



# Bangko Sentral ng Pilipinas

MAYNILA, PILIPINAS

## OFFICE OF THE GOVERNOR

Circular No. 247  
Series of 2000

The Monetary Board, in its Resolution No. 783 dated May 12, 2000 approved the amendment of Circular No. 210 dated September 9, 1999 on the guidelines in the classification of loans, and the provisioning requirements for classified loan accounts.

**SECTION 1.** As a general policy, banks must observe the provisions of Section 76 of R.A. No. 337, as amended, to wit:

*"Before granting a loan, banks must exercise proper caution to ascertain that the debtor is capable of fulfilling his commitments to the bank.*

*xxx."*

**SECTION 2. Classification of Loans.** In addition to classifying loans as either current or past due, the same should be qualitatively appraised and grouped as Unclassified or Classified.

**A. Unclassified Loans.** These are loans that do not have a greater-than-normal risk and do not possess the characteristics of classified loans as defined in Item B of this Section. The borrower has the apparent ability to satisfy his obligations in full and therefore no loss in ultimate collection is anticipated. The following loans, among others, shall not be subject to classification:

1. Loans or portions thereof secured by hold-outs on deposits/deposit substitutes maintained in the lending institution, and margin deposits, or government-supported securities;
2. Loans with technical defects, and deficiencies in documentation and/or collateral requirements. These deficiencies are isolated cases where the exceptions involved are not material nor is the bank's chance to be repaid or the borrower's ability to liquidate the loan in an orderly manner undermined. These exceptions should be brought to Management's attention for corrective action during the examination and those not corrected shall be

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included in the Report of Examination under "Miscellaneous Exceptions – Loans". Moreover, deficiencies which remained uncorrected in the following examination shall be classified as "Loans Especially Mentioned".

The following are examples of loans to be cited under "Miscellaneous Exceptions – Loans".

- a. Loans with unregistered mortgage instrument which is not in compliance with the loan approval;
- b. Loans with improperly executed supporting deed of assignment/pledge agreement/chattel mortgage/real estate mortgage;
- c. Loans with unnotarized mortgage instruments/agreements;
- d. Loans with collaterals not covered by appraisal reports or appraisal reports not updated;
- e. Loan availments against expired credit line; availments in excess of credit line; availments against credit line without prior approval by appropriate authority;
- f. Loans with collaterals not insured or with inadequate/expired insurance policies or the insurance policy is not endorsed in favor of the bank;
- g. Loans granted beyond the limits of approving authority;
- h. Loans granted without compliance with conditions stated in the approval; and
- i. Loans secured by property the title to which bears an uncanceled annotation or lien or encumbrance.

**E. Classified Loans.** These are loans which possess the characteristics outlined hereunder. Classified loans are subdivided into (1) loans especially mentioned; (2) substandard; (3) doubtful; and (4) loss.

**1. Loans Especially Mentioned.** These are loans that have potential weaknesses that deserve Management's close attention. These potential weaknesses, if left uncorrected, may

affect the repayment of the loan and thus increase credit risk to the bank. Their basic characteristics are as follows:

- a. Loans with unlocated collateral folders and documents including but not limited to title papers, mortgage instruments and promissory notes;
  - b. Loans to firms not supported by board resolutions authorizing the borrowings;
  - c. Loans without credit investigation report;
  - d. Loans with no latest income tax returns and/or latest audited financial statements;
  - e. Loans the repayment of which may be endangered by economic or market conditions that in the future may affect the borrower's ability to meet scheduled repayments as evidenced by a declining trend in operations, illiquidity, or increasing leverage trend in the borrower's financial statements;
  - f. Loans to borrowers whose properties securing the loan (previously well-secured by collaterals) have declined in value or with other adverse information;
  - g. Loans past due for more than thirty (30) days up to ninety (90) days;
  - h. Loans previously cited as "Miscellaneous Exceptions" still uncorrected in the current Bangko Sentral examination.
2. **Substandard.** These are loans or portions thereof which appear to involve a substantial and unreasonable degree of risk to the institution because of unfavorable record or unsatisfactory characteristics. There exists in such loans the possibility of future loss to the institution unless given closer supervision. Those classified as "Substandard" must have a well-defined weakness or weaknesses that jeopardize their liquidation. Such well-defined weaknesses may include adverse trends or development of financial, managerial, economic or political nature, or a significant weakness in collateral. Their basic characteristics are as follows:

a. Secured Loans

- i. Past due and circumstances are such that there is an imminent possibility of foreclosure or acquisition of the collateral because of failure of all collection efforts;
- ii. Past due loans to borrowers whose properties securing the loan have declined in value materially or have been found with defects as to ownership or other adverse information;
- iii. Current loans to borrowers whose audited financial statements show impaired/negative net worth except for start-up firms which should be evaluated on a case-to-case basis.

