



CENTRAL BANK OF CYPRUS
EUROSYSTEM

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22 December 2008

To banks

CIRCULAR LETTER
VIA ELECTRONIC MAIL

Dear Sir,

Re: Non-performing credit facilities

We refer to the above subject and enclose a new directive that replaces the existing directive on the suspension of interest and other income on non-performing credit facilities that was issued in December 2005. The directive takes effect as from the 1st January 2009 and defines the criteria for the classification of non-performing facilities and provides explanations on their application.

The main changes to the existing directive are:

1. The rules on income recognition have been removed and this issue is now allowed to be dealt with in accordance with the provisions of International Financial Reporting Standards.
2. A new column has been added to tables 1 and 2 in which banks must report the amount of credit facilities that fulfil the criteria for non-performing but are not classified as such because they are fully covered by tangible security.
3. A new table has been added in which banks must report the customers with non-performing credit facilities for which the security gap is not fully provided together with brief explanations on the reasons for not fully providing for the security gap.

The issue of how to treat existing interest and other income suspended should be discussed and agreed with your external auditors.

Yours faithfully,

C.S. Poullis
Senior Director
Banking Supervision and
Regulation Division

ArP Enclosures: (1)
ArP



CENTRAL BANK OF CYPRUS

BANKING SUPERVISION AND REGULATION DIVISION

DIRECTIVE ISSUED TO BANKS

ON

THE DEFINITION OF NON-PERFORMING CREDIT FACILITIES

DECEMBER 2008

**DIRECTIVE ISSUED TO BANKS ON THE DEFINITION OF
NON-PERFORMING CREDIT FACILITIES**

Directive based on the article 41

The Central Bank of Cyprus, by virtue of the powers vested in it by section 41 of the Banking Laws of 1997-2008, issues this Directive to all banks on the definition of non-performing credit facilities.

PART I – GENERAL PROVISIONS

- 1.(a) This Directive will be referred to as the Directive on the Definition of Non-Performing Credit Facilities of 2008.
- (b) This Directive is applicable to:
 - i) banks incorporated in the Republic of Cyprus, and:
 - their subsidiaries the business of which is integral or closely related to banking business as defined in Section 13(3) of the Banking Laws of 1997-2008,
 - their overseas branches
 - ii) Cyprus registered branches of foreign banks incorporated outside Cyprus, with regard to all “funded credit facilities” and “credit substitutes”, denominated in any currency.
2. For the purposes of the present Directive:

The term “funded credit facilities” includes the following:

 - i) loans, including housing loans secured by mortgages
 - ii) overdraft accounts,
 - iii) revolving credit facilities, financial leasing, including hire purchase financing,
 - iv) corporate bonds,
 - v) discounting of promissory notes or bills of exchange, payments under documentary letters of credit, payments under letters of guarantee,

- advances against goods in bonded warehouses, advances against promissory notes, and
- vi) any other interest-bearing credit facility.

“Central Bank” means the Central Bank of Cyprus.

“Non-performing credit facility” means a credit facility which is in excess of its approved limit or whose repayment, in regard to principal or interest or other income, is in arrears for more than three (3) months, unless otherwise specified in this Directive. It is, hereby, clarified that the term “in arrears for more than three (3) months” includes interest or other income which remain unpaid for at least three months from the date on which they fell due.

“foreign currency” means any currency other than the euro

“bank” has the meaning given to this term by the Banking Laws

“banking group” includes all the subsidiaries and overseas branches of a bank registered in the Republic of Cyprus

The term “credit substitutes” refers to transactions entered into by banks whose risk of loss depends on the counterparty’s repayment ability. Such transactions include, inter-alia, the following:

- i) Guarantees issued by a bank in support of a customer’s obligations towards a third party (e.g. a bank guarantee issued in favour of another bank to be used as collateral security for credit facilities to be obtained by the customer),
- ii) letters of credit usance,
- iii) acceptances granted,
- iv) standby letters of credit.

