (interests, commissions and other similar remunerations) to the Bank from a natural person (including a bank) for the period longer than 30 days; c) overdue indebtedness of a legal entity, for the period longer than 7 days, and (or) overdue indebtedness of a natural person, for the period longer than 30 days, to the Bank, where such economic and (or) legal relations exist between the debtor, on the one part, and the legal entity and (or) the natural person, on the other part, that the worsening of their

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debtors, correspond to interest and fees DPD, well under 90 days in all cases.[15] However, the last two cases are closer to UFR. This means that only in these two last cases, NI can play a role in the definition of NPL in international terms, but it seems that this role must be quite modest in global quantitative terms.

18. **It is suggested to eliminate the NI concept and distribute its current concepts according to its nature between DPD and UFR.** NI is made of different components of different nature as just commented. It is suggested to eliminate it and incorporate those components based on DPD to the time past due criterion and those others related to the financial situation to the UFR criterion. The related parties component scope should be broadened and not just focused on the current specific aspects.

UFR Criterion

19. **UFR is an independent criterion that complements the time past due criterion.** UFR means that it is unlikely that the debt will be fully repaid without realization of collateral or other risk mitigants, regardless of the debt not being past due or past due for fewer than 90 days (DPD < 90 days). Basel II provides examples of possible indicators of UFR (paragraph 453).[16]

20. **UFR is mostly based on the analysis of the financial situation of the debtor, although no specific guidance is provided by the BCBS.** UFR can be evaluated through a comprehensive analysis of the financial situation of the counterparty, using all available inputs.[17] Special attention should be paid in this regard to financial analysis, although the BCBS

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financial position results in or make likely the worsening of the debtor's financial position. The criteria and procedure for recognizing the debtors as related with other debtors of the Bank shall be specified in the Bank's local regulatory legal acts; d) the decision made by competent agencies to suspend transactions with debtor's accounts (with the correspondent accounts of banks) in the Bank and (or) to impose an arrest on debtor's money placed on accounts opened by the Bank including the bank deposit accounts; and e) counterparty bank classification as a bank of the group C in accordance with ratings assigned to the banks by international rating agencies."

[15] The limitation to interests and fees is not relevant in this context, as these amounts must be considered for NPLs determination purposes.

[16] These include: the bank puts the credit obligation on non-accrued status; the bank makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure; the bank sells other credit obligations from the same counterparty at a material credit-related economic loss; the bank consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees; the bank has filed for the obligor's bankruptcy or a similar order in respect of the obligor's credit obligation to the banking group; and the obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of the credit obligation to the banking group.

[17] More specifically, the BCBS suggests three examples: a) patterns of payment behaviors in past circumstances; b) new facts that change the counterparty's situation; and c) financial analysis. However, only financial analysis is addressed later on in some detail.

Guidelines do not provide an exhaustive or even a long list of indicators.[18] Furthermore, the BCBS Guidelines do not provide guidance regarding reference values for the suggested ratios. Most probably, this generic approach is due to a low degree of commonality.

21. **The Regulation uses a relatively similar concept, financial imbalance, whose minimum cases are mostly related to the financial situation of the debtor, especially for banks.**[19] Banks must define FI internally in detail, but article 20 of the Regulation establishes the following minimum cases: (1) a debtor, except another bank, has a negative net asset value; (2) overdue payments of interests, commissions, and other similar remunerations for more than 30 days; (3) indebtedness written off by a bank to off-balance sheet accounts if this indebtedness is overdue; (4) not enough information is available to evaluate the financial position of the debtor; (5) a counterparty bank (except for an intergovernmental bank or a development bank) fails to meet regulatory requirements including those related to capital adequacy and liquidity; (6) a bank classified into the group D in accordance with international credit ratings; and (7) suspension or termination of licenses for banking activity (special rules are given for legal entities or individual entrepreneurs applying the simplified taxation system and not keeping accounting records and natural persons as well as for microloans).[20]

[18] According to the BCBS Guidelines: "Financial analysis of non-retail counterparties may include, as appropriate, the following ratios: leverage ratio; debt/EBITDA ratio; interest coverage ratio; current liquidity ratio; or ratio of (operating cash flow + interest expenses)/interest expenses; loan-to-value ratio; and any other relevant indicators. For retail counterparties, this analysis may include consideration of debt service coverage ratio, loan-to-value ratio, credit scores and any other relevant indicators. In the case of debt securities, a situation of partially or totally missed payment for more than 30 days will trigger a specific assessment of the counterparty's creditworthiness. When the assessment evidences a situation where the full repayment of the security is unlikely, the security will be considered as nonperforming regardless of the number of days it is past due."

[19] "As in the case of assets, 'debtor' is used here in a broad sense, including also counterparties of contingent liabilities."

[20] "A debtor or a counterparty under contingent liabilities may not be considered as having no indicators of financial imbalance, irrespective of existence (or non-existence) of other financial imbalance indicators specified in the Bank's local regulatory legal acts, if at least one of the following facts exists: a) a debtor or a counterparty under contingent liabilities, except for a bank, has the negative net asset value; b) overdue payments of remunerations (interests, commissions and other similar remunerations) to the Bank from a debtor or a counterparty under contingent liabilities for the period longer than 30 days; c) the indebtedness of a debtor or a counterparty under contingent liabilities exists, written off by the Bank to off-balance accounts, if this indebtedness is overdue; d) no information is available making it possible to evaluate the financial position of a debtor or a counterparty under contingent liabilities and their capability to fulfill their obligations, or information is insufficient for reliable assessment; e) a counterparty bank (except for intergovernmental banks and development banks) fails to meet the requirements in terms of the capital including the requirements for capital adequacy and liquidity stipulated by the supervising agency of a country in the territory of which the bank has been registered; f) a counterparty bank classification as a bank of the group D in accordance with ratings assigned to the banks by international rating agencies; and g) suspension, termination, cancellation or withdrawal of special permits (licenses) for banking activity that can affect the fulfillment of obligations by the counterparty bank. For the purposes of classification of indebtedness of legal entities or individual entrepreneurs applying the simplified taxation system and not keeping the accounting records in accordance with the legislation, local executive and regulatory agencies and natural persons: a) the facts stipulated in the second and fifth paragraph of the first part of this Clause shall not be applied; b) the facts stipulated in the third and fourth paragraph of the first part of this Clause shall be considered as negative

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22. **Given the list of minimum factors and the focus placed on banks, it does not seem that FI can play a significant role in the NPLs definition in international terms unless this concept is reviewed in depth.** Three of the seven minimum factors are related to banks, two to time past due considerations, and one to incomplete information, leaving only one really focused on the financial situation of nonbank debtors. Furthermore, this factor is too simple as it is just based on having a negative net asset value, the economic equivalent of bankruptcy and insolvency in legal terms. It is also important to note that natural persons are not thought of at all in this context (article 20 does not differentiate between legal and natural persons, but FI is never a criterion to be used to classify debts of natural persons into the different RGs).

23. **The review of FI should follow the related content of the BCBS Guidelines, especially in what it refers to UFR and financial analysis.** Even though the contents of the BCBS Guidelines related to UFR and financial analysis are somewhat generic, as already commented, incorporating them to the Regulation in terms of a revised FI would mean making great progress compared to the current situation.

24. **There are other factors from the legal side that are usually and traditionally considered in international terms, although the BCBS's Guidelines only mention them tangentially.** Most of these factors are related to the legal status of the debtors regarding their incapability to repay their debts, thus reflecting UFR in legal terms. The most common factors in this regard are the legal processes and procedures to declare the debtor bankrupt or insolvent (although in many cases it is not necessary to wait until the process ends and the legal declaration is made; once the process begins, UFR is automatically assumed, even if on a temporary basis). The BCBS mentions this case in the Guidelines, although in a tangential way, as it is mentioned as an example in a footnote contained in paragraph 453 of Basel II.

25. **The Regulation discusses two legal situations related to the financial situation of the debtor, used to classify debts into the group with the highest risk (RG-VI) and provision (100 percent).** These legal situations are bankruptcy and force majeure, and are explored in the part of the Regulation devoted to the classification criteria for RG-VI. More specifically, the provisions can be found in article 37, points 10 and 11.[21]

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information with regard to the capability of a debtor or a counterparty under contingent liabilities to fulfill their obligations to the Bank. For the purposes of classification of indebtedness on microloans and assets listed in the eleventh paragraph, Subclause 5.1, Clause 5 of this Instruction, the facts stipulated in the second–fourth paragraph of the first part of this Clause shall be considered as negative information with regard to the capability of a debtor or a counterparty under contingent liabilities to fulfill their obligations to the Bank."

[21] 37.10: "indebtedness on assets exposed to the credit risk, for such debtors that bankruptcy proceedings are initiated against them, or debtors declared insolvent (bankrupt) in accordance with the procedure established by the legislation, with liquidation proceedings initiated against them; 37.11: indebtedness on assets exposed to the credit risk, subject to the occurrence of force majeure circumstances stipulated in the contract and inflicting damage to the debtor preventing it from further operation."

Application of the Recognition Criteria to Assets for RGs Definition Purposes

26. **The Regulation devotes Chapter 4 to the detailed application to assets of the recognition criteria to be used for RGs definition purposes.** Chapter 4, on "Classification of assets exposed to the credit risk and building up the special reserve on assets exposed to the credit risk" (Articles 30–38), contains the detailed provisions for the application of the recognition criteria to assets to define the RGs. While article 30 is just a general provision stating that asset classification should be done according to the credit risk level, article 31 is particularly relevant, as it contains the different types of RGs as well as the NPLs definition.[22] From this point on, the Regulation devotes one article to each of the RGs, from article 32 to RG-I to article 37 to RG-VI. It must be noted that each of these articles contains not only the specific asset classification rules, but also the provisions to be made in each case for LLP purposes. Finally, article 38 states that banks can classify assets into RGs with higher risk levels than those resulting from the application of the provisions of this chapter.

27. **There are six RGs, from "standard" to "bad," although three of them receive the common generic name of "supervised."** The table below contains the detail for each of the RGs regarding its name and the related provisions for LLP purposes:

Table 1. Risk Groups (RGs)
(in percent)

Risk Group	Name	Provision
I	Standard	0.5–2
II		5–20
III	Supervised	20–30
IV		30–50
V	Doubtful	50–100
VI	Bad	100

28. **Even though there are no international benchmarks in a strict sense regarding RG types and related provisions, it seems that the RGs scheme is largely in line with common international practices, even though the distribution of provisions is somewhat concentrated in the higher extreme.** It is quite common in international terms to have five or six RGs, according to credit risk levels, devoting most of them to assets with significant provision needs (usually four). This is the case of the Regulation with six RGs in total and four of them requiring provisions not lower than 20 percent.[23] However, what is not so common is

[22] "Depending on the credit risk level, assets exposed to the credit risk shall be subdivided into standard (risk group I), supervised (risk groups II–IV), doubtful (risk group V), bad (risk group VI) assets. Assets exposed to the credit risk and assigned to the risk groups V and VI as well as the restructured indebtedness assigned to the risk groups IV–VI shall be considered as nonperforming assets."

[23] As commented, banks usually build provisions according to the lower values of the ranges provided.

the distribution between RGs of significant provisions, which tends to be relatively uniform between the related RGs, about 25, 50, 75, and 100 percent and not 20, 30, 50, and 100 percent, as is the case in the Regulation. This means that the distribution of provisions is relatively concentrated in this case in two of the six RGs (RG-V and RG-VI).

29. **However, the definition of NPLs does not seem to be so aligned, as most of the RGs are not deemed NPLs, including some of them with significant related provision levels**. According to the definition made in article 31, NPLs are conformed by RG-V and RG-VI exposures as well as part of RG-IV (the restructured exposures classified into this group). This means that RG-I to RG-III as well as parts of RG-IV are performing, even though some of them such as RG-III and RG-IV have significant associated provision levels (from 20–50 percent in theory and from 20–30 percent in practice).

30. **Even though there are no international benchmarks in a strict sense regarding asset types that should be used for RGs classification, the mission suggests reviewing and streamlining the current asset types being used.** The Regulation does not have a single definition of the type of assets to be considered for asset classification and LLP purposes. Instead, it mentions in each of the articles devoted to each of the RGs, which are the assets to be considered and under which circumstances (basically in terms of DPD, NI, FI, and collateral), up to the point that some types of assets are considered only for some specific RGs. This approach is not only confusing sometimes in terms of interpretation, but also favors too casuistic considerations in detriment of more general treatments, as can be observed in the table below, which summarizes the main types of assets used for RGs classification purposes:

Table 2. Types of Assets Used for RGs Classification Purposes

Types of Assets
Assets with high-quality collateral
Legal persons (including individual entrepreneurs): loans except microloans, assignment of the right of a monetary claim or alienation of assets and factoring
Legal persons – financial leasing
Natural persons – loans, financial leasing and factoring
Microloans
Banks
Securities
Fulfillment of obligations by the Bank instead of third parties
Provision of an advance in payment for goods, works, and services (commercial loans)
Other active transactions
Other circumstances

Source: Author's elaboration based on the contents of articles 32–37.

31. **A single asset type classification could be used for all RGs, based on the relative importance of each type of asset and easily linkable to the balance sheet or business categories.** The use of a single asset type classification based on the relative importance of each type would help keep the focus on the most important issues and prevent too casuistic approaches. In addition, linking the classification to balance sheet or business categories would certainly facilitate not only its interpretation, but also its practical application and monitoring.

32. **The next table summarizes the application of the recognition criteria to define the different RGs.** The rows reflect the different types of assets mentioned in articles 32–37, while the columns show the different types of RGs, including not only their number, but also the name and the related provisions. Each of the resulting cells or buckets contains the classification criteria for each type of asset and RG. To facilitate both its elaboration and interpretation, abbreviations are used to express the contents of the buckets; these abbreviations are defined below the table.

33. **Colors have been used to facilitate a quick understanding of how NPLs. according to the BCBS Guidelines, are reflected in terms of the RGs; green is used to denote performing assets, while yellow is reserved for NPLs.** Even though it is a rough interpretation of how the criteria for RG classification purposes can be evaluated in terms of NPLs in the BCBS Guidelines, the table can be very useful to have a quick and general understanding of the situation. Using an intuitive approach, green is used to denote performing assets, while yellow, more concerning, reflects NPLs and gray, a neutral color, is used to clarify those cases where the regulation does not allocate certain types of assets to specific RGs.

34. **Considering comments already made, NI is not taken into account in this regard, while FI, even with its limitations, is considered an equivalent of UFR.** This means that the cases considered equivalent for these purposes to NPLs in the BCBS Guidelines terms are: (1) DPD longer than 90 days; and (2) presence of FI. Collateral, detailed in the next part of this section, has not been considered at all in this regard, as the BCBS determines.[24]

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[24] A specific although important case is assets with high-quality collateral with fewer than seven DPD. For the sake of simplicity, it has been considered that these assets are performing, even though it could be that some debtors with UFR should be classified as NPLs. It is assumed that those would be rare cases and that these debtors would have a clear incentive to repay given the provided collateral, especially if the LTV is low.