b. Unsecured Loans

- i. Renewed/extended loans of borrowers with declining trend in operations, illiquidity, or increasing leverage trend in the borrower's financial statements without at least twenty percent (20%) repayment of the principal before renewal or extension;
- ii. Current loans of borrowers with unfavorable results of operations for two (2) consecutive years or with impaired/negative net worth except for start-up firms which should be evaluated on a case-to-case basis.

c. Loans under litigation;

d. Loans past due for more than ninety (90) days;

e. Loans granted without requiring submission of the latest audited financial statements (AFS)/ income tax returns and/or statements of assets and liabilities to determine paying capacity of the borrower;

f. Loans with unsigned promissory notes or signed by unauthorized officers of the borrowing firm;

g. Loans classified as "Loans Especially Mentioned" in the last Bangko Sentral examination which remained uncorrected in the current examination.

3. **Doubtful.** These are loans or portions thereof which have the weaknesses inherent in those classified as "Substandard", with the added characteristics that existing facts, conditions, and values make collection or liquidation in full highly improbable and in which substantial loss is probable. Their basic characteristics are as follows:
  - a. Past due clean loans classified as "Substandard" in the last Bangko Sentral examination without at least twenty percent (20%) repayment of principal during the succeeding twelve (12) months or with current unfavorable credit information;
  - b. Past due loans secured by collaterals which have declined in value materially such as, inventories, receivables, equipment, and other chattels without the borrower offering additional collateral for the loans and previously classified "Substandard" in the last Bangko Sentral examination;
  - c. Past due loans secured by real estate mortgage, the title to which is subject to an adverse claim rendering settlement of the loan through foreclosure doubtful;
  - d. Loans wherein the possibility of loss is extremely high but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until a more exact status is determined.
4. **Loss.** These are loans or portions thereof which are considered uncollectible or worthless and of such little value that their continuance as bankable assets is not warranted although the loans may have some recovery or salvage value. The amount of loss is difficult to measure and it is not practical or desirable to defer writing off these basically worthless assets even though partial recovery may be obtained in the future. Their basic characteristics are as follows:
  - a. Past due clean loans the interest of which is unpaid for a period of six (6) months;
  - b. Loans payable in installments where amortization applicable to interest is past due for a period of six (6) months, unless the loan is well secured;

- c. When the borrower's whereabouts is unknown, or he is insolvent, or his earning power is permanently impaired and his co-makers or guarantors are insolvent or that their guaranty is not financially supported;
- d. Where the collaterals securing the loans are considered worthless and the borrower and/or his co-makers are insolvent;
- e. Loans considered as absolutely uncollectible;
- f. Loans classified as "Doubtful" in the last Bangko Sentral examination and without any payment of interest or substantial reduction of principals during the succeeding twelve (12) months, or have current unfavorable credit information which renders collection of the loans highly improbable.

**SECTION 3. Allowance for Probable Losses.** An allowance for probable losses on the loan accounts should be set up in accordance with the following schedule:

	<u>Classification</u>	<u>Allowance</u>
1.	Unclassified	0%
2.	Loans Especially Mentioned	5%
3.	Substandard – Secured	6% to 25%
4.	Substandard – Unsecured	25%
5.	Doubtful	50%
6.	Loss	100%

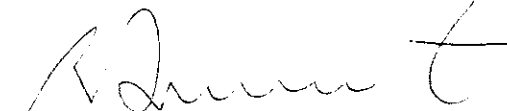
The percentage of allowance within the specified range to be provided on loans classified "Substandard – Secured" shall be based on sound judgment taking into account, among others, the nature of collateral, the location of the property, in case of real estate collateral, the assessment of borrower's current capacity to pay as shown by updated cash flow projections, credit rating given by credit rating agencies and expectations on the industry of the borrower.

The allowance for probable losses shall be adjusted accordingly for additional allowance required by the BSP.

Management is encouraged to provide additional allowance as it deems prudent and to formulate additional specific guidelines within the context of the herein-described system.

This Circular shall supersede other BSP rules inconsistent herewith and shall take effect immediately.

FOR THE MONETARY BOARD:

  
RAFAEL B. BUENAVENTURA  
Governor

*June 2*  
~~May~~, 2000