PART II – GENERAL PRINCIPLES FOR CLASSIFYING FACILITIES

AS NON-PERFORMING

3. (1) The classification of credit facilities as non-performing should be made at the end of each month, by taking into account the total of the credit facilities extended to each customer (physical or legal person) by the bank .
 - (2) In case a customer also enjoys a limit on a credit card(s), the bank is allowed to treat the said credit card facility(ies) as part of a separate portfolio, as prescribed in paragraph 8 of this Directive and not as being part of the overall credit facilities extended to the customer.
 - (3) Joint accounts should be considered as part of the personal accounts of each joint account holder and be treated as if they were separate personal accounts. Apportionment of a joint account to the joint account holders is not allowed.
 - (4) A non-performing credit facility in one currency which is converted into another currency, should continue to be classified as non-performing as long as there are arrears over three (3) months.
 - (5) Notwithstanding the provisions of this Directive, a bank may adopt more stringent criteria where it considers this to be more appropriate.
- 4.(1) If a rescheduling of credit facilities which had previously been classified as non-performing is effected either through the granting of new credit facilities or through a readjustment in the repayment schedule, the credit facilities concerned should continue to be classified as non-performing for a period of 180 days after the commencement of the new repayment schedule. At the end of the above period, the credit facility concerned will continue to be classified as non-performing only if it fulfills the prescribed criteria relating to the classification of credit facilities as non-performing. Banks should maintain a register of all credit facilities which have been rescheduled in order to facilitate verification by the Central Bank of Cyprus.

- (2) Needless to emphasize that no rescheduling is allowed in order to avoid classifying a credit facility as non-performing, in circumstances where a credit facility, although performing, it is being transpired that, fairly soon, may have to be classified as non-performing.
5. In the case of a joint collateral security covering more than one customer, the accounts concerned are considered to be fully covered only if, after taking into account the separate collateral security of each customer, the remaining balance of a customer's obligations is fully covered by the joint collateral security. If the above prerequisite is not satisfied, all the credit facilities of a customer should be considered as not being fully collateralised and, consequently, the criteria for their classification as non-performing apply.
6. Loan installments credited to a loan account by the debit of a current account, as a result of which an excess over the latter's limit is created or an existing excess is increased, are considered to be overdue. Furthermore, if more than three months have elapsed from the date on which the installments fell due, the loans concerned should be classified as non-performing.

**PART III – CRITERIA FOR THE CLASSIFICATION OF CREDIT FACILITIES
AS NON-PERFORMING AND EXCEPTIONS**

7. (1) If the sum of all debit balances of a customer's accounts, which are in arrears for more than three (3) months, is greater than 20% of the total of the funded credit facilities extended to him by the bank, then all the credit facilities granted to the customer concerned should be treated as non-performing. If the sum of all debit balances of a customer's accounts, which are in arrears for more than three (3) months, is lower than or equal to 20% of the total of the funded credit facilities granted to him by the bank, then only the customer's accounts which are in arrears for more than three (3) months should be treated as non-performing.
 - (2) (a) An overdraft account is considered to be non-performing:
 - i) when its debit balance exceeds, on a continuous basis and for a period of more than three (3) months, by more than 5% the limit which was advised to the account holder by the bank or

- ii) when three (3) months have elapsed from the first day on which repayment of the debit balance of the account was demanded by the bank, provided that the account has not already been classified as non-performing.
 - (b) It should be noted that a bank may increase the approved limit of an overdraft account or allow a temporary excess over a customer's approved limit in order to accommodate his short-term liquidity needs, provided that an application to the above effect has been examined and approved by the competent credit approving authority of the bank concerned.
- (3) Notwithstanding the provisions of Part II and the subparagraphs (1) and (2) above, all accounts of a customer, with the exception of credit card accounts managed on a separate portfolio basis by the bank, are considered to be non-performing if, at least one of the following, occurs:
- i) The bank has raised a provision against bad and doubtful debts covering all or part of a customer's obligations, or
 - ii) The bank has written off at least one of the customer's accounts, including cases where a part of the debit balance of an account has been written off. It is clarified that, if the balance remaining after the write off of amounts that cannot be claimed in a court (e.g compound interest) is fully covered by tangible security, then these facilities are not classified as non-performing. In case the balance remaining after the write off of amounts that cannot be claimed in a court is not fully covered by tangible security but a new repayment program has been agreed, then the provisions of subparagraph (1) of paragraph 4 should be applied. In all other cases of write offs the facilities remain as non-performing or

- iii) There are circumstances having regard to the agreed repayment schedule which, in the bank's view, render doubtful the repayment of the principal amount or interest or other income due on at least one of the credit facilities extended to the customer.
- (b) In case the provision and / or write off referred to in paragraphs (i) and (ii) above are made in the course of a settlement agreement, does not relate to amounts that cannot be claimed in a court and a new repayment program is agreed, then the facility is treated as a rescheduling and the provisions of subparagraph (1) of paragraph 4 should be applied. This applies also in the cases where the amounts remaining after the write off of any amounts, other than those that cannot be claimed in court, are not fully covered by tangible security.