Table 3. Application of the Recognition Criteria to Assets for RGs Definition Purposes
(Since April 2018)

TYPE OF ASSET	RISK GROUPS (RGs)					
	STANDARD I (0.5–2%)	SUPERVISED			DOUBTFUL V (50–100%)	BAD VI (100%)
		II (5–20%)	III (20–30%)	IV (30–50%)		
Assets with high-quality collateral	O < = 7					
Legal persons (including individual entrepreneurs): loans except microloans, assignment of the right of a monetary claim or alienation of assets and factoring	ST - O < = 7, no NI, no FI	All T - no FI, no NI ST and PT - O < = 7 and NI UT and PT - no NI, no FI	All T - O < = 7 and FI UT - O < = 7 and NI All T – 7 < O < = 30, no FI, no NI All T – 7 < O < = 30, NI	UT - O < = 7 and FI ST and PT - 7 < O < = 30 and FI ST and PT - 30 < O < 90	UT - 7 < O < = 30 and FI UT - 30 < O < = 90 All T - 90 < O < = 180	UT – 90 < O < 180 All T – O > 180
Legal persons – financial leasing	O < = 7, no NI nor FI	O < = 7, NI and FI	O < = 7, FI 7 < O < = 30, no NI no FI 7 < O < = 30 and NI	7 < O < = 30 and FI 30 < O < 90	90 < O < = 180	O > 180
Natural persons – loans, financial leasing, and factoring	O < = 30, no NI	O < = 30 and NI	30 < O < = 60	60 < O < = 90	90 < O < = 180	O > 180
Microloans	O < = 7, no NI	O < = 7 and NI	7 < O < = 30	30 < O < = 90	90 < O < = 180	O > 180
Banks	No O, no NI, no FI	NI	FI	O < = 30	30 < O < = 90	O > 90
Securities	O < = 7, no NI, no FI	O < = 7 and NI	O < = 7, FI 7 < O < = 30, no NI no FI 7 < O < = 30 and NI	7 < O < = 30 and FI 30 < O < = 90	90 < O < = 180	O > 180

Table 3. Application of the Recognition Criteria to Assets for RGs Definition Purposes (concluded)

(Since April 2018)

TYPE OF ASSET	RISK GROUPS (RGs)					
	STANDARD I (0.5–2%)	SUPERVISED			DOUBTFUL V (50–100%)	BAD VI (100%)
		II (5–20%)	III (20–30%)	IV (30–50%)		
Fulfillment of obligations by the Bank instead of third parties			ST and PT – F < = 30	UT – F < = 30 ST and PT – 30 < F < = 90	UT – 30 < F < = 90 ST and PT – 90 < F < = 180	UT – F > 90 ST and PT – F > 180
Provision of an advance in payment for goods, works, and services (commercial loans)			7 < O < = 30	30 < O < = 90	90 < O < = 180	O > 180
Other active transactions	O < = 7, no NI	O < = 7 and NI	7 < O < = 30	30 < O < = 90	90 < O < = 180	O > 180
Other circumstances						Bankruptcy and force majeure

Source: Author's elaboration based on the contents of articles 32–37.

Notes:
XXX: performing exposures according to the BCBS Guidelines (approximation).
YYY: NPLs according to the BCBS Guidelines (approximation).
ZZZ: no exposures of this type of assets are considered for this RG.
Time past due: O: days overdue (DPD – days past due).
Negative indicators: NI: negative information; FI: financial imbalance.
Collateral: All T: all transactions; ST: secured transactions; PT: partially secured transactions (under-secured transactions); and UT: unsecured transactions.
Other: F: fulfillment date.

35. **As it can be observed, the contents of RG-V and -VI practically correspond to NPLs, according to the BCBS Guidelines, due to the application of the time past due criterion.** With just three exceptions[25], the contents of RG-V and -VI are based on the application of the time past due criterion and the existence of DPD longer that 90 days.

36. **The rest of NPLs, according to the BCBS Guidelines, are due to the existence of FI and are classified into RG-II to -IV, which are not considered NPLs under the Regulation, apart from RG-IV restructured debt.** There is no clear pattern regarding FI, as it is used to classify assets into three different RGs, from RG-II to RG-IV[26]. It seems that the differential

[25] Two of these three exceptions would not be considered NPLs, according to international benchmarks.

[26] Although it seems that the case classified in RG-II is an inconsistency, as FI and the same seven DPD are also considered for the classification into RG-III, being the difference the requirement of NI for the classification into RG-II.

factor is the amount of DPD simultaneously required, from fewer than seven in RG-III to fewer than 30 in RG-IV. In any case, this means that a significant number of NPLs, according to the BCBS Guidelines, are not recognized as such by the Regulation.

37. **It must be noted that FI is only considered for banks and other legal persons, but not for natural persons.** Although there is no explicit statement in this regard (the Regulation mentions the terms debtor or counterparty for FI purposes, without further specification), the detailed criteria set out in articles 32–37 for the different RGs only consider FI for banks and other legal persons. FI is not considered for natural persons or in other cases where no distinction is made between legal and natural persons, such as "commercial loans." Probably FI is not considered for natural persons because they do not produce financial statements, but this should not be an impediment considering financial analysis can be applied to personal wealth and income data.

38. **There is no clear separation between time past due and FI criteria in terms of their application; FI is considered in practice as an intermediate situation between short and long DPD.** FI is not considered separately from DPD, but as a complement to it. As seen in the table above, RG-I and RG-II are mostly populated by short DPD, while RG-III and -IV usually consist of combinations of short DPD and FI (as commented, RG-V and -VI are mostly based on long DPD).

39. **The simultaneous consideration of NI and collateral overcomplicates the framework, to the point of producing inconsistencies in some cases.** NI is used in such a way for classification purposes that it tends to be an early indicator of NPLs, primarily for RG-II and -III. Collateral is mostly used for legal persons, but combining the different types of coverage (secured, under-secured, and unsecured) in a confusing way with DPDs, NI, and FI, up to the point of producing inconsistencies in some cases.

40. **To prevent inconsistencies and maintain clarity, consider only DPD and FI for all asset types, on a separate and parallel basis.** As already mentioned, NI should not be used for asset classification purposes. The same applies to collateral, as explained in full detail in the next part of this section. From this point on, is the mission recommends using just DPD (time past due criterion) and FI (UFR criterion in broader terms). DPD and FI/UFR should be used on a parallel basis, applying them separately to all types of assets. FI/UFR should not be used to classify assets into a single RG, but in several of them (for example, from RG-I to RG-VI), depending on the severity of the FI/UFR identified problems.

Application of the Recognition Criteria to Contingent Liabilities for RGs Definition Purposes

41. **The Regulation devotes Chapter 9 to the detailed application to CL of the recognition criteria to be used for RGs definition purposes.** Chapter 9 on "Procedure of building up and use of special reserves for covering probable losses on CL" (articles 65–75)

contains the detailed provisions for the application of the recognition criteria to CL to define the RGs.

42. **CL are considered on a parallel basis to assets for asset classification and LLP purposes, but no mention is made, directly or indirectly, to its potential consideration as NPLs.** Article 65 clarifies that provisions related to NI, FI, and collateral types shall be applicable to CL as well, although no reference is made to the consideration of CL for NPLs purposes.[27] In fact, the definition of NPLs mentions just assets. Most probably this inconsistency is due to the incorporation of the definition on top of the framework, but it seems that it does not make a difference in practical terms, as the total amounts of the relevant RGs, including both assets and CL, seem to be considered for NPLs purposes.

43. **Classification of assets into RG-III to -VI due to the DPD criterion determines the classification of the CL of the same counterparty, although the wording is somewhat unclear.** Article 66 states that if the bank can refuse fulfilling CL when there is NI or FI regarding the counterparty, and there are assets corresponding to the same counterparty classified into RG-III to -VI for time past due reasons, these CL shall be classified into the same RGs as the assets.[28] However, each of the specific articles for these RGs states that CL corresponding to debtors with assets classified into that RG because of the application of the time past due criterion shall be classified into the same RG, without considering at all the existence of NI or FI. Accordingly, it can be interpreted that CL must be classified into the same RGs as the assets of the same counterparty classified into RG-III to RG-VI, according to DPD.

44. **Classification of assets into RG-III to RG-VI not due to the DPD criterion determines the classification of CLs according to the counterparty and CL characteristics, although surprisingly, into RG-I to RG-III.** Article 67 considers the situation where the bank can refuse fulfilling CL when there is NI or FI regarding the counterparty, and there are assets corresponding to the same counterparty classified into RG-III to RG-VI for different reasons to time past due considerations, determining that in these cases CL shall be classified according to the counterparty and CL characteristics.[29] However, it must be noted that the reference made in

[27] "For the purpose of classification of contingent liabilities, counterparty's capability to fulfill its obligations shall be assessed in accordance with Clauses 18–20 of this Instruction. Quality and adequacy of the collateral shall be estimated for each contingent liability. Contingent liabilities shall be classified as secured, under-secured or unsecured in accordance with Clauses 22–28 of this Instruction."

[28] "If the contract terms and conditions allow the Bank to refuse to fulfill contingent liabilities for financing in cases when a counterparty demonstrates the signs of financial imbalance and (or) negative information becomes available concerning the counterparty's capability to fulfill its obligations to the Bank, and this counterparty has an indebtedness on assets exposed to the credit risk, assigned to the risk groups III–VI in accordance with the overdue indebtedness delay criterion, these contingent liabilities shall be assigned to the risk group corresponding to the risk group where the counterparty's indebtedness on assets exposed to the credit risk has been assigned to."

[29] "If the contract terms and conditions allow the Bank to refuse to fulfill contingent liabilities for financing in cases when a counterparty demonstrates the signs of financial imbalance and (or) negative information becomes available concerning the counterparty's capability to fulfill its obligations to the Bank, and this counterparty has an

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articles 67, 68, 69, 71, and 72 implies that, surprisingly, only RG-I to RG-III should be considered in this regard.

45. **As in the case of assets, there is a specific article for each RG, including both the criteria for classification and the related reserves for LLP purposes.** The Regulation devotes one article to each of the RGs, from article 69 to RG-I to article 74 to RG-VI.[30] Each of these articles contains not only the specific asset classification rules, but also the provisions to be made in each case for LLP purposes.[31]

46. **Even though there are no international benchmarks in a strict sense regarding CL types that should be used for RGs classification, the current types being used should be reviewed.** The Regulation does not have a single definition of the type of CL to be considered for asset classification and LLP purposes. Instead, in addition to the general mentions made in articles 66 and 67, the Regulation mentions in each of the articles devoted to each of the RGs which are the types of CL to be considered and under which circumstances, and includes that some types of CL are considered only for some specific RGs. Furthermore, these mentions are made on the one hand in terms of DPD, NI, FI, and collateral, but, on the other hand, also in terms of the assets of the same counterparty. This approach is somewhat confusing in terms of interpretation, as shown in the table below, which summarizes the types of CL used for RGs classification purposes:

Table 4. Types of Assets Used for RGs Classification Purposes

Type of Assets
Assets with high-quality collateral
Natural persons
Microloans
Banks
Counterparties with indebtedness on assets assigned in accordance with the time past due criterion (with or without NI and/or FI)
Counterparties with indebtedness on assets NOT assigned in accordance with the time past due criterion, where the bank can refuse if there is NI and/or FI
Other counterparties
Other circumstances

Source: Author's elaboration based on the contents of articles 69–74.

indebtedness on assets exposed to the credit risk, assigned to the risk group III – VI (except for the indebtedness assigned to these groups in accordance with the overdue indebtedness delay criterion), these liabilities shall be classified in accordance with Clauses 69, 71 and 72 of this Instruction."

[30] Article 70 is the exception, as it is devoted to a generic consideration for CL without high-quality collateral.

[31] A specific, important case is CL with high-quality collateral. For the sake of simplicity, it has been considered that these CL are performing, even though it can be the case of some debtors with UFR that should be classified as NPLs. It is assumed that those would be rare cases and that these debtors would have a clear incentive to fulfill their obligations given the provided collateral, especially if the LTV is low.

47. **It is suggested to use a single CL's type classification for all RGs, based on their basic nature and ease of linking to the balance sheet or business categories.** The use of a single CL's type classification based on the basic nature of each type would help to keep the focus on the most important issues and prevent too casuistic approaches. In addition, linking the classification to the balance sheet or business categories would certainly facilitate not only its interpretation, but also its practical application and monitoring. More specifically, the division made in article 5.8 between financing obligations, guarantees, and other CL can and should be used in this regard. From this point on, subdivisions could be made for each main type of counterparty (for example, banks, legal persons, and natural persons).

48. **The next table summarizes the application of the recognition criteria to define the different RGs in the same way it has been done for assets.** The rows show the different types of CL mentioned in articles 69–74, while the columns illustrate the different types of RGs, including not only their number, but also the name and the related provisions. Each of the resulting cells or buckets contains the classification criteria for each type of CL and RG. To facilitate both its elaboration and interpretation, abbreviations are used to express the contents of the buckets; these abbreviations are described in detail below the table.

49. **Colors have been used as well to facilitate a quick understanding of how NPLs, according to the BCBS Guidelines, are reflected in terms of the RGs.** Green is used again to denote performing assets, while yellow is reserved for NPLs, and grey for cases where no CL are considered. A new color is used in this case, purple, to reflect those cases where a clear evaluation cannot be made due to the generic contents. Even though it is a rough interpretation of how the criteria for RG classification purposes can be evaluated in terms of NPLs in the BCBS Guidelines, the table below can be especially useful for gaining a quick, general understanding of the situation.

50. **As in the case of assets, NI is not taken into account in this regard, while FI, even with its limitations, is considered equivalent to UFR.** This means that the cases considered equivalent for these purposes to NPLs in the BCBS Guidelines terms are the same as for assets, that is: (1) DPD longer than 90 days; and (2) presence of FI. Collateral has not been considered at all in this regard, as the BCBS determines.

51. **The contents of RG-V and -VI practically correspond to NPLs, according to the BCBS Guidelines, in most cases due to the application of the time past due criterion to the related assets.** Contents of RG-V and -VI are mostly referred to CL- related to assets of the same counterparty classified into these RGs. As it was commented, apart from three exceptions, the contents of RG-V and -VI for assets were based on the application of the time past due criterion and the existence of DPD longer that 90 days.

52. **The rest of NPLs according to the BCBS Guidelines are due to the existence of FI and are classified into RG-III; they are not NPLs according to the Regulation.**

Furthermore, natural persons are not considered in this regard. There are only two cases where FI is considered, one for banks and another one for other counterparties (basically other legal persons). Both cases are reflected in RG-III. As in the case of assets, it seems that FI is not considered for natural persons, because they do not produce financial statements, but this should not be an impediment, as financial analysis can be applied to personal wealth and income data. In any case, the most important fact is that RG-III is not considered to determine NPLs according to the Regulation, so there is a clear difference in this regard between the BCBS Guidelines and the Regulation.

53. **The simultaneous consideration of intrinsic aspects of CL and the way the assets of the same counterparty are classified into RGs overcomplicate the framework to the point of producing inconsistencies and dubious interpretations.** NI and collateral are used on the one hand, and the treatment of assets of the same counterparty are considered as well on the other hand, without clear rules regarding their interaction. This causes the existence of a significant number of cases where it is not possible to evaluate which cases would be considered NPLs according to the BCBS Guidelines and which would not (those marked in purple in Table 5).

54. **It is suggested to consider just UFR for all CL types, but on a consistent and parallel basis to what is done for assets of the same counterparty.** CL should be evaluated for asset classification and NPL purposes considering their specific characteristics on the one hand and the UFR aspects related to the financial situation of the counterparty. If this counterparty is also a debtor of the bank, the UFR should be made on a consistent and parallel basis for both the assets and the CL. It must be noted that FI/UFR should not be used to classify assets and/or CL in a single RG, but in several RGs (for example, from RG-I to RG-VI) depending on the severity of the FI/UFR identified problems.

