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**The National Bank of Ukraine's New Approach to  
Defining Non-Performing Exposures/Loans**

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**Київ, May 2017**



# The methodology for calculating non-performing loans has changed

- Changes to the categorization of bank assets were introduced on 30 June 2016 as Resolution No. 351 came into effect. Data was collected in test mode until February 2017.
- The “non-performing exposure/loan” term was introduced, which is consistent with the internationally accepted notion of non-performing exposures/loans (NPE/NPL).
- A non-performing exposure/loan is one that is past due more than 90 days (30 days for debtor banks) or one in which the debtor is unlikely to fully meet obligations without the foreclosure of collateral.
- The historical data on NPLs disclosed on the NBU’s website as part of financial soundness indicators<sup>2</sup> were based on balance sheet and off-balance sheet assets. Large amounts of revocable credit lines (off-balance), which were part of the highest quality categories, significantly understated the NPL ratio. Going forward, the key NPL ratio published by the NBU will include only balance sheet items.
- The significant increase in NPL ratios in February 2017 (the first month based on the new methodology) was mainly the result of the recognition of non-performing loans by Privatbank after its nationalization (+15.1 pp). Changes to the methodology of categorization (2.1 pp) and the exclusion of off-balance sheet assets from the calculation (7.4 pp) account for the balance of the increase.
- The NPE/NPL ratios could see minor movements over the next few months as possible errors are corrected and as banks adapt to the new reporting requirements.

<sup>1</sup> NBU Board Resolution No. 351 dated 30 June 2016 *On the Regulation for Measuring Credit Risk Generated by Banks’ Asset Operations*

<sup>2</sup> National Bank of Ukraine website: [http://www.bank.gov.ua/control/uk/publish/category?cat\\_id=44575](http://www.bank.gov.ua/control/uk/publish/category?cat_id=44575).



# International standards for problem assets

## Internationally, there are three main approaches for categorizing problem assets

### (1) Accounting approach (impaired/non-impaired):

- An asset is impaired when there is objective evidence of loss incurrence (including significant financial difficulties of the obligor, a breach of contract, the possibility of bankruptcy, granting concessions to the borrower that in normal circumstances would be impossible, etc.)
- Impairment is determined based on the availability of collateral

### (2) Prudential approach (default exposure/loan) – Used to calculate regulatory capital, assess credit risk, etc. The debtor is in default if:

- Past due by more than 90 days
- A fulfillment of obligations is unlikely without foreclosure of collateral

### (3) Statistical approach to normalize for differences between jurisdictions and to compare international data. Non-performing exposures include:

- All impaired exposures
- All exposures at default
- All other non-impaired and non-default exposures if at least one of the following conditions are met:
  - Material exposures past due more than 90 days
  - Signs that the fulfillment of an obligation is unlikely without foreclosure regardless of the number of days past due

### Simplified categorization of different categories of problem loans

(3) Non-performing exposures: Basel/EBA-ITS<sup>3,4,5</sup>

(2) Default: Basel II/CRR Art. 178<sup>2</sup>

(1) Impairment: IAS 39/IFRS 9<sup>1,3</sup>



The European Banking Authority (EBA) recommends the use of “non-performing exposure”, which is currently being used for regulatory reporting purposes, asset diagnostics and stress testing, internal risk management, and public reporting<sup>4</sup>.

<sup>1</sup> IFRS, paragraphs 58, 59 of IAS 39 “Financial Instruments: Recognition and Measurement” – [http://ec.europa.eu/internal\\_market/accounting/docs/consolidated/ias39\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/consolidated/ias39_en.pdf)

<sup>2</sup> Regulation (EU) No. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms. – <http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex%3A32013R0575>

<sup>3</sup> Guidance to banks on non-performing loans. ECB 2017 - [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance\\_on\\_npl\\_en.pdf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl_en.pdf)

<sup>4</sup> Regulation (EU) No. 680/2014 - Implementing Technical Standards (ITS) on supervisory reporting of institutions (as amended). EBA 2014 - <https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/implementing-technical-standard-on-3-supervisory-reporting/-/regulatory-activity/press-release>

<sup>5</sup> Guidance on Prudential Treatment of Problem Assets – definitions of non-performing exposures and forbearance. BCBS 2017 - <http://www.bis.org/bcbs/publ/d403.pdf>