The term "amounts that cannot be claimed in court" relates to any part of a facility that has been judged as such by a court decision or which the bank has obtained a legal opinion that it cannot claim it if it takes the case to court.

- 8.(1) Funded credit facilities in the form of credit card limits may be managed by a bank on a separate portfolio basis. Hence if, for the purposes of implementing the provisions of this Directive, a bank opts for the above method of managing a customer's credit card accounts, then each credit card facility included in the above portfolio should be separately examined in order to assess whether it is in excess of the approved limit or in arrears for more than three months, without taking into account any other credit facilities granted to the customer/holder of the credit card(s). Consequently, a customer's credit card account(s), which is/are managed on a separate portfolio basis, should not be grouped with the customer's funded credit facilities.
- (2) Funded credit facilities and credit substitutes extended to customers, which are fully secured, should not be classified as non-performing. The method of computation of the realizable value of the collateral security held should be in accordance with the guidelines included in Annex XV of the Central Bank

Directive on the "Calculation of the capital requirements and large exposures" which specifies the value to be assigned to the various types of security for the purposes of large exposures and facilities to directors.

It is understood that, if a customer's credit facilities have been classified as non-performing and the customer concerned (provides the bank with additional collateral security so that there is no longer a security gap, then the customer's credit facilities should cease to be classified as non-performing.

- (3) In case a loan installment has not been fully paid and the unpaid part exceeds 20% of the loan installment, then the loan concerned should be treated as non-performing.

PART IV – RECOGNITION OF INTEREST AND OTHER INCOME

9. (1) The calculation of interest and other income on non-performing loans that is credited to a bank's Profit and Loss Account must be made in accordance with International Accounting Standard 39 – Financial Instruments: Recognition and Measurement. According to this standard, the amount of interest and other income that is credited to the Profit and Loss account must be calculated on the net amount of the facilities, that is, on the amount of the facilities net of any provisions made. Therefore, the interest and other income that relates to the part of the facilities that is covered by provisions must be credited directly to provisions and not affect the Profit and Loss account.
 - (2) In the cases where a bank has made a collective impairment for a portfolio of facilities which it subsequently allocates proportionally to the balances of the customers forming part of the portfolio, then the same treatment described in the previous paragraph must be made with regard to the respective interest and other income.
10. The Central Bank of Cyprus expects sufficient explanations in the cases of non-performing loans for which the security gap has not been fully provided. Therefore, the quarterly return of non-performing facilities to be submitted to the

Central Bank includes a table with a list of the borrowers with non-performing facilities for which the security gap has not been fully provided together with brief explanations as to why the security gap has not been fully provided.

PART V – GENERAL AND FINAL PROVISIONS

11. (1) Under the provisions of section 25 of the Law, banks are, hereby, required to submit on a quarterly basis, periodic returns as per Tables 1 to 5 of the Annex to this Directive on 31st March, 30th June, 30th September and 31st December of each year. In the case of a banking group table 1 must be completed with consolidated data for the banking group, while Tables 2, 3, 4 and 5 must be completed separately for each subsidiary and each overseas branch. In the case of a Cyprus registered branch of foreign bank incorporated outside Cyprus Table 2 is not required to be submitted.
 - (2) The said periodic returns should be submitted to the Central Bank of Cyprus, Supervision of International Banks, Regulation and Financial Stability Department, within one month from the end of the reporting period to which they refer.
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12. This Directive shall enter into force on the 1st of January, 2009.

STATEMENT OF NON-PERFORMING CREDIT FACILITIES

BANKING GROUP or BRANCH REGISTERED IN THE REPUBLIC :

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REPORTED PERIOD: QUARTER ENDED AT

To: Central Bank of Cyprus,
Banking Supervision and Regulation Division

We submit the Statement of non-performing credit facilities and certify that the Statement was prepared in accordance to the provisions of the Directive on the Definition of Non-Performing Credit Facilities of 2008.

.....

Signature

.....

Name

.....