Table 5. Application of the Recognition Criteria to CL for RGs Definition Purposes
(Since April 2018)

TYPE OF COUNTERPARTY	RISK GROUPS (RGs)					
	STANDARD	SUPERVISED			DOUBTFUL	BAD
	I (0.5–2%)	II (5–20%)	III (20–30%)	IV (30–50%)	V (50–100%)	VI (100%)
High-quality collateral	All					
Natural persons	No NI	NI				
Microloans	No NI	NI				
Banks	No NI and no FI	NI	FI			
Other counterparties	ST - No NI and no FI	UT and PT – No NI and no FI ST and PT – NI	UT – NI All T – FI			
Counterparties with indebtedness on assets assigned in accordance with the time past due criterion (with or without NI and/or FI)			All counterparties with indebtedness on assets assigned to the risk group III	All counterparties with indebtedness on assets assigned to the risk group IV	All counterparties with indebtedness on assets assigned to the risk group V	All counterparties with indebtedness on assets assigned to the risk group VI
Counterparties with indebtedness on assets NOT assigned in accordance with the time past due criterion where the bank can refuse if there is NI and/or FI	Depending on the counterparty and the CL characteristics	Depending on the counterparty and the CL characteristics	Depending on the counterparty and the CL characteristics			
Other circumstances						Bankruptcy, insolvency, and force majeure

Source: Author's elaboration based on the contents of articles 65–74.
XXX: performing exposures according to the BCBS Guidelines (approximation).
YYY: NPLs according to the BCBS Guidelines (approximation).
ZZZ: not evaluated due to generic contents.
WWW: no exposures of this type of assets are considered for this RG.
Negative indicators
NI: negative information.
FI: financial imbalance.
Collateral
All T: all transactions; ST: secured transactions; PT: partially secured transactions (under-secured transactions); and UT: unsecured transactions.

Other Considerations

55. **Taking into account other contexts, the BCBS Guidelines also consider "default" according to Basel II and "impairment" in accounting terms, although the related factors are the same in substance.** The formal definition provided by the BCBS Guidelines considers not only the asset quality monitoring perspective, but also the capital adequacy (Basel II) and the accounting perspectives. The first point reflects exposures that are defaulted according to Basel II: "all exposures that are defaulted under the Basel framework (for example, paragraphs 452 and following the Basel II rules text and their subsequent amendments), where applicable."[32] The second point considers exposures that are impaired in accounting terms: "all exposures that are credit-impaired (in the meaning of exposures having experienced a downward adjustment to their valuation due to deterioration of their creditworthiness) according to the applicable accounting framework."[33] Finally, the third point contains both the time past due and the UFR criteria.[34]

56. **The Regulation contains some references to ratings issued by international rating agencies, but there are no specific indications of how to consider them.** Article 4 states that ratings from international rating agencies should be used but does not say how.[35] As already commented, there are also some other references in the Regulation to credit ratings (for example, article 20 f) in the context of FI), but no clear connection between them. Maybe the connection can be made in terms of the groups from A to E that are repeatedly mentioned in the Regulation in the sense that international credit ratings are used to define these groups.

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[32] Paragraph 452 of the Basel II framework: "a default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place: a) the bank considers that the obligor is unlikely to pay its credit obligations to the banking group in full, without recourse by the bank to actions such as realizing security (if held); and b) the obligor is past due more than 90 days on any material credit obligation to the banking group (footnote 89). Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current outstandings." On its turn, footnote 89 states: "In the case of retail and public sector entities obligations, for the 90-day figure, a supervisor may substitute a figure of up to 180 days for different products, as it considers appropriate to local conditions. In one member country, local conditions make it appropriate to use a figure of up to 180 days also for lending by its banks to corporates; this applies for a transitional period of five years."

[33] "In particular, when the accounting framework is IFRS 9, 'impaired exposures' are those that are considered 'credit-impaired' in the meaning of IFRS 9 Appendix A. When the accounting framework is US GAAP, 'impaired exposures' are those exposures for which credit losses are measured under ASC Topic 326 and for which the bank has recorded a partial write-off."

[34] ". . . all other exposures that are not defaulted or impaired but nevertheless:(a) are material exposures that are more than 90 days past due; or (b) where there is evidence that full repayment based on the contractual terms, original or, when applicable, modified (e.g., repayment of principal and interest) is unlikely without the bank's realization of collateral, whether or not the exposure is current and regardless of the number of days the exposure is past due."

[35] For the purposes of this Instruction, the rating of a debtor, an issuer of securities (hereinafter referred to as the "debtor" unless otherwise specified) or a contingent liability counterparty, assigned by international rating agencies and corresponding to the term and currency of the liability, shall be used.

Conclusions

57. **Considering all the comments made above, the conclusion is that the Regulation is materially non-aligned with the BCBS Guidelines on harmonized recognition criteria for NPLs.** The Regulation uses time past due and UFR, although not in a very clear, complete, or direct way. Furthermore, the definition of NPLs is not based on the recognition criteria but on RGs and seems to be too restrictive on the one hand, as RGs subject to high provisions are not considered NPLs (RG-III and RG-IV at least, even considering that restructured debt of RG-IV is considered NPLs). On the other hand, while the application of the time past due criterion seems to determine NPLs in line with the BCBS Guidelines, this is not usually the case for UFR. Given the importance of these shortcomings, it is considered that the Regulation is materially non-aligned regarding harmonized recognition criteria for NPLs.

Role of Collateralization

58. **According to the BCBS Guidelines, collateral should not be taken into account as a direct factor for NPL determination, although it can have an indirect impact on UFR.** In principle, assets should be classified or not as NPL regardless of the collateral,[36] whatever its type or quality. Although the BCBS Guidelines do not mention it explicitly, collateral should be taken into account after asset classification, while calculating losses and related provisions in the LLP process. Collateral may, however, influence a borrower's economic incentive to pay and, therefore, has an indirect impact on the assessment of a borrower's UFR.

59. **However, in the case of legal entities, the Regulation takes collateral under consideration for asset classification and LLP purposes.** Article 22 states that quality and adequacy of the collateral shall be taken under consideration for the assessment of the credit risk of legal entities on loans (except microloans), factoring, and other specific cases. The article also says that collateral shall be assessed in the scope of each transaction.[37]

60. **The Regulation defines "high-quality collateral," although there are some confusing aspects in the definition.** Article 5.2 defines "high-quality collateral" in detail.[38] The first

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[36] The term "assets" is used again in very broad terms, including off-balance sheet items.

[37] "The quality and adequacy of the collateral shall be taken into consideration for the assessment of the credit risk with regard to the indebtedness of legal entities on loans (except for indebtedness on microloans), indebtedness of legal entities resulting from financing against the assignment of the monetary claim (factoring), from assignment, to the Bank, of the right of a monetary claim, or from alienation, by the Bank, of assets arising as a result of termination of obligations on assets exposed to the credit risk, with the right for payment deferment (payment by installment) granted. The quality and adequacy of the collateral for timely repayment of the indebtedness shall be assessed in the scope of each separate agreement."

[38] "High-quality collateral—means the collateral meeting the conditions as follows: 5.2.1. it covers at least 90 per cent of the principal debt amount and available as: a) guarantees of the Government of the Republic of Belarus or the National Bank, pledging of governmental securities of the Republic of Belarus or the National Bank denominated in Belarusian Rubles, other tools of collateral for fulfillment of obligations where the aforementioned

(continued)

condition is that it must represent 90 percent of the principal debt amount (loan-to-value (LTV) or LTV > 90 percent), which should not be a requirement, as LTV is not related to quality but quantity of collateral (LTV should be used instead in the LLP process at the time of determining provisions). The second condition is that it must consist of: (1) pledging of securities and/or guarantees of the Government of the Republic of Belarus, the NBRB, governments, central (national) banks of countries of the group A, banks of the group A, or international financial organizations or development banks; (2) deposits of money; (3) banks' own securities; and (4) insurance provided by a group A company. All these items can be considered high-quality credit indeed, but then the Regulation introduces an additional provision in 5.2.2,[39] which is quite confusing, as it refers to the coverage of the residual 10 percent and one-year interests and commissions on the one hand and to the collateral types on the other hand, specifically to articles 23 and 29, which just describe generic types of collateral, not necessarily of high quality.

61. **The Regulation includes all debt related to high-quality collateral in the group with the lowest risk if it is not overdue by more than seven days.** Article 32.1 states that debt covered by high-quality collateral shall be classified into RG-I if it is not overdue for a period longer than one week.[40] RG-I is the group with the lowest risk, denominated as standard and subject to a low provision, 0.5–2 percent (0.5 percent in practice). This means that debt covered by high-quality collateral is practically exempted from being considered NPLs, which should not be the case, at least in theory. In fact, article 32.1 explicitly states that the existence of NI or FI is irrelevant in this regard. However, on the other hand, it must be said that this consideration does not really affect in substance the LLP results (provisions), even if the process and the calculations are done in a different order.

62. **Collateral is also used to divide transactions into secured, under-secured (partially secured), and unsecured, applying different requirements to each of these types to classify**

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securities are used as the sources of fulfillment of obligations to the Bank; b) guarantees (standby letters of credit), suretyships, reimbursement liabilities and other irrevocable tools of collateral for fulfillment of obligations provided by governments, central (national) banks of countries of the group A, banks of the group A, international financial organizations or development banks; c) pledging of securities of governments, central (national) banks of countries of the group A, banks of the group A, international financial organizations or development banks, bills of exchange avalized or accepted by governments, central (national) banks of countries of the group A or banks of the group A, or other tools of collateral for fulfillment of obligations where the aforementioned securities are used as the sources of fulfillment of obligations to the Bank; d) guarantee deposits of money in fully convertible currency and (or) Belarusian Rubles (irrespective of the obligation currency) or in currency with restricted convertibility (if the currency of the guarantee deposit is the same as the obligation currency); e) Bank's own debt securities; f) insurance against risks of failure to return (failure to repay) and (or) delay of return (repayment) of a loan, or entrepreneurial risk insurance by an insurance organization being the legal entity of the group A."

[39] ". . . it covers in total the amount of the principal debt not covered in accordance with Clause 5.2.1 and the amount of remunerations (interests, commissions and other similar remunerations) payable in the next 12 months including those incurred and payable in the current month, and it is provided as the collateral specified in Clauses 23 and 29 of this Instruction."

[40] ". . . future indebtedness or indebtedness overdue for the period not longer than 7 days, provided with high-quality collateral, on assets exposed to the credit risk, irrespective of whether the indicators of financial imbalance and negative information with regard to the debtor's capability to fulfill its obligations to the Bank are available."

them into the RGs. Articles 24–27 of the Regulation divide collateral transactions into three types.[41] Transactions are considered secured if the related collateral fully covers the debt´s principal and the interest and fees for the next year.[42] Under-secured transactions are those where the related collateral represents more than 70 percent of the debt's principal and the interest and fees for the next year or, covering these amounts in full, the bank has to carry out preliminary legal arrangements. All other transactions are considered unsecured. From this point on, different requirements are made, especially in the case of legal persons,[43] for all types of transactions in order to classify them into the different RGs, with more benevolent considerations for secured transactions than for under-secured transactions, being unsecured transactions, the ones receiving logically the strictest treatment.

63. **Collateral can be considered according to the BCBS to calculate UFR.** Collateral may influence a borrower's economic incentive to pay and, therefore, has an indirect impact on the assessment of UFR. A clear example in this regard is a residential mortgage where the LTV is very low because the final maturity of the loan is relatively close in time.

64. **The Regulation does not consider indirect effects of collateral on UFR.** As commented before, FI is the closest concept in the Regulation to UFR. The Regulation does not consider collateral when evaluating FI, so it can be said, in conceptual terms, that the Regulation does not consider indirect effects of collateral on UFR. In fact, the only potential link goes in the

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[41] Article 24: "Depending on quality and adequacy of the collateral, the indebtedness shall be classified as secured, under-secured, and unsecured indebtedness." Article 25: "The indebtedness shall be deemed secured if it is provided with the collateral available as high-quality collateral and (or) other collateral specified in Clauses 23 and 29 of this Instruction with the amount of this collateral, as of the time of assessment of the indebtedness risk, fully covering the Bank's claims for repayment of the principal debt amount and payment of remuneration (interests, commissions and other similar remunerations) payable in the next 12 months including those accrued and payable in the current month." Article 26; "The indebtedness shall be deemed undersecured if: a) it is provided with the collateral specified in Clauses 23 and 29 of this Instruction with the amount of this collateral, as of the time of assessment of the indebtedness risk, over 70 per cent of the Bank's claims for repayment of the principal debt amount and payment of remuneration (interests, commissions and other similar remunerations) payable in the next 12 months including those accrued and payable in the current month; or b) it is provided with such guarantees (suretyships) that, to receive relevant payments, the Bank has to carry out preliminary legal arrangements (besides submission of payment requests by the Bank with regard to the debtor's accounts for collection of indebtedness and sending the notification to the debtor for debt repayment), and the amount of these guarantees (suretyships), as of the time of assessment of the indebtedness risk, fully covers the Bank's claims for repayment of the principal debt amount and payment of remuneration (interests, commissions and other similar remunerations) payable in the next 12 months including those accrued and payable in the current month." Article 27: "The indebtedness shall be deemed unsecured if it has no collateral specified in Clauses 23 and 29 of this Instruction or if it has the collateral specified in these Clauses but not meeting the requirements listed in Clauses 25 and 26 of this Instruction."

[42] Over 70 percent must be interpreted as between 70 percent and 100 percent; if collateral represents more than 100 percent, the transaction would be considered secured.

[43] Cases where types of collateral are used to classify transactions in RGs are: a) legal persons (including individual entrepreneurs)—loans except microloans, assignment of the right of a monetary claim to the Bank, or factoring; and b) fulfillment of obligations by the Bank instead of third parties. The first case is obviously the most relevant one, as it implies that a huge part of the loan portfolio is classified in RGs depending on the related collateral.

opposite direction, as a high LTV is one of the conditions to consider collateral as high-quality collateral.

65. **Considering all the comments made above, the conclusion is that the Regulation is non-aligned with the BCBS Guidelines on the role of collateralization for NPLs.** Collateral is taken under consideration in the case of legal entities for asset classification and LLP purposes. Furthermore, not only high-quality collateral is used to classify debt into the lowest RG, but collateral in more general terms is used to distribute debts between RGs, basically according to their LTVs. Given the importance of these shortcomings, it is considered that the Regulation is non-aligned regarding the role of collateralization for NPLs.

Level of Application

66. **The BCBS considers that the Guidelines should be applied at the total exposures level for nonretail exposures, while allowing doing so at the transaction level for retail exposures.** In the case of exposures to a nonretail counterparty, all exposures to that counterparty must be considered NPLs when one or more than one of the material exposures is an NPL. However, in the case of exposures to a retail counterparty, NPL status should be considered at the transaction level, although some consideration should be given as well to the status of the other exposures. Although the BCBS Guidelines do not mention it, the reason for this consideration is that a retail customer may repay only one or more types of transactions (for example, residential mortgages, but not credit cards) due to the different consequences of nonpayment.[44]

67. **The Regulation states that the criteria for RG classification should be applied at the total exposure level when the time past due criterion is applied, without differentiating between retail and nonretail exposures.** Article 11 states, "If a debtor to the bank has several assets exposed to the credit risk and overdue indebtedness arose for one of these assets resulting in its classification into the group with the higher risk level, then the debtor's all assets must be assigned to the same risk group."