Position

CONSOLIDATED RETURN ON NON-PERFORMING CREDIT FACILITIES

TABLE 1

BANKING GROUP/CYPRUS REGISTERED BRANCH OF A FOREIGN BANK:

QUARTER ENDING ON

		Total of non-performing credit facilities		Total Credit Facilities		Provisions against the accounts (includes total interest and other income suspended)*1		Collateral Security	Unsecured amount against which no provision has been made	Total credit facilities which would have been classified as non performing had the security criterion not been in force
		Euro €000	Foreign Currency €000	Euro €000	Foreign Currency €000	Euro €000	Foreign Currency €000			
A	Credit facilities extended by the subsidiary/overseas branch, by customer where the funded credit facilities are not fully secured:									
A1	Corporate Loans:									
A1.1	Trade ¹²									
A1.2	Construction ¹³									
A1.3	Tourism ¹⁴									
A1.4	Remaining categories of business loans									
	Total of Subcategory A1									
A2	Retail Loans									
A3	Other categories:									
A3.1	Credit facilities to customers for which a provision for doubtful debts has been made for part or the total of the customer's liability (Part III, paragraph 7.3 (i) and (iii) of the directive)									
A3.2	Credit facilities to customers for which at least one account has been written off (Part III, paragraph 7.3.(ii) of the directive)									
	Total of Subcategory A3									
	Total of Subcategory A (A1+A2+A3)									
B	Credit cards facilities which the subsidiary/overseas branch manages on a separate portfolio basis									
C	Total of Categories A and B									
	Collective Impairment									
D	Analysis of non-performing credit facilities:									
D1	Credit facilities which are in arrears/ or exceed their limit for more than three months to six months									
D2	Credit facilities which are in arrears/ or exceed their limit for more than six months to twelve months									
D3	Credit facilities which are in arrears/ or exceed their limit for more than twelve months									
D4	Other credit facilities not included in categories D1 - D3.									
	Total of credit facilities in arrears/ in excess of their limits, as C above									

*1 Interest and other income suspended: It refers to the amount that has been debited to customer accounts but has not been recognised as income in profit and loss account and has been credited to provisions

¹² Classification NACE - Section G

¹³ Classification NACE - Section F

¹⁴ Classification NACE 0 Section H 55.1 (Hotels) & Section H 55.2 (Camping sites and other provision of short stay accommodation)

RETURN ON NON-PERFORMING CREDIT FACILITIES

TABLE 2

BANKING GROUP:
 NAME OF SUBSIDIARY or OVERSEAS BRANCH
 QUARTER ENDING ON

	Total of non-performing credit facilities		Total Credit Facilities		Provisions against the accounts (includes total interest and other income suspended) ¹		Collateral Security	Unsecured amount against which no provision has been made	Total credit facilities which would have been classified as non performing had the security criterion not been in force
	Euro €000	Foreign Currency €000	Euro €000	Foreign Currency €000	Euro €000	Foreign Currency €000			
A	Credit facilities extended by the subsidiary/overseas branch, by customer where the funded credit facilities are not fully secured:								
A1	<i>Corporate Loans:</i>								
A1.1	Trade ²								
A1.2	Construction ³								
A1.3	Tourism ⁴								
A1.4	Remaining categories of business loans								
	Total of Subcategory A1								
A2	<i>Retail Loans</i>								
A3	<i>Other categories:</i>								
A3.1	Credit facilities to customers for which a provision for doubtful debts has been made for part or the total of the customer's liability (Part III, paragraph 7.3 (i) and (ii) of the directive)								
A3.2	Credit facilities to customers for which at least one account has been written off (Part III, paragraph 7.3 (ii) of the directive)								
	Total of Subcategory A3								
	Total of Subcategory A (A1+A2+A3)								
B	Credit cards facilities which the subsidiary/overseas branch manages on a separate portfolio basis								
C	Total of Categories A and B Collective Impairment								
D	Analysis of non-performing credit facilities:								
D1	Credit facilities which are in arrears/ or exceed their limit for more than three months to six months								
D2	Credit facilities which are in arrears/ or exceed their limit for more than six months to twelve months								
D3	Credit facilities which are in arrears/ or exceed their limit for more than twelve months								
D4	Other credit facilities not included in categories D1 - D3.								
	Total of credit facilities in arrears/ in excess of their limits, as C above								

¹ Interest and other income suspended: it refers to the amount that has been debited to customer accounts but has not been recognised as income in profit and loss account and has been credited to provisions

² Classification NACE - Section G

³ Classification NACE - Section F

⁴ Classification NACE 0 Section H 55.1 (Hotels) & Section H 55.2 (Camping sites and other provision of short stay accommodation)