68. **In the case of economic groups, the BCBS Guidelines should be applied at the individual level, although considering the other group members' status.** This is a similar situation to retail exposures, as it can be the case, for different reasons, that a member of the group is considered an NPL (for example, a long DPD) while other members are considered performing. However, some attention has to be paid as well to the situation of the other members of the group, especially in the context of UFR in terms of their financial situation and the contagion risk.

69. **The Regulation is silent respect economic groups in itself, although some considerations are made for related parties in the NI context.** Economic groups are not

[44] These cases are usually related to the presence of collateral, although there also could be reputational reasons.

mentioned at all in the Regulation, so the only provision that can be applicable to them by analogy would be article 19(c). This (forced) interpretation would imply that group members' debt should be reclassified/dragged to the highest risk RG in which one member's debt has been classified.

70. **Considering all the comments made above, the conclusion is that the Regulation is non-aligned with the BCBS Guidelines on the level of application for NPLs.** The Regulation should be applied at the transaction level for retail exposures and a specific consideration should be made of economic groups, clarifying that the Regulation should be applied at the individual level but considering the situation of the other members of the group. Given the importance of these shortcomings, the Regulation is considered non-aligned with the level of application for NPLs.

Upgrading to Performing

71. **The** BCBS **Guidelines requires four conditions, all of which must be met, to allow NPLs reclassification to normal status.** The first one is that the counterparty cannot have any material exposure more than 90 DPD. The second condition is that repayments must have been made when due over a continuous repayment period as specified by the supervisor of at least three months (probation period),[45] although a longer repayment period can be required for nonperforming forborne exposures. The third condition is that the counterparty's situation has improved so that the full repayment of the exposure is likely, according to the original, or, when applicable, modified conditions (no UFR in summary). Finally, the fourth condition is that the exposure is not "defaulted" according to the Basel II standard or "impaired" according to the applicable accounting framework.

72. **On the contrary, the BCBS Guidelines mention three situations that do not lead to reclassification on its own.** The first one is a partial write-off of an existing NPL (that is, when a bank writes off part of an NPL that it deems to be uncollectible). The second situation is the repossession of collateral on an NPL until the collateral is actually disposed of and the bank realizes the proceeds (when the exposure is kept on the balance sheet, it is still deemed an NPL). Finally, the last situation refers to the extension or granting of forbearance measures to an exposure that is already identified as an NPL subject to the relevant exit criteria for NPLs.

73. **The BCBS Guidelines clarify the level at which the reclassification should be made.** The reclassification of an NPL as performing should be made at the same level (that is, counterparty or transaction) as when the exposure was originally classified as an NPL.

74. **The Regulation does not contain any provision related to NPLs reclassification, so it can be assumed that reclassification is automatic and does not consider the previous**

[45] In exceptional circumstances and subject to prior agreement from supervisors, a shortened period may be used when a bank puts in place specific remedial measures to restructure the borrower's business, which include a direct participation in the borrower, are immediately applicable, and make the full repayment of the exposure likely.

classification. As there are no specific provisions in place, it seems that each time the asset classification and LLP processes are performed, all assets and CL are reclassified ex novo, considering just the current situation.

75. **Automatic reclassification implies that at least one and probably two of the four conditions established in the BCBS Guidelines are not considered.** While it can be assumed that the 90 DPD and no UFR conditions are complied with automatically when applying the criteria for RGs classification,[46] this is clearly not the case by nature of the probation period, as no checks are made in this regard. The same can probably be said of the last condition referred to exposures not being defaulted or impaired.

76. **Automatic reclassification implies on the other hand that reclassifications are made at the level required by the BCBS Guidelines.** An automatic reclassification of an NPL would always be made by definition at the same level in which the exposure was previously classified as an NPL, so there is no need for a specific provision in this regard.[47]

77. **Considering all the comments made above, the conclusion is that the Regulation is non-aligned with the BCBS Guidelines on upgrading NPLs to performing.** The Regulation does not contain any provision related to NPLs reclassification; automatic reclassification implies that at least one (the probation period) and probably two (exposures not being defaulted or impaired) of the four conditions established in the BCBS Guidelines are not considered. Given the importance of these shortcomings, the Regulation is considered non-aligned regarding upgrading NPLs to performing.

Interaction with Forbearance

78. **According to the BCBS, banks should not use forbearance practices to avoid classifying loans as NPLs.** This is one of the main problems in practice of NPLs recognition, as banks tend to use forbearance practices not only to prevent classification of assets as NPLs, but also to promote NPLs de-recognition.

79. **The Regulation is not explicit in this regard, but establishes some specific backstops on a just-in-case basis.** Even though the Regulation does not say that banks should not use forbearance practices to avoid classifying loans as NPLs,[48] the message is implicit, especially when specific backstops are introduced, such as prohibiting in principle classifying forbearance exposures in RGs with a lower risk, or excluding forbearance exposures being reclassified into RG-I under any circumstance.

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[46] Differences between the BCBS Guidelines and the Regulation regarding time past due and UFR criteria are not considered in this context, as they do not affect compliance with the Guidelines conditions for NPLs reclassification.
[47] Again, no consideration is made here in this regard of the different application levels for retail exposures between the BCBS Guidelines and the Regulation.

[48] In terms of RGs in this case.

80. **Accordingly, the conclusion is that the Regulation is aligned with the BCBS Guidelines on interaction with forbearance.** Even though the Regulation does not contain any specific provision related to NPLs interaction with forbearance, the message is implicit and specific backstops are included on a just-in-case basis. Consequently, it is considered that the Regulation is aligned regarding interaction with forbearance.

Materiality

81. **The BCBS Guidelines consider materiality, although in a generic way, without providing specific criteria or thresholds.** Materiality is not considered in a direct way a harmonizing feature, but is mentioned several times in the BCBS Guidelines. However, no specific criteria or thresholds are provided due to the low degree of commonality (for example, some countries consider all loans and other credit risk transactions, while other countries only take into account those that are material).

82. **The Regulation does not consider materiality, and makes no exception in this regard.** As materiality is not considered in the Regulation, this means that all the provisions are applicable to all cases without any exception related to size or relative importance. This implies that the Regulation is more stringent than the applicable BCBS Guidelines, so it cannot be said that the Regulation is not aligned, as the BCBS Guidelines are minimum standards in this case.

83. **However, some recommendations can be made regarding materiality, especially one referred to the assets and CL types, which should be defined more in terms of their importance than their specific characteristics.** The current types of assets and CL used for asset classification and LLP purposes are too casuistic and do not take in account their representativeness in quantitative terms (materiality). This approach does not help having a clear view on how the most important types of assets and CL should be treated for asset classification and LLP purposes. The fact of considering collateral for asset classification purposes and not differentiating the two main criteria for asset classification well enough, as discussed in the next parts of this section, makes the situation worse.

84. **There are other issues where materiality could be introduced, especially when a part of the total exposure is reclassified according to the time past due criterion.** Materiality could be considered in the following cases: (1) to determine in which cases the full loan should be reclassified when part of it (for example, some installments of a residential mortgage loan) should be reclassified; (2) to determine in which cases a reclassified exposure of a customer should force the reclassification of his/her other exposures; and (3) to determine in which cases a bad classification of the exposures of a member of an economic group should force the reclassification of the exposures of other members of the group (including, in this case, considerations about the financial situation and the contagion risk).

Evaluation Summary for NPLs

85. **According to the former comments made for each of the harmonization criteria, the evaluation summary for NPLs is as follows:**

Table 6. Evaluation Summary for NPLs

HARMONIZATION FEATURE	CURRENT REGULATION MAIN SHORTCOMINGS	EVALUATION[1]
Scope	Some exclusions are made, the most relevant ones being those related to high-credit quality securities.	LA
Harmonized recognition criteria	The Regulation uses time past due and UFR, although not in a particularly clear, complete, or direct way; the definition of NPLs is not based on the recognition criteria but on RGs and seems to be too restrictive in principle, as RGs subject to high provisions are not considered NPLs (RG-III and RG-IV at least, even considering that restructured debt of RG-IV is considered NPL).	MNA
Role of collateralization	Collateral is unduly taken under consideration in the case of legal entities for asset classification purposes; high-quality collateral is improperly used to classify debt into the lowest RG.	NA
Level of application	The Regulation should be applied at the transaction level for retail exposures and a specific consideration should be made of economic groups, clarifying that the Regulation should be applied at the individual level, but should consider the situation of the other members of the group.	NA
Upgrading to performing	The Regulation does not contain any provision related to NPLs reclassification; automatic reclassification implies that at least one (the probation period) and probably two (exposures not being defaulted or impaired) of the four conditions established in the BCBS Guidelines are not considered.	MNA
Interaction with forbearance	No shortcomings.	A
SUMMARY		MNA

[1]A: aligned; LA: largely aligned; MNA: materially non-aligned; and NA: non-aligned.

86. **The summary evaluation regarding alignment of NPLs to the BCBS Guidelines is materially non-aligned.** As it can be observed, two criteria are evaluated as mostly non-aligned, another two as non-aligned, one as largely aligned, and another one as aligned. This would place the simple average on materially non-aligned, a situation that is confirmed taking into account the relative importance of each of these criteria, especially the harmonized recognition criteria and, to a lesser extent, the scope and the role of collateralization.

Appendix III. Alignment to the BCBS Guidelines on Forbearance

Harmonization Criteria

1. **The seven main harmonization criteria considered by the BCBS in the context of forbearance will be used here for evaluation purposes in order to facilitate an objective, complete, and structured evaluation.** The main harmonization criteria used to evaluate the alignment of the current Regulation with the BCBS Guidelines regarding forbearance are: (1) scope; (2) level of application; (3) concept of forbearance; (4) examples of financial difficulty and concessions; (5) classification of forbearance exposures; (6) discontinuation of the forbearance classification; and (7) interaction of forbearance with NPLs.

2. **The terminology used in the Regulation is somewhat different but is traditional and quite common in many countries.** The Regulation does not use the term "forbearance," but rather "debt restructuring" or "restructured indebtedness." "Restructuring" is considered a synonym by the BCBS, apart from being a traditional term used in many countries for decades. Accordingly, for the sake of simplicity and ease of comparison, the term "forbearance" will be used in this report both for the BCBS Guidelines and the Regulation (except in those cases where literal transcriptions are made of specific articles of the Regulation).

Scope

3. **The scope considered for forbearance purposes in the BCBS Guidelines is the same as for NPL purposes.** This means that the scope is not limited to loans but includes all credit risk-related exposures except those forming part of the trading book. On the other hand, it must be noted that having the same scope for NPLs and forbearance is necessary to ensure consistency and prevent gaps.

4. **The scope considered for forbearance purposes in the Regulation is the same as for NPL purposes.** This means that the scope is not limited to loans but includes other credit risk-related exposures as well. However, as it was commented for NPLs, some types of assets are excluded based on their high-credit quality, and no mentions are made regarding the trading book. This means that there is consistency in the Regulation in terms of scope between NPLs and forbearance, and also that the differences between the Regulation and the BCBS Guidelines in terms of scope for forbearance are exactly the same as for NPLs.

5. **Accordingly, as in the case of NPLs that have the same scope, the conclusion is that the Regulation is largely aligned with the BCBS Guidelines on the scope for forbearance.** While there are some differences that should be eliminated to ensure full alignment to the BCBS Guidelines on the scope for forbearance, these differences are not important enough to qualify the situation as worse than largely aligned. Not only loans are considered in the Regulation, but also securities and CL.

Level of Application

6. **Forbearance should be applied on a transaction basis, according to the BCBS Guidelines.** Given the specific nature of forbearance, it has to be applied necessarily at a transaction level, case by case. As explained below, concessions are one of the two main elements of forbearance and concessions must be evaluated by definition at the transaction level.[1]

7. **The Regulation implicitly states that forbearance should be applied on a transaction basis.** Although there is no specific provision in this regard, the wording related to forbearance implicitly states so, especially in the case of the forbearance definition made in article 5.6.

8. **Accordingly, the obvious conclusion is that the Regulation is aligned with the BCBS Guidelines on the level of application for forbearance.** It must be remembered in this regard that the terminology used in the BCBS Guidelines is somewhat different from that of the Regulation, so any difference related to the level of application is purely formal. Consequently, the Regulation is considered aligned regarding the level of application.

Concept of Forbearance

9. **The BCBS defines forbearance as a concession granted to a counterparty for reasons of financial difficulty that would not be considered otherwise by the lender.** This definition has two main components: concessions (CS) and financial difficulty (FD). Both of them are needed to differentiate forbearance from normal, business-based, commercial renegotiation[2] to the point that there is no forbearance if either of these two components is not present.

10. **Although forbearance is certainly related to economic loss, default, and impairment, forbearance is an independent concept.** First of all, forbearance recognition is not limited to measures that give rise to an economic loss for the lender. In fact, refinancing an existing exposure with a new contract due to the FD of a counterparty could qualify as CS, even if the terms of the new contract are no more favorable for the counterparty than those of the existing transaction. Furthermore, the identification of an exposure as forborne does not affect its classification as impaired for accounting purposes or as defaulted in accordance with the capital adequacy regulatory framework.

11. **The Regulation defines forbearance as the modification of terms and conditions of a contract to facilitate full and due repayment of the debt that would not be possible otherwise.** This definition is made in article 5.6 and is based on the modification of the terms

[1] The other main element, financial difficulty, is evaluated at the debtor´s level.

[2] Especially relevant in the case of working capital lending.

and conditions in such a way that full and due repayment would be possible only after it. The definition provides examples of the ways this modification can take place in formal terms.[3]

12. **The definition of the Regulation contains the two main components of the BCBS Guidelines definition, CS and FD, although in an implicit form.** CS is not mentioned at all in the definition of the Regulation, but it is implicitly present, as it can be assumed that the modification of the conditions and terms of the contracts mentioned is not made in normal market circumstances, but in a special and relatively benevolent way to make possible due and full repayment by the debtor. The same can be said about FD in this case, its implicit presence being even clearer, as the definition explicitly mentions the debtor's inability to fulfill its credit obligations, something practically equivalent in practice to FD.

Concessions

13. **According to the BCBS Guidelines, CS is special contractual terms and conditions that would not be granted under normal market conditions.** CS is provided by a lender to a counterparty facing FD so that the counterparty can repay its debt. The main characteristic of these concessions is that a lender would not grant financial support on such terms and conditions under normal market conditions to customers not facing FD.

14. **The BCBS allows supervisors to set specific materiality thresholds for what constitutes CS.** The BCBS Guidelines do not specifically define what constitutes CS, although they provide some examples (see the next part of this section), giving some room as well in terms of materiality thresholds.

15. **The BCBS Guidelines consider three ways in which CS can be granted.** The first one is changes in the conditions of the existing contract, giving considerably more favorable terms for the counterparty. The second one is a supplementary agreement, or a new contract to refinance the current transaction. The last one consists of the exercise of clauses embedded in the contract that enable the counterparty to change the terms and conditions of its contract or to take on additional lending at its own discretion. These actions should only be treated as CS if the bank assesses that the counterparty is in FD.

16. **Although the Regulation does not explicitly consider CS, it provides four different ways in which it can be granted, although it only covers dates and maturities postponing changes.** According to article 5.6, there are four ways to implement CS: (1) modification of the

[3] "... debt restructuring—means modification of terms and conditions of a contract such as modification of the time of return (repayment) of the principal debt and (or) modification of the time of payment of interests, and (or) modification of the schedule of repayment of the principal debt (times and amounts), and (or) modification of the schedule of repayment of interests (times), as well as signing the new contract providing for formation of the Bank's asses exposed to the credit risk and resulting in termination of obligations between the Bank and the debtor in terms of the contract signed earlier where the same party is the debtor, as a result of debtor's inability to fulfill its obligations to the Bank and with the purpose of formation of conditions providing the fulfillment of obligations by the debtor to the Bank in due time and fully."

time of repayment of the principal debt; (2) modification of the time of payment of interests; (3) modification of the schedule of repayment of the principal debt (periods and amounts); and (4) modification of the schedule of repayment of interests (periods). All of them refer to dates and maturities, so there are no references to other relevant terms and conditions such as interest rates or collateral. Other possibilities such as partial condoning or converting debt into equity are not considered at all.

Financial Difficulty

17. **The** BCBS **Guidelines do not define the concept of FD, although they provide several examples that can help explain FD in terms of the NPLs recognition criteria.** There is no formal definition of FD in the BCBS Guidelines, but the examples provided are helpful in illustrative terms. As such, as is detailed below, the BCBS Guidelines consider situations directly or indirectly related to the main recognition criteria for NPLs determination, that is, time past due and UFR.

18. **As commented, the Regulation does not formally define FD, although the concept can be understood from the context.** The Regulation only mentions the "debtor's inability to fulfill its obligations to the Bank," without elaborating on this concept. However, from the context, it is understood that this inability is reflected in terms of the time past due criterion and the related DPD and/or on a weak financial situation evaluated in terms of FI.

Conclusions

19. **According to the previous considerations, the conclusion is that the Regulation is materially non-aligned with the BCBS Guidelines on the forbearance concept.** The Regulation should include in the case of CS changes to terms and conditions other than dates and maturities, especially regarding interest rates and collateral. Furthermore, other possibilities like partial condoning of the debt and conversion of debt into equity are not considered at all. These are significant limitations, both in theory and practice, to the CS concept, so the conclusion is that the Regulation is materially non-aligned with the BCBS Guidelines regarding the forbearance concept.

Examples of Concessions and Financial Difficulty

20. **The BCBS provides eleven detailed examples of CS.** The full list is as follows: (1) extending the loan term; (2) rescheduling the dates of principal or interest payments; (3) granting new or additional periods of nonpayment (grace period); (4) reducing the interest rate, resulting in an effective interest rate below the current interest rate that counterparties with similar risk characteristics could obtain from the same or other institutions in the market; (5) capitalizing arrears;(6) forgiving, deferring, or postponing principal, interest, or relevant fees; (7) changing an amortizing loan to an interest payment only; (8) releasing collateral or accepting lower levels of collateralization; (9) allowing the conversion of debt to equity of the

counterparty; (10) deferring recovery/collection actions for extended periods of time; and (11) easing of covenants.

21. **The Regulation contains four examples of CS, although all of them are focused on dates and maturities issues.** As mentioned, the Regulation should adopt a broader concept for CS, incorporating changes to other relevant terms and conditions and other potential options. Consequently, the Regulation should provide also examples related to all these changes and options.

22. **The BCBS provides seven detailed examples of FD.** The full list is as follows: (1) a counterparty is currently past due on any of its material exposures; (2) 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 concession, for instance, when there has been a pattern of delinquency in payments on its material exposures; (3) a counterparty's outstanding securities have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange due to noncompliance with the listing requirements or for financial reasons; (4) on the basis of actual performance, estimates, and projections that encompass the counterparty's current capabilities, the bank forecasts that all the counterparty's committed/available cash flows will be insufficient to service all of its loans or debt securities (both interest and principal) in accordance with the contractual terms of the existing agreement for the foreseeable future; (5) a counterparty's existing exposures are categorized as exposures that have already evidenced difficulty in the counterparty's ability to repay in accordance with the supervisory categorization scheme in force or the credit categorization scheme in a bank's internal credit rating system; (6) a counterparty is of nonperforming status or would be categorized as nonperforming without CS; and (7) the counterparty cannot obtain funds from sources other than the existing banks at an effective interest rate equal to the current market interest rate for similar loans or debt securities for a non-troubled counterparty.

23. **The Regulation does not contain any example related to FD, and those related to FI are too limited.** FD is mentioned only briefly in terms of the debtor's inability to fully repay in due time. Consequently, there are no examples related to FD. On the other hand, examples related to FI that could be taken as a reference for FD are, as already commented, too limited, so they cannot serve the purpose.

24. **According to the previous considerations, the conclusion is that the Regulation is materially non-aligned with the BCBS Guidelines regarding forbearance examples.** While there are some examples in the case of CS, these are limited to dates and maturities changes. The situation is even more limited in the case of FD, as there are no direct examples and the ones that could be taken indirectly as a reference cannot serve the purpose. Consequently, the Regulation is considered materially non-aligned regarding forbearance examples.

Classification of Forborne Exposures

25. **According to the BCBS Guidelines, forbearance exposures can be included in the performing or NPLs category.** When forbearance is applied to an NPL, the exposure should remain an NPL. When forbearance is applied to a performing exposure, the bank then needs to assess whether the exposure meets the NPL criteria, even if the forbearance resulted in a new exposure. The appropriate classification depends on: (1) the status of the exposure at the time when forbearance is granted; and (2) the counterparty's payment history or creditworthiness after the extension of forbearance.

26. **The Regulation establishes, even if in an indirect way, that forbearance exposures shall be initially classified as NPLs.** The Regulation states in article 39 that the restructured indebtedness (forbearance exposures) cannot be assigned to an RG with a risk level lower than that for the RG where the indebtedness was assigned before the decision was made to restructure it. This article also states that indebtedness assigned to RG-I to RG-III shall be assigned to RG-IV after making the decision to restructure the debt; this means that all forbearance exposures will be initially classified into RG-IV to RG-VI. Finally, the definition of NPLs made in article 31 says that forbearance exposures assigned to RG-IV to RG-VI shall be considered NPLs; this means that all forbearance exposures will be initially considered NPLs.

27. **The Regulation allows the reclassification of forbearance exposures as performing, implying that forbearance exposures can be classified as NPLs or performing exposures depending on the circumstances.** Article 39 allows the reclassification by the bank of forbearance exposures into any other RG but RG-I, even if subject to certain requirements expressed in this article and article 40. This means that forbearance can be reclassified into RG-II or RG-III, which are not considered as NPLs, even in what it refers to forbearance exposures forming part of them.

28. **According to the previous considerations, the conclusion is that the Regulation is aligned with the BCBS Guidelines on the categorization of forbearance exposures.** Even though the Regulation does not say so explicitly, a detailed analysis such as the one made above shows without any doubt that forbearance exposures can be classified NPLs or performing categories, as the BCBS Guidelines state. Consequently, the Regulation is considered aligned with the categorization of forbearance exposures.

Discontinuation of the Forbearance Classification

29. **The BCBS requires two criteria to cease being considered forbearance: a probation period and a solvency test.** The probation period requires that all payments, per the revised contractual terms, have been made in a timely manner over a continuous repayment period of not less than one year. The starting date of the probation period should be the scheduled start of payments under the revised terms, regardless of the performing or nonperforming status of the

exposure at the time that forbearance was granted. The solvency test is simple to state, since it simply implies that the counterparty has resolved its FD.

30. **The Regulation has similar requirements: a probation period and no NI or FI.** The third and last part of article 39 allows banks to reclassify forbearance exposures if payments were made by the debtor in due time and fully during the continuous period of at least 12 months from its initial classification (probation period). It also explicitly requires no signs of NI or FI.[4]

31. **According to the previous considerations, the conclusion is that the Regulation is aligned with the BCBS Guidelines on the discontinuation of the forbearance categorization.** Both elements required by the BCBS Guidelines are present in the Regulation: (1) the probation period of at least one year since the forbearance categorization; and (2) the solvency test (even if in analogous terms to FD using, in this case, FI). Consequently, the Regulation is considered aligned with the discontinuation of the forbearance categorization.

Interaction of Forbearance with NPLs

32. **Banks should not use forbearance practices to avoid classifying loans as NPLs, according to the BCBS Guidelines.** Classifying loans as performing or as less risky by extending forbearance is a source of divergence. Therefore, the definition prohibits the upgrading of an NPL exposure by granting forbearance measures and requires a separate categorization for forborne exposures.

33. **The Regulation is not explicit in this regard but establishes some specific backstops on a just-in-case basis.** Even though the Regulation does not say that banks should not use forbearance practices to avoid classifying loans as NPLs[5], the message is implicit, especially when specific backstops are introduced, such as prohibiting in principle classifying forbearance exposures into RGs with a lower risk or excluding forbearance exposures being reclassified into RG-I under any circumstance.

34. **The BCBS states that forbearance may be granted on performing exposures or NPLs and determines the outcomes depending on the circumstances.** When forbearance is applied to an NPL, the exposure should remain NPL. When forbearance is applied to a

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[4] "The bank has a right, by virtue of a reasonable judgement, to make a decision to reclassify the restructured indebtedness with the requirements stipulated in the first part of this Clause not taken into consideration if payments on the principal debt were paid by the debtor in due time and fully during the continuous period of at least 12 months from the date of beginning of payments on the principal debt after the indebtedness restructuring in accordance with the terms and conditions of the modified contract and no indicators of the financial imbalance and (or) negative information concerning the capability to fulfill obligations to the Bank were found for the debtor. However, the reclassified restructured indebtedness may not be assigned to the risk group I. If the facts of unfair fulfillment of obligations by the debtor to the Bank are revealed for the aforementioned reclassified indebtedness, the special reserve for covering probable losses on this indebtedness shall be built up in accordance with the maximum amount stipulated for the risk group where the indebtedness is assigned to, taking the requirements of this Instruction into consideration."

[5] In terms of RGs in this case.

performing exposure, the bank then needs to assess whether the exposure meets the NPL criteria, even if the forbearance resulted in a new exposure. When the original exposure would have been categorized as an NPL at the time of granting forbearance, had the forbearance not been granted, the new exposure should be categorized as an NPL.

35. **According to the Regulation, forbearance may be granted on a performing exposure or an NPL, but it has to be classified as an NPL in any case.** When forbearance is applied to an exposure classified into a RG qualified as an NPL (RG-V and RG-VI), the exposure cannot be classified into an RG with a lower risk, according to article 39, so it would always continue to be classified into a RG qualified as an NPL (RG-V or RG-VI). The result is the same when forbearance is applied to a performing exposure (RG-I to RG-IV), as article 39 requires these exposures to be classified at least into RG-IV, and forbearance exposures of RG-IV are considered NPLs, according to article 31.

36. **The BCBS also states that banks should pay particular attention to the appropriate classification of exposures on which forbearance has been granted more than once.** When a forborne exposure under the probation period is granted new forbearance, this should trigger a restart of the probation period, and banks should consider whether the exposure should be categorized as NPL.

37. **The Regulation prohibits the reclassification of forbearance exposures when forbearance has been granted more than twice, except in the case of natural persons and microloans.** The Regulation (article 40)[6] goes further than the BCBS Guidelines in terms of the consequences of ulterior forbearances, but only after forbearance has been granted twice, not just after one time and not in all cases, as natural persons and microloans are exempted.

38. **According to the BCBS Guidelines, the continuous repayment period for NPLs and the probation period for forbearance can run concurrently.** All NPL forborne exposures should remain NPL until they meet the criteria for reclassification as performing. Thereafter, the remaining probation period for forbearance exit shall apply and the exposure should be identified as a performing forborne exposure. When a forborne exposure becomes nonperforming during the 12-month probation period, the probation period starts again.

39. **There is no probation period for NPLs in the Regulation, only for forbearance exposures.** NPLs reclassification is made automatically considering the recognition criteria, so there is no probation period that can be compared to the one established for forbearance

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[6] "If terms and conditions of the contract specified in Clause 5.6 of this Instruction are modified more than twice and (or) if more than two contracts are signed providing for the new asset arising for the Bank, exposed to the credit risk and resulting in termination of obligations under the contract signed earlier where the same party is the debtor, the indebtedness shall be classified in accordance with the approaches used for classification of the restructured indebtedness irrespective of whether the Bank's reasonable judgement is available concerning the Debtor's capability to fulfill its obligations to the Bank. The requirements listed in the second part of this Clause shall not be applied to the indebtedness of natural persons on assets exposed to the credit risk and to the indebtedness on microloans."

exposures. In practice, this means that the probation period runs independently, being aligned so with what the BCBS Guidelines prescribe.

40. **According to the previous considerations, the conclusion is that the Regulation is largely aligned with the BCBS Guidelines on the interaction of forbearance with NPLs.** While there are some differences regarding the Guidelines approach for interaction of forbearance with NPLs and the Regulation approach, as already commented, these differences are not significant enough to evaluate the situation worse than largely aligned. In fact, the Regulation is sometimes stricter than what is required by the BCBS Guidelines (for example, forbearance exposures are always classified as NPLs). Consequently, the Regulation is considered largely aligned with the interaction of forbearance with NPLs.

Evaluation Summary for Forbearance

41. **According to the former comments made for each of the harmonization criteria, the evaluation summary for forbearance is as follows:**

Table 1. Evaluation Summary for Forbearance

HARMONIZATION FEATURE	CURRENT REGULATION MAIN SHORTCOMINGS	EVALUATION 1/
Scope	As in the case of NPLs, some exclusions are made, the most relevant being those related to high-credit quality securities.	LA
Level of application	No shortcomings.	A
Concept of forbearance	The main elements of the concept of forbearance are not formally present and, more important, only dates and maturities changes are considered for CS purposes.	MNA
Examples of FD and CS	While there are some examples in the case of CS, these are limited to dates and maturities changes. The situation is even more limited in the case of FD, as there are no direct examples and the ones that could be taken indirectly as a reference cannot serve the purpose.	MNA
Categorization of forbearance exposures	No shortcomings.	A
Discontinuation of the forbearance categorization	No shortcomings.	A
Interaction of forbearance with NPLs	While there are some differences regarding the BCBS Guidelines approach for interaction of forbearance with NPLs and the Regulation approach, these differences are not significant.	LA
SUMMARY		LA

1/ A: aligned; LA: largely aligned; MNA: materially non-aligned; and NA: non-aligned.

42. **The summary evaluation regarding alignment of forbearance to the BCBS Guidelines is largely aligned.** As shown, three criteria are evaluated as aligned, two as largely aligned, and another two as materially non-aligned. This places the simple average on largely aligned, a situation that is confirmed by taking into account the relative importance of each of these criteria, especially the two related to the classification of forbearance exposures and the discontinuation of the forbearance classification, which are rated as aligned on the one hand, and the other one related to the forbearance concept on the other hand, evaluated as materially non-aligned.

Appendix IV. Qualitative Comparison with the Previous Regulation

Previous Regulation

1. **The Regulation (Instruction 138) has been partially amended and modified on numerous occasions since it was issued in September 2006.**[1] The version that has been considered for comparison purposes is the one issued in June 2016 (Instruction 138-361), hereinafter the previous Regulation. For the sake of simplicity, this version of the Regulation will be called hereinafter the previous Regulation and the latest version, which entered into force in 2018, the current Regulation.[2] In a similar vein, terms like "previously" or "before" and "now" or "currently" will be used to respectively denote what was established by the previous Regulation and what is established in the current Regulation.

Main Changes Regarding the Current Regulation

2. **There are many differences between the previous and the current Regulations; although many of them are purely formal, some of them are substantial.** It would be quite laborious to cite and comment on all the amendments made in the new version of the Regulation versus the previous one, as changes are not limited to punctual aspects or even provisions. However, in terms of substance, there are not that many important changes.

3. **Even though neither NPLs nor forbearance existed as such before, changes can be grouped in terms of the harmonization criteria for each of them, as shown in the two tables below.** Even though the most important change in each case is the introduction of the main concept, NPLs or forbearance, the rest of the changes can be better explained if the harmonization criteria framework is used for these purposes. The two tables below, one for NPLs and the other one for forbearance, show in a summarized way the main changes by harmonization criteria.

4. **In general terms, it can be said that, compared to the previous version, the current Regulation has made significant progress regarding alignment with the BCBS Guidelines.** Even though there is still substantial room for further alignment with the BCBS Guidelines, it must be noted that the current version of the Regulation has made significant progress compared to the previous version, especially in that it refers to the introduction of the NPLs concept on the one hand and the forbearance concept and its related framework on the other hand. Advances made in asset classification and LLP should be further structured and integrated with the NPLs concept into a robust related framework.

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[1] Twenty-three criteria.

[2] Even though the Regulation was changed twice in the meantime, as these were minor changes.

Table 1. Main Changes Made in the Current Regulation Regarding NPLs

#	MAIN CHANGES BY HARMONIZATION CRITERIA[1]
SCOPE	
1	Debt incurred by the bank due to the purchasing of property for its activities, the accounts receivable related to economic activities, the accrued incomes, and other assets are no longer excluded from the scope.
2	All shares are excluded now; previously only those shares included in the trading book were.
HARMONIZED RECOGNITION CRITERIA	
1	A definition of NPLs has been included in the new Regulation even though NPLs are not mentioned elsewhere; no mention of NPLs was made before.
2	The description of and guidance for the bank's internal procedures for asset classification and LLP have been drastically shortened and summarized; now, no reference to external factors is made.
3	The provisions for NI and FI have been summarized and clarified; NI is now clearly differentiated from FI.
4	NI and FI concepts and minimum requirements have been streamlined, but are substantially the same; however, references to debtors' credit performance with other parties, including related courts proceedings, have been eliminated.
5	There are six RGs now instead of five; the former RG-II with related provisions of 5% to 30% has been subdivided between the new RG-II (5% to 20%) and the new RG-III (20% to 30%). Former RG-IV and -V are now RG-V and –VI, respectively, and specific names have been established for each of the RGs.
6	The types of assets and CL to be considered for RGs classification purposes have been changed in the new Regulation.
7	The term "prolonged debt" is not used anymore for asset classification purposes; "restructured indebtedness" is used instead, even if in a summarized way (to define NPLs and to determine in a general way how restructured debt should be classified into RGs.
ROLE OF COLLATERALIZATION	
1	A new chapter is devoted to the role of collateralization, but the contents are basically the same in substance as before in the chapter devoted to RGs; the only, and important, exception is the introduction of a special type of collateral, the high-quality collateral.
2	High-quality collateral is now used to classify all covered debt and CL into RG-I.
INTERACTION WITH FORBEARANCE	
1	The specific backstops to prevent banks using forbearance to avoid classifying exposures have been changed[2].

[1] The harmonization criteria reflected here are only those where there are substantial changes between the previous and the current versions of the Regulation.

[2] Being precise, as the previous Regulation did not explicitly consider NPLs, it can be said that the current Regulation incorporates specific backstops and that the previous Regulation had some backstops preventing reclassification into RGs with lower risks.

Table 2. Main Changes Made in the Current Regulation Regarding Forbearance

#	MAIN CHANGES BY HARMONIZATION CRITERIA[1]
SCOPE	
1	Same changes as for the NPL scope.
CONCEPT OF FORBEARANCE	
1	The concept of forbearance is introduced in the Regulation through the terms "debt restructuring" and "restructured debt."
2	CS and FD are introduced in the new Regulation, although implicitly; the previous version just used the term "prolonged debt" and the number of prolongations without defining the term. This means that even when some provisions of the previous version can be relatively interpreted in a forbearance context, the main elements, CS and FD would be missing and no differentiation could be made between forbearance and transactions being renewed just on business and commercial grounds (for example, working capital financing).
EXAMPLES OF CS AND FD	
1	Some examples related to CS have been incorporated into the new Regulation.
DISCONTINUATION OF THE FORBEARANCE CLASSIFICATION	
1	Even though forbearance was not part of the previous Regulation, the conditions for the discontinuation of forbearance classification were there in some way, as the probation period and the solvency test were required to write off exposures. This was necessary to reclassify them as on-balance sheet items under RG-II.

[1] The harmonization criteria reflected here are only those where there are substantial changes between the previous and the current versions of the Regulation.

Analysis of the Changes Considering the Detailed RGs Definitions

5. **A more in-depth analysis of the changes introduced in the current Regulation can be made through the comparison of the RG detailed definitions for assets.** The RGs detailed definitions for assets allow a deeper analysis of the differences between the two versions of the Regulation. They can be compared according to how and which criteria specific types of assets and CL are being classified into the different RGs.

6. **In order to allow a homogeneous comparison, it is necessary to first build the detailed RGs definition table for assets for the previous Regulation.** The RG detailed definition for assets of the previous Regulation is shown in the table below, using the same presentation framework as the one used for the current Regulation. In this case, there are only five RGs and not six as in the other case.

Table 3. Application of the Recognition Criteria to Assets for RGs Definition Purposes
(until April 2018)

TYPE OF ASSET	GROUPS				
	I (0.5–2%)[1]	**II (5–30%)[2]**	**III (30–50%)**	**IV (50–100%)**	**V (100%)**
Debt under credit (except credits of natural persons and microcredits)	ST – D or P or O < 7, no NI or FI	ST – D or P or O < 7 and NI UT and PT – D or P or O < 7, no NI, no FI PT – D or P or O < 7 and NI	All T – P>1, no NI no FI ST – P>1 and NI PT – P>1 and NI UT – D or O < 7 and NI ST and PT – D or P>1 or O < 7 and NI ST – 7 < = O < 90	UT – P>1 and NI UT – D or P>1 or O < 7 and FI UT – 7 < O < = 90 PT – 7 < O < = 180 ST – 90 < O < = 180	UT – O > 90 PT and ST – O > 180
Natural persons credits	D or P or O < = 30, no NI	D or P or O < = 30 and NI	P>1 30 < O < = 90	90 < O < = 180	O > 180
Microcredits	D or P or O < = 7, no NI	D or P or O < = 7 and NI	P>1 7 < O < = 90	90 < O < = 180	O > 180
Leasing	D or P or O < = 7, no NI, no FI	D or P or O < = 7 and NI	D or P or O < = 7 and FI P>1 7 < = O < = 90	90 < O < = 180	O > 180
Factoring (except natural persons)	D or P or O < = 7, no NI and RR	P>1, no NI and RR D or P or O < = 7 and no NI, no RR D or P or O < = 7 and NI and RR	P>1, NI and RR P>1, no NI, no RR D or P or O < 7, NI, no RR P>1, NI, no RR 7 < = O < = 90 and RR	90 < O < = 180 and RR 7 < = O < = 90, no RR	O > 180 and RR O > 90, no RR
Factoring (natural persons)	D or P or O < = 30, no NI	D or P or O < 30 and NI	P>1, NI and RR P>1, no NI, no RR P>1, NI, no RR 30 < = O < 90	90 < O < = 180 and RR 90 < = O < = 180, no RR	O > 180 and RR O > 180, no RR

Table 3. Application of the Recognition Criteria to Assets for RGs Definition Purposes (continued)

(until April 2018)

TYPE OF ASSET	GROUPS				
	I (0.5–2%)[1]	II (5–30%)[2]	III (30–50%)	IV (50–100%)	V (100%)
Banks	D or P>1, no NI, no FI	D or P>1 and NI	D or P>1 and FI O < = 30	30 < O < = 90	O > 90
Securities (according to Chapter 4, articles 42.1–42.4)	No NI, no FI	NI, no SPD	SPD and FI, no SPR	SPR and nonperformance probability No available information	High probability of nonperformance[3] Other cases[4]
Securities (according to Chapter 3, articles 27–31)			7 < = O < = 90 FI	90 < O < = 180	O > 180
Promissory notes and certificates of deposit	D or O < = 7, no NI	D or O < = 7 and NI			
Performed obligations for third parties			90 < F and RR	90 < F, no RR 90 < F < = 180 and RR	F > 90, no RR F > 180 and RR
Debt related to RG-IV classified by the bank according to additional criteria				C < = 90	C > 90
Debt with incomplete or no information on the debtors (except GA)				All	
Other assets	D or O < = 7, no NI	D or O < = 7 and NI	7 < O < = 30	30 < O < = 90	O > 90
Other circumstances					[5]

Table 3. Application of the Recognition Criteria to Assets for RGs Definition Purposes (concluded)
(until April 2018)

[1] 1% for securities.
[2] 10%–30% for securities.
[3] Attribution by the bank of RG-IV securities based on additional criteria.
[4] Securities of Group D legal persons, nonrated nonresident legal persons, Group D banks, Group C banks (unavailable annual reports), governments, and central banks of Group E countries (except GA for all these cases) and encumbered assets in the absence of information.
[5] Debtor liquidated or insolvent, force majeure; debt of Group D legal persons, nonrated nonresident legal persons, Group D banks, Group C banks (unavailable annual report) (except GA for all these cases), and encumbered assets in the absence of information.
Source: Author's elaboration based on the contents of articles 27–31 and 42.1–42.4.
XXX: performing exposures according to international standards (approximation).
YYY: NPLs according to international standards (approximation).
ZZZ: not evaluated due to generic contents or contents including both performing exposures and NPLs.
WWW: no exposures of this type of assets are considered for this RG.

Time past due
D: due; and O: days overdue (DPD—days past due).

Prolonged
P: prolonged just once
P>1: due or prolonged more than once

Negative indicators
NI: negative information.
FI: financial imbalance.

Collateral
All T: all transactions; ST: secured transactions; PT: partially secured transactions (under-secured transactions); and UT: unsecured transactions.

Securities
SPD: significant price decrease.
SPR: significant price reduction.

Other
C: classification date by the bank.
F: fulfillment date.
GA: debt secured by Group A governments and banks or other high-quality guarantees.
RR: right of recourse.

7. **There are some elements that introduce heterogeneity in the framework—the number of RGs, the term "prolonged debt," and the types of assets being the most relevant ones—that can make the comparison significantly difficult.** The number of RGs has been increased in the current Regulation, as there are six RGs now instead of five. The term "prolonged debt" is not used anymore in the current Regulation, as "debt restructuring" has taken its place. Finally, there are substantial differences between the types of assets used in the two versions.

8. **The variation in the number of RGs is the easiest element to address, as the new RG is a subdivision of the former RG-II.** Current RG-II and -III represent the former RG-II, as it can be deducted in general terms from the related provisions ranges (5–30 percent for former RG-II, 5–20 percent for the new RG-II, and 20–30 percent for the new RG-III). More specifically, it can also be observed how the criteria used for the former RG-II are now used

for the new RG-II or RG-III—even though there are some exceptions to the rule (this is further explored later on). This interpretation implies that the current RG-IV to RG-VI correspond respectively to the previous RG-III to RG-V.

9. **The comparison of the use of the term "prolonged debt" versus the new forbearance concept is more complex, as "prolonged debt" is not defined on the one hand, and it is used on the other hand together with other time past-due related criteria.** As there is no definition of the term, it is necessary to interpret it, even if in a general way. It seems that the most appropriate interpretation, considering the asset classification and LLP context, is to think that "prolonged debt" corresponds mostly to forbearance, as it can be assumed that cases of lending renewals based on commercial and business grounds will be unusual. The argument would be even stronger for those situations where the criterion is "prolonged more than once." From this point on, taking into account the forbearance framework of the current Regulation, prolonged debt would be equivalent to NPLs—unless reclassified after a probation period and a solvency test. However, there is not enough information to evaluate these cases, of which, on the other hand, there would be relatively few.

10. **From this point on, a global evaluation shows that NPLs, according to international benchmarks, would be represented in the previous Regulation mostly by RG-III to RG-V.** Most of the contents of RG-III to RG-V represent situations that would be qualified as NPLs according to international benchmarks. In the case of RG-IV and RG-V, the main criterion would be time past due, while in the case of RG-III, the main criterion would be prolonged debt. It must also be noted that prolonged debt is present in many cases in RG-I and –II as well, but it is not possible to know without having more detailed data the extent to which this presence is important or not.

11. **There is not a definition of "problem assets" in the previous Regulation; the term was defined in another regulation as the aggregate of RG-III to RG-V.** This assumption is supported by the quantitative data provided and is reinforced by the fact that these RGs include those cases where provisions are significant enough (30–100 percent). Although it can be argued that RG-II should be taken into account in this regard as well, given its related provision range (5–30 percent), it does not seem to be the case, considering that banks use just the lower figure (5 percent) for LLP purposes. The specific criteria used to define RG-II confirm this impression as well.

12. **As a general impression, it seems that problem assets were more representative of NPLs in international terms than the NPLs definition used in the current Regulation.** Apart from detailed considerations, the basic difference in simple terms between problem assets and the NPLs defined in the current Regulation is related to the consideration of the previous RG-III/current RG-IV. Problem assets include all of it, while current NPLs only consider the restructured or forbearance exposures part of it.

13. **The types of assets used in the previous Regulation is significantly different from those used in the current Regulation.** The table below shows in detail and in a comparative form the type of assets used in the previous and current regulations:

14. **There are only four cases where a direct comparison is possible.** These cases are: (1) "Microloans"; (2) "Banks"; (3) "Other active transactions"; and (4) "Other circumstances." The last two cases are residual categories by nature.

15. **There are four other cases where some aggregation/disaggregation is needed to perform comparisons.** These cases are: (1) current "Legal persons (including individual entrepreneurs): loans except microloans, assignment of the right of a monetary claim, or alienation of assets and factoring," which has to be compared to the current "Debt under credit (except credits of natural persons and microcredits)" and "Factoring (except natural persons)"; (2) current "Natural persons—loans, financial leasing, and factoring" that have to be compared to the current "Natural persons credits" and "Factoring (natural persons)"; and (3) current "Securities," to be compared to the two former types for "securities." In addition, the current "Legal persons—financial leasing" has to be compared to the previous "leasing," that includes also "natural persons."

Table 4. Comparison of the Types of Assets Used in the Current and Previous Versions of the Regulation

TYPE OF ASSETS	
CURRENT REGULATION	**PREVIOUS REGULATION**
Assets with high-quality collateral.	N.A. (it is a term introduced in the current Regulation).
Legal persons (including individual entrepreneurs): loans except microloans, assignment of the right of a monetary claim or alienation of assets and factoring.	Debt under credit (except credits of natural persons and microcredits). Factoring (except natural persons).
Legal persons—financial leasing.	Leasing (includes both legal and natural persons however).
Natural persons—loans, financial leasing, and factoring.	Natural person credits. Factoring (natural persons).
Microloans.	Microcredits.
Banks.	Banks.
Securities.	Securities (according to Chapter 4). Securities (according to Chapter 3).
Fulfillment of obligations by the Bank instead of third parties.	Performed obligations for third parties.
Provision of an advance in payment for goods, works, and services (commercial loans).	N.A.
N.A.	Promissory notes and certificates of deposit.

Table 4. Comparison of the Types of Assets Used in the Current and Previous Versions of the Regulation (concluded)

TYPE OF ASSETS	
CURRENT REGULATION	**PREVIOUS REGULATION**
N.A. (there are no additional criteria anymore).	Debt related to RG-IV classified by the Bank according to additional criteria.
N.A.	Debt with incomplete or no information on the debtors (except GA).
Other active transactions.	Other assets.
Other circumstances.	Other circumstances.

16. **Finally, there are five cases where there is no correspondence at all between types of assets, so these situations cannot be compared.** The cases where there is no correspondence are: (1) assets with high-quality collateral; (2) provision for an advance in payment for goods, works, and services (commercial loans); (3) promissory notes and certificates of deposit; (4) debt related to RG-IV classified by the bank according to additional criteria; and (5) debt with incomplete or no information on the debtors (except GA).

17. **A specific scheme is used for comparative purposes in the tables below, highlighting the differences in blue when the current Regulation is stricter, in red when it is more benevolent, and in gray when there are no changes.** The scheme is illustrated in specific tables for each type of asset. Each table contains the detailed criteria for the classification into the different RGs, according to the previous Regulation in the first block and to the current Regulation in the second block. To facilitate a quick understanding of the situation, colors are used to highlight the current Regulation criteria in an intuitive way. Blue is used to denote when the current Regulation has adopted a stricter approach, red in the opposite case, and gray when there are no changes. In most cases and for the reasons stated, the evaluation of prolonged debt is limited in scope.

18. **Legal persons are now treated more benevolently in general terms, as requirements have been lowered one grade for current RG-III to RG-VI.** As the table below shows, it is quite difficult to evaluate the direction and importance of the changes, mainly because of three factors. The first one is that factoring was evaluated separately in the previous Regulation, while the second one is related to the casuistic treatment made based on the existing collateral. Finally, the intensive use of the prolonged debt criterion in the previous Regulation, but not in the current one, makes the evaluation even more difficult. Using the table below, a careful consideration of all the involved factors and criteria leads to the conclusion that legal persons are now treated more benevolently in general terms, as requirements have been lowered practically one grade for current RG-III to RG-VI.

Table 5. Comparison of the Current and Previous Regulations for Legal Persons

REGULATION	RISK GROUPS				
	I (0.5–2%)	II (5–30%)	III (30–50%)	IV (50–100%)	V (100%)
PREVIOUS	ST – D or P or O < 7, no NI or FI	ST – D or P or O < 7 and NI UT and PT – D or P or O < 7, no NI, no FI PT – D or P or O < 7 and NI	All T – P>1, no NI, no FI ST – P>1 and NI PT – P>1 and NI UT – D or O < 7 and NI ST and PT – D or P>1 or O < 7 and NI ST – 7 < = O < 90	UT – P>1 and NI UT – D or P>1 or O < 7 and FI UT – 7 < O < = 90 PT – 7 < O < = 180 ST – 90 < O < = 180	UT – O > 90 PT and ST – O > 180
	D or P or O < = 7, no NI and RR	P>1, no NI and RR D or P or O < = 7 and no NI, no RR D or P or O < = 7 and NI and RR	P>1, NI and RR P>1, no NI, no RR D or P or O < 7, NI, no RR P>1, NI, no RR 7 < = O < = 90 and RR	90 < O < = 180 and RR 7 < = O < = 90, no RR	O > 180 and RR O > 90, no RR

Table 5. Comparison of the Current and Previous Regulations for Legal Persons (concluded)

REGULATION	RISK GROUPS					
CURRENT	I (0.5–2%)	II (5–20%)	III (20–30%)	IV (30–50%)	V (50–100%)	VI (100%)
	ST - O < = 7, no NI, no FI	All T - no FI, no NI ST and PT - O < = 7 and NI UT and PT - no NI, no FI	All T - O < = 7 and FI UT - O < = 7 and NI All T – 7 < O < = 30, no FI, no NI All T – 7 < O < = 30, NI	UT - O < = 7 and FI ST and PT - 7 < O < = 30 and FI ST and PT - 30 < O < 90	UT - 7 < O < = 30 and FI UT - 30 < O < = 90 All T - 90 < O < = 180	UT – 90 < O < 180 All T – O > 180

19. **Legal persons-financial leasing is treated now in a slightly more benevolent way.** As the table below shows, the application of the time past due criterion for legal persons—financial leasing has been relatively relaxed, as situations with fewer than 30 DPD are integrated now in RG-III and subject so to lower provisions (20 percent instead of 30 percent). The same happens with FI. It must be noted that the previous Regulation did not differentiate leasing to legal persons from leasing to natural persons, so the criteria and requirements for both cases were the same.

Table 6. Comparison of the Current and Previous Regulations for Legal Persons—Financial Leasing

<table>
<tr><th>REGULATION</th><th colspan="6">RISK GROUPS</th></tr>
<tr><td rowspan="2">PREVIOUS</td><td>I (0.5–2%)</td><td colspan="2">II (5–30%)</td><td>III (30–50%)</td><td>IV (50–100%)</td><td>V (100%)</td></tr>
<tr><td>D or P or O < = 7, no NI, no FI</td><td colspan="2">D or P or O < = 7 and NI</td><td>D or P or O < = 7 and FI

P>1

7 < = O < = 90</td><td>90 < O < = 180</td><td>O > 180</td></tr>
<tr><td rowspan="2">CURRENT</td><td>I (0.5–2%)</td><td>II (5–20%)</td><td>III (20–30%)</td><td>IV (30–50%)</td><td>V (50–100%)</td><td>VI (100%)</td></tr>
<tr><td>O < = 7, no NI, no FI</td><td>O < = 7, NI and FI[1]</td><td>O < = 7, FI

7 < O < = 30, no NI, no FI

7 < O < = 30 and NI</td><td>7 < O < = 30 and FI

30 < O < 90</td><td>90 < O < = 180</td><td>O > 180</td></tr>
<tr><td colspan="7">[1] FI here seems to be an inconsistency.</td></tr>
</table>

20. **Natural persons are now treated slightly more benevolently, as situations with fewer than 60 DPD are integrated into RG-III and therefore subject to lower provisions.** As the table below shows, it is quite difficult to evaluate the direction and importance of the changes, mainly because of three factors. The first one is that factoring was evaluated separately in the previous Regulation, while the second one is related to the casuistic treatment made depending on the existing collateral. Finally, the intensive use of the prolonged debt criterion in the previous Regulation, but not in the current one, makes the evaluation even more difficult. Nevertheless, a careful consideration of all the involved factors and criteria leads to the conclusion that natural persons are now treated slightly more benevolently, as situations with fewer than 60 DPD are now integrated into RG-III and therefore subject to lower provisions (20 percent instead of 30 percent).

Table 7. Comparison of the Current and Previous Regulations for Natural Persons

<table>
<tr><th>REGULATION</th><th colspan="6">RISK GROUPS</th></tr>
<tr><td rowspan="3">PREVIOUS</td><td>I (0.5–2%)</td><td colspan="2">II (5–30%)</td><td>III (30–50%)</td><td>IV (50–100%)</td><td>V (100%)</td></tr>
<tr><td>D or P or O < = 30, no NI</td><td colspan="2">D or P or O < = 30 and NI</td><td>P>1
30 < O < = 90</td><td>90 < O < = 180</td><td>O > 180</td></tr>
<tr><td>D or P or O < = 30, no NI</td><td colspan="2">D or P or O < 30 and NI</td><td>P>1, NI and RR

P>1, no NI, no RR

P>1, NI, no RR

30 < = O < 90</td><td>90 < O < = 180 and RR

90 < = O < = 180, no RR</td><td>O > 180 and RR

O > 180, no RR</td></tr>
<tr><td rowspan="2">CURRENT</td><td>I (0.5–2%)</td><td>II (5–20%)</td><td>III (20–30%)</td><td>IV (30–50%)</td><td>V (50–100%)</td><td>VI (100%)</td></tr>
<tr><td>O < = 30, no NI</td><td>O < = 30 and NI</td><td>30 < O < = 60</td><td>60 < O < = 90</td><td>90 < O < = 180</td><td>O > 180</td></tr>
</table>

21. **Microloans are now treated in a slightly more benevolent way.** As the table below shows, the application of the time past due criterion for microloans has been relatively relaxed, as situations with fewer than 30 DPD are now integrated into RG-III and therefore subject to lower provisions (20 percent instead of 30 percent).

22. **Banks are now treated in a slightly more benevolent way.** As the table below shows, banks' FI is now integrated into RG-III and therefore subject to lower provisions (20 percent instead of 30 percent).

Table 8. Comparison of the Current and Previous Regulations for Microloans

REGULATION	RISK GROUPS					
PREVIOUS	I (0.5–2%)	II (5–30%)		III (30–50%)	IV (50–100%)	V (100%)
	D or P or O < = 7, no NI	D or P or O < = 7 and NI		P>1 7 < O < = 90	90 < O < = 180	O > 180
CURRENT	I (0.5–2%)	II (5–20%)	III (20–30%)	IV (30–50%)	V (50–100%)	VI (100%)
	O < = 7, no NI	O < = 7 and NI	7 < O < = 30	30 < O < = 90	90 < O < = 180	O > 180

Table 9. Comparison of the Current and Previous Regulations for Banks

REGULATION	RISK GROUPS					
PREVIOUS	I (0.5–2%)	II (5–30%)		III (30–50%)	IV (50–100%)	V (100%)
	D or P>1, no NI, no FI	D or P>1 and NI		D or P>1 and FI O < = 30	30 < O < = 90	O > 90
CURRENT	I (0.5–2%)	II (5–20%)	III (20–30%)	IV (30–50%)	V (50–100%)	VI (100%)
	No O, no NI, no FI	NI	FI	O < = 30	30 < O < = 90	O > 90

Table 10. Comparison of the Current and Previous Regulations for Securities

REGULATION	RISK GROUPS					
PREVIOUS	I (0.5–2%)	II (5–30%)		III (30–50%)	IV (50–100%)	V (100%)
	No NI, no FI	NI, no SPD		SPD and FI, no SPR	SPR and nonperformance probability No available information	High probability of nonperformance[1] Other cases[2]
				7 < = O < = 90 FI	90 < O < = 180	O > 180
CURRENT	I (0.5–2%)	II (5–20%)	III (20–30%)	IV (30–50%)	V (50–100%)	VI (100%)
	O < = 7, no NI, no FI	O < = 7 and NI	O < = 7, FI 7 < O < = 30, no NI, no FI 7 < O < = 30 and NI	7 < O < = 30 and FI 30 < O < = 90	90 < O < = 180	O > 180

[1] Attribution by the bank of RG-IV securities based on additional criteria.
[2] Securities of Group D legal persons, nonrated nonresident legal persons, Group D banks, Group C banks (unavailable annual reports), governments and central banks of Group E countries (except GA for all these cases), and encumbered assets in the absence of information.

23. **Securities are now treated slightly more benevolently, as situations with fewer than 30 DPD and/or FI are now integrated into RG-III and therefore subject to lower provisions.** As the table below shows, it is difficult to evaluate the direction and importance of the changes, mainly because securities were evaluated in two different ways in the previous Regulation. That said, careful consideration leads to the conclusion that securities are now treated slightly more benevolently, as situations with fewer than 30 DPD are now integrated in RG-III and therefore subject to lower provisions (20 percent instead of 30 percent).

24. **Other active transactions are now treated more benevolently.** As the table below shows, the application of the time past due criterion to other active transactions has been relaxed, increasing the minimum required DPD for current RG-III to -VI (former RG-II to -V) in a sort of landslide.

Table 11. Comparison of the Current and Previous Regulations for Other Active Transactions

REGULATION	RISK GROUPS					
PREVIOUS	**I (0.5–2%)**	**II (5–30%)**		**III (30–50%)**	**IV (50–100%)**	**V (100%)**
	D or O < = 7, no NI	D or O < = 7 and NI		7 < O < = 30	30 < O < = 90	O > 90
CURRENT	**I (0.5–2%)**	**II (5–20%)**	**III (20–30%)**	**IV (30–50%)**	**V (50–100%)**	**VI (100%)**
	O < = 7, no NI	O < = 7 and NI	7 < O < = 30	30 < O < = 90	90 < O < = 180	O > 180

25. **Other circumstances are now treated more benevolently, as the number of cases to be included in the worst RG has been substantially reduced.** As the table below shows, even though all the circumstances considered are included in both cases in the RG with the highest risk and provisions, the number of cases to be included has been substantially reduced, from eight to two.

26. **Furthermore, this change has resulted in practice in moving forbearance exposures to RGs with higher risk and related provision levels.** Even though a precise evaluation cannot be made because not enough data are available, it seems that replacing the extensive use of the prolonged debt criterion in the RGs with a more structured approach based on forbearance considerations has resulted in practice in making the contents of the different RGs more necessary, in the sense that forbearance exposures have been moved to RGs with higher risk and related provisions levels.

27. **The replacement of the "prolonged debt" scheme with the "debt restructuring" framework has resulted in a more aligned regulation with the BCBS Guidelines on forbearance.** As it was evaluated in the previous section of this report, the current "debt restructuring" framework is largely aligned with BCBS Guidelines on forbearance.

Compared to the previous scheme based on "prolonged debt", the adoption of the current Regulation represents significant progress in this regard.

28. **Finally, it is not possible to perform the same kind of analysis for CL, as the types of CL defined in each version of the Regulation are totally different, making comparisons practically impossible.** The previous Regulation classifies CL basically in terms of the kind of CL (financing obligations, guarantees, and so on), while the current Regulation classifies CL basically in terms of counterparties (banks, natural persons, and so on). Accordingly, it is not possible to compare the criteria of the previous Regulation to those of the current Regulation. Nevertheless, it must be noted that the relative importance of CL in the asset classification and LLP context is relatively low, so it is not a significant limitation not being able to evaluate if the current Regulation is more or less strict regarding CL than the previous Regulation.

Table 12. Comparison of the Current and Previous Regulations for Other Circumstances

REGULATION	RISK GROUPS					
PREVIOUS	I (0.5–2%)	II (5–30%)		III (30–50%)	IV (50–100%)	V (100%)
						Eight different situations[1]
CURRENT	I (0.5–2%)	II (5–20%)	III (20–30%)	IV (30–50%)	V (50–100%)	VI (100%)
						Bankruptcy and force majeure

[1] Debtor liquidated or insolvent, force majeure; debt of Group D legal persons, non-rated non-resident legal persons, Group D banks, Group C banks (unavailable annual reports) except GA for all these cases; and encumbered assets in the absence of information.

Appendix V. Quantitative Comparison to the Previous Regulation

Objective

1. **The objective of the quantitative comparison to the previous Regulation is to identify significant quantitative changes.** The comparison between the two regulations is focused on asset classification and LLP in general and more particularly on NPLs.

2. **The provided data set is limited and does not allow precise conclusions, although some relevant inferences can be made supported by professional judgment.** Available data are scarce and do not allow the kind of detailed analysis that could lead to precise estimates and conclusions. More specifically, no detailed information about the type of assets and CL and the way they have been considered in the asset classification and LLP processes has been provided. However, some analytical progress supported by professional judgment can be made identifying the most significant changes in asset classification and LLP in general terms and NPLs in more particular terms.

3. **This quantitative comparison should be taken as a complement to the qualitative assessment made in the previous section of this report.** Once the qualitative evaluation has been made, it is important to perform a quantitative analysis that can confirm and/or complement the conclusions obtained through the qualitative analysis. On the other hand, although it should not be deemed likely or expected, quantitative conclusions can differ significantly from the qualitative ones. If this were the case, the conceptual reasons for this divergence should be investigated.

Scope

4. **The first evaluation that has to be made is related to the scope, which can be measured in terms of the assets and CL, included in the asset classification process.** The figures to be considered are the total amounts of the different RGs on the one hand and the total assets amount on the other hand. It is important to remember that the current Regulation entered into force in April 2018, but that the first reported figures according to the current Regulation correspond to May 2018.

5. **The first important difference that has been identified is that total assets increased significantly (12.8 percent) once the regulatory change entered into force even though no major changes were made in terms of scope.** The table below shows the evolution of the total assets and the RG amounts since January 2018 to October 2018. There is a significant increase in May 2018 of 12.8 percent. This increase should be due to the introduction of a broader scope in the Regulation, but this does not seem to be the case, judging by what the two versions of the Regulation state, so further investigation should be made.

6. **The second identified difference is that there is a relevant amount of assets not classified into any RG.** The table below shows the evolution of the total assets and the RGs amounts since January 2018 to October 2018. As it can be observed before and after the regulatory change, there are relatively significant amounts of total assets that are not included in any RG. These other assets represent on average about 2 percent of the total assets (see Tables 2 and 3 below). Maybe these figures correspond to CL, but even in this case, these figures should be distributed into the different RGs.

Table 1. Total Assets Evolution
(BYN Million)

PERIOD	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
Total Assets	43.177	42.850	43.232	43.800	49.402	49.581	49.526	49.692	50.827	52.788
Increase (%)		-0.8%	0.9%	1.3%	12.8%	0.4%	-0.1%	0.3%	2.3%	3.9%

Source: Author's elaboration based on data provided by the NBRB.

Table 2. Total Assets and RGs Amounts Evolution
(BYN Million)

PERIOD / RG	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
RG-I	24.521	23.916	24.699	24.526	28.393	28.488	28.252	28.472	28.601	30.363
RG-II	12.461	12.601	12.234	12.741	12.919	12.671	12.843	12.674	13.554	13.049
RG-III	4.692	4.773	4.639	4.680	3.117	3.290	3.106	3.070	3.221	3.837
RG-IV	770	778	835	945	3.020	2.979	3.261	3.362	3.365	3.352
RG-V	87	80	77	104	671	833	806	791	735	782
RG-VI	-	-	-	-	368	398	219	148	156	129
SUBTOTAL	**42.531**	**42.148**	**42.484**	**42.996**	**48.488**	**48.659**	**48.488**	**48.517**	**49.630**	**51.512**
Other assets	646	703	749	804	913	922	1.038	1.175	1.196	1.275
Total Assets	**43.177**	**42.850**	**43.232**	**43.800**	**49.402**	**49.581**	**49.526**	**49.692**	**50.827**	**52.788**

Source: Author's elaboration based on data provided by the NBRB.

Composition in Terms of RGs

7. **Once the scope has been analyzed, the next step is to evaluate whether the relative importance of the different RGs has changed due to the new Regulation.** To evaluate this, it is necessary to calculate the relative importance of each RG and analyze its evolution during the period. Changes due to the new Regulation should be reflected since the first figures reported in accordance to it are available, in this case May 2018. It is also important in this case to keep in mind that the number of RGs has increased from five to six.

8. **The relative importance of each of the RGs has been stable, both before and after the regulatory change.** As the table below illustrate, the relative importance of the different RGs remained relatively constant before and after the regulatory change. The composition only changed significantly when the current Regulation entered into force.

Table 3. Total Assets in Terms of the RGs

PERIOD / RG	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
RG-I	56.8%	55.8%	57.1%	56.0%	57.5%	57.5%	57.0%	57.3%	56.3%	57.5%
RG-II	28.9%	29.4%	28.3%	29.1%	26.2%	25.6%	25.9%	25.5%	26.7%	24.7%
RG-III	10.9%	11.1%	10.7%	10.7%	6.3%	6.6%	6.3%	6.2%	6.3%	7.3%
RG-IV	1.8%	1.8%	1.9%	2.2%	6.1%	6.0%	6.6%	6.8%	6.6%	6.3%
RG-V	0.2%	0.2%	0.2%	0.2%	1.4%	1.7%	1.6%	1.6%	1.4%	1.5%
RG-VI	0.0%	0.0%	0.0%	0.0%	0.7%	0.8%	0.4%	0.3%	0.3%	0.2%
SUBTOTAL	**98.5%**	**98.4%**	**98.3%**	**98.2%**	**98.2%**	**98.1%**	**97.9%**	**97.6%**	**97.6%**	**97.6%**
Other assets	1.5%	1.6%	1.7%	1.8%	1.8%	1.9%	2.1%	2.4%	2.4%	2.4%
Total Assets	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Author's elaboration based on data provided by the NBRB.

9. **A correct comparison of RGs requires some realignment of previous and current RGs, considering the main change was the division of the previous RG-II between the current RG-II and -III.** From this point on, the previous RG-II should be compared to the aggregate amount of current RG-II and -III; on its turn, the previous RG-III, -IV, and -V should be, respectively, compared to the current RG-IV, -V, and -VI. Obviously, the previous RG-I would still be compared to the current RG-I. The table below shows this realignment for comparison purposes:

Table 4. Changes in the RGs' Relative Importance Due to the Regulatory Change

PREVIOUS RG	04/2018	CURRENT RG	05/2018	DIFFERENCE
RG-I	56.0%	**RG-I**	57.5%	**1.5%**
RG-II	29.1%	**RG-II**	26.2%	**3.4%**
		RG-III	6.3%	
RG-III	10.7%	**RG-IV**	6.1%	-4.6%
RG-IV	2.2%	**RG-V**	1.4%	-0.8%
RG-V	0.2%	**RG-VI**	0.7%	0.5%
SUBTOTAL	98.2%	**SUBTOTAL**	98.2%	**0.0%**
Other assets	1.8%	**Other assets**	1.8%	**0.0%**
Total Assets	100.0%	**Total Assets**	100.0%	**0.0%**

Source: Author's elaboration based on data provided by the NBRB.

10. **The importance of the two RGs with the higher risk levels is relatively low: 2.4 percent before the regulatory change and 2.1 percent after it.** RG-IV and RG-V, according to the previous regulation, represent only 2.4 percent of the total assets, while the equivalent RGs after the regulatory change, RG-V and -VI, represent a similar figure, 2.1 percent.

11. **The current RG-II and -III aggregate amount represents significantly more than the amount of the previous RG-II, confirming the landslide identified in the qualitative section.** The change from the division of the previous RG-II into the current RG-II and -III would imply that the amount of the previous RG-II should be similar to the aggregate amount of the current RG-II and -III. However, this is not the case: previous RG-II represented 29.1 percent before the regulatory change, and the aggregate of RG-II and -III after the regulatory change represented significantly more, 32.5 percent. Most probably, this difference results from the landslide observed in the qualitative section, especially regarding displacements from current RG-IV to III.

12. **The importance of RG-I also increases in a similar vein, being compensated by the decrease of the previous RG-III, now the current RG-IV.** In addition to the increase of the current RG-II and –III, similarly, the importance of RG-I increases significantly. Conversely to all these increases is the significant decrease of the previous RG-III, now the current RG-IV.

13. **All these changes confirm that the new Regulation is softer than the previous one, but also suggest that the prolonged debt approach was not effective in practice.** The

previous Regulation was more conservative, as the detailed criteria used for the RGs definition implied that the RGs with higher risk levels received more exposures in relative terms. However, the substitution of the prolonged debt should have produced the opposite effect. Therefore, based on professional judgment and even though detailed data are not available, it seems that the application of the prolonged debt approach was quite limited in practice.

Problem Assets and NPLs

14. **Problem assets represented about 13 percent, while NPL levels represented much lower, around 4 percent.** The previous Regulation used the problem assets term, defined as the aggregate of the three RGs with the highest risk levels, that is, RG-III to -V. Problem assets calculated in this way represented 13.1 percent just before the regulatory change. On its turn, NPLs, according to the current Regulation, have to be calculated based on the amounts of the two RGs with the highest risk levels, RG-V to -VI, plus the part of RG-IV corresponding to restructured debt. NPLs just after the regulatory change were 3.6 percent, almost four times less.

Table 5. Problem Assets and NPLs

PERIOD	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
Problem assets or NPLs	5.549	5.631	5.551	5.729	1.743	1.989	1.849	1.922	2.118	2.178
Total Assets	43.177	42.850	43.232	43.800	49.402	49.581	49.526	49.692	50.827	52.788
%	**13.0%**	**13.4%**	**13.1%**	**13.3%**	**3.6%**	**4.1%**	**3.8%**	**4.0%**	**4.3%**	**4.2%**

Source: Author's elaboration based on data provided by the NBRB.

Table 6. Composition of NPLs in RGs Terms

PERIOD / RG	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
Restructured debt in RG-IV	704	757	823	983	1.228	1.267
RG-V	671	833	806	791	735	782
RG-VI	368	398	219	148	156	129

Table 6. Composition of NPLs in RGs Terms (concluded)

PERIOD / RG	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
TOTAL NPLs	1.743	1.989	1.849	1.922	2.118	2.178
% of RG-IV that corresponds to restructured debt	**23.3%**	**25.4%**	**25.2%**	**29.2%**	**36.5%**	**37.8%**

Source: Author's elaboration based on data provided by the NBRB.

15. **Given the quantitative values reflected here and the qualitative comments made before, it seems that NPLs aligned with international benchmarks can be somewhat in the middle of problem assets and NPLs.** In both quantitative and qualitative terms, it seems that problem assets can be a bit conservative, while NPLs, according to the current Regulation, can fall quite short of what would be NPLs in an international sense.

16. **A significant part of NPLs come from restructured debt classified into RG-IV; this restructured debt represents on its turn a significant and increasing part of RG-IV.** The major components of NPLs are exposures included in RG-V and restructured debt from RG-IV, whose relative importance is increasing, as seen in Table 6. Restructured debt represents a significant part of RG-IV, and its relative importance is also increasing in this regard.

Provisions

17. **The next step is to evaluate whether the regulatory changes have had significant effects on the provisioning levels.** The figures to be considered are the total amounts of provisions on the one hand and the total assets amount on the other hand. The table below reflects these amounts during the period and the resulting provisioning percentages:

Table 7. Global Provisioning Levels
(BYN Millions)

PERIOD	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
Provisions	2.688	2.743	2.735	2.868	3.162	3.285	3.168	3.139	3.189	3.310
Total Assets	43.177	42.850	43.232	43.800	49.402	49.581	49.526	49.692	50.827	52.788
%	**6.2%**	**6.4%**	**6.3%**	**6.5%**	**6.4%**	**6.6%**	**6.4%**	**6.3%**	**6.3%**	**6.3%**

Source: Author's elaboration based on data provided by the NBRB.

18. **The provisioning percentages are stable and have not been affected by the regulatory changes, representing an average 6.4 percent of the total assets.** It is important to note that the provisioning percentages have been stable, both before and after the regulatory change, and that they have not been affected at all by the change.

19. **As in the case of the assets, there is a relevant amount of provisions not classified into any RG.** The table below shows the provisions distribution since January 2018 to October 2018. Before and after the regulatory change, there have been relatively significant amounts of provisions not attributed to any RG. These other provisions represent an average of about 6.7 percent of the total provisions. Maybe these figures correspond to provisions for CL, but even in this case, these figures should be distributed into the different RGs.

Table 8. Provisions Distribution in Terms of RGs
(BYN Million)

PERIOD / RG	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
RG-I	120	121	124	123	137	138	137	138	139	144
RG-II	501	524	513	537	594	593	598	599	633	611
RG-III	1.408	1.432	1.392	1.405	630	665	628	621	651	776
RG-IV	391	390	418	473	915	902	987	1.017	1.015	1.012
RG-V	87	80	77	104	346	418	404	397	371	398
RG-VI	-	-	-	-	368	398	219	148	156	129
SUBTOTAL	**2.508**	**2.547**	**2.525**	**2.642**	**2.990**	**3.114**	**2.973**	**2.919**	**2.965**	**3.071**
Other provisions	181	196	210	226	172	170	195	220	224	239
Total Provisions	**2.688**	**2.743**	**2.735**	**2.868**	**3.162**	**3.285**	**3.168**	**3.139**	**3.189**	**3.310**

Source: Author's elaboration based on data provided by the NBRB.

20. **The provisioning levels per RGs have been stable and close to the minimum regulatory values both before and after the regulatory change.** The table below reflects the provisioning levels for the different RGs during the period. As it can be observed, the provisioning levels have been not only stable throughout the period, but also close to the minimum regulatory values (0.5, 5, 30, 50, and 100 percent for the previous RGs and 0.5, 5, 20, 30, 50, and 100 percent for the current RGs). This means that banks do not build provisions over the minimum regulatory values, even though they are not just allowed to do

so, but also are incentivized to the point of the Regulation's containing legal provisions related to internal regulatory acts of the banks.

21. **The average provisioning for total assets has remained coincidentally stable after the regulatory change, due to the emergence of the new provisioning percentage of 30 percent for RG-III.** Even though it is probably a coincidence, the reason for the stability of the average provisioning for total assets and for each of the RGs is the emergence of a new value of 30 percent for RG-III. This is practically in the center of the 20 percent and 50 percent required for the previous RG-II and -III.

Table 9. Provisioning Levels per RGs

PERIOD / RG	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
RG-I	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
RG-II	4.0%	4.2%	4.2%	4.2%	4.6%	4.7%	4.7%	4.7%	4.7%	4.7%
RG-III	30.0%	30.0%	30.0%	30.0%	20.2%	20.2%	20.2%	20.2%	20.2%	20.2%
RG-IV	50.8%	50.1%	50.1%	50.1%	30.3%	30.3%	30.3%	30.3%	30.2%	30.2%
RG-V	100.0%	100.0%	100.0%	100.0%	51.6%	50.2%	50.1%	50.2%	50.5%	50.9%
RG-VI	N.A.	N.A.	N.A.	N.A.	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
SUBTOTAL	**5.9%**	**6.0%**	**5.9%**	**6.1%**	**6.2%**	**6.4%**	**6.1%**	**6.0%**	**6.0%**	**6.0%**
Other provisions	28.0%	28.0%	28.1%	28.1%	18.8%	18.5%	18.7%	18.7%	18.7%	18.8%
Total Provisions	**6.2%**	**6.4%**	**6.3%**	**6.5%**	**6.4%**	**6.6%**	**6.4%**	**6.3%**	**6.3%**	**6.3%**

Source: Author's elaboration based on data provided by the NBRB.

22. **The average provisioning levels of problem assets were stable, about 34 percent, while the average provisions for NPLs are higher, but significantly decreasing, from more than 53 percent to almost 42 percent.** As shown in the table below, problem asset average provisions were stable, about 34 percent. However, provisions for NPLs are not only higher, but also decreasing, from more than 50 percent to levels close to 40 percent. Most probably, this shows once again the different nature and composition of problem assets and NPLs. It must be noted that the provisions amounts are relatively similar, indicating that a significant part of problem assets have relatively low provisioning levels. From that point on, it can be said that current NPLs are a kind of problem asset with higher credit risk and provisioning.

Table 10. Provisioning Levels for Problem Assets and NPLs

PERIOD / RG	01/2018	02/2018	03/2018	04/2018	05/2018	06/2018	07/2018	08/2018	09/2018	10/2018
Provisions	1.887	1.902	1.887	1.982	1.743	1.989	1.849	1.922	2.118	2.178
Problem assets	5.549	5.631	5.551	5.729	930	1.048	875	844	900	913
%	**34.0%**	**33.8%**	**34.0%**	**34.6%**	**53.3%**	**52.7%**	**47.3%**	**43.9%**	**42.5%**	**41.9%**

Source: Author’s elaboration based on data provided by the NBRB.