# Comparing approaches to defining non-performing exposures/loans

	Previous <sup>1,2</sup> From 1 January 2012 to 1 February 2017	New <sup>3</sup> From 1 February 2017
Terminology	Negatively classified assets/loans	Non-performing exposures/loans
International comparability	Based on the national classification of banks' assets/loans (partial comparability with international standards)	Maximum harmonization with international standards (including IMF Financial Soundness Indicators)
Denotation	Assets in the 4 <sup>th</sup> and 5 <sup>th</sup> categories (the last two of five categories)	Assets classified by a bank into the lowest class (10, 5 and 2, depending on the asset type)
Determination principles	Negatively classified assets/loans include: <ul style="list-style-type: none"><li>- All assets/loans past due more than 90 days</li><li>- Certain assets/loans past due more than 30 days and with a low financial class for the debtor</li></ul>	Non-performing exposures/loans are those that meet at least one of the following criteria: <ul style="list-style-type: none"><li>- A bank counterparty past due more than 90 days (30 days for debtor banks)</li><li>- A counterparty that is unable to fulfill its obligation in due time without foreclosure of collateral*</li></ul>

\* Resolution No. 351 determines that a debtor is unable to fulfill its obligations and an event of default occurred:

- 1) If there are attributes specified in Art. 165 (see Annex 1 on slide 9)
- 2) If there are attributes specified in Art. 166, if a bank based on professional judgment failed to prove the opposite (see Annex 2 on slide 10)



The NBU's new approach includes the concepts of "default" and "non-performing" exposures. A full harmonization with EU standards (wider use of NPE/NPL terms) will take place after the transition to IFRS 9 accounting standards, but this change is not expected to have a significant impact on NPE/NPL statistics.

<sup>1</sup> NBU Board Resolution No. 346 dated 17 August 2012 *On the Application of Enforcement Measures by the National Bank of Ukraine for Violations of Banking Law*

<sup>2</sup> NBU Board Resolution No. 23 dated 25 January 2012 *On the Procedures for Creating and Using Provisions Against Possible Losses on Asset Operations by Banks of Ukraine*

<sup>3</sup> NBU Board Resolution No. 351 dated 30 June 2016 *On the Regulation for Measuring Credit Risk Generated by Banks' Asset Operations*



## Additional explanation of methodology

- The allocation of an asset to the non-performing category (NPE) does not depend on the availability of collateral. The availability of collateral affects the provision amount (according to IFRS) and assessment of credit risk (in accordance with Resolution No. 351), but is not considered while categorizing assets as performing or non-performing.
- If an asset of a specific debtor is recognized as non-performing, all other exposures of that debtor are also deemed non-performing (requirements of Resolution No. 351). The sole exception is made for loans assessed on a group basis. The assessment of these loans is independent of a particular counterparty's individual assessment.
- A bank may derecognize a defaulting debtor and change the asset category/class from non-performing to performing under the following conditions (Art. 167 of Resolution No. 351):
  - A debtor has resumed regular repayments and has been making repayments of the principal or interest in full for 180 consecutive days (for monthly repayments) or 365 days (for quarterly repayments)
  - None of the debtor's obligations are overdue by more than 30 days
  - A bank has made a judgment that despite current difficulties the debtor is able to service his/her debt



# International statistics for the Non-Performing Loans ratio

- The IMF's Financial Soundness Indicators (FSI) <sup>1</sup> are the most comprehensive source of country-specific statistical data on Non-Performing Loans (NPLs)
- The IMF recognizes NPLs according to the following criteria<sup>2</sup>:
  - Loan repayment (principal and/or interest) is past due more than 90 days;
  - Interest payments equivalent to interest for more than 90 days have been capitalized, refinanced, or rolled over;
  - Loans past due less than 90 days are recognized as non-performing according to national supervision standards.

**Methodological note:** The historical data on NPLs disclosed on the NBU's website as part of financial soundness indicators were based on balance sheet and off-balance sheet assets. Large amounts of revocable credit lines (off-balance), which were part of the highest quality categories, significantly understated the NPL ratio. Going forward, the key NPL ratio published by the NBU will include only balance sheet figures.



The IMF developed its definition of "non-performing loans" to improve the international comparability of statistics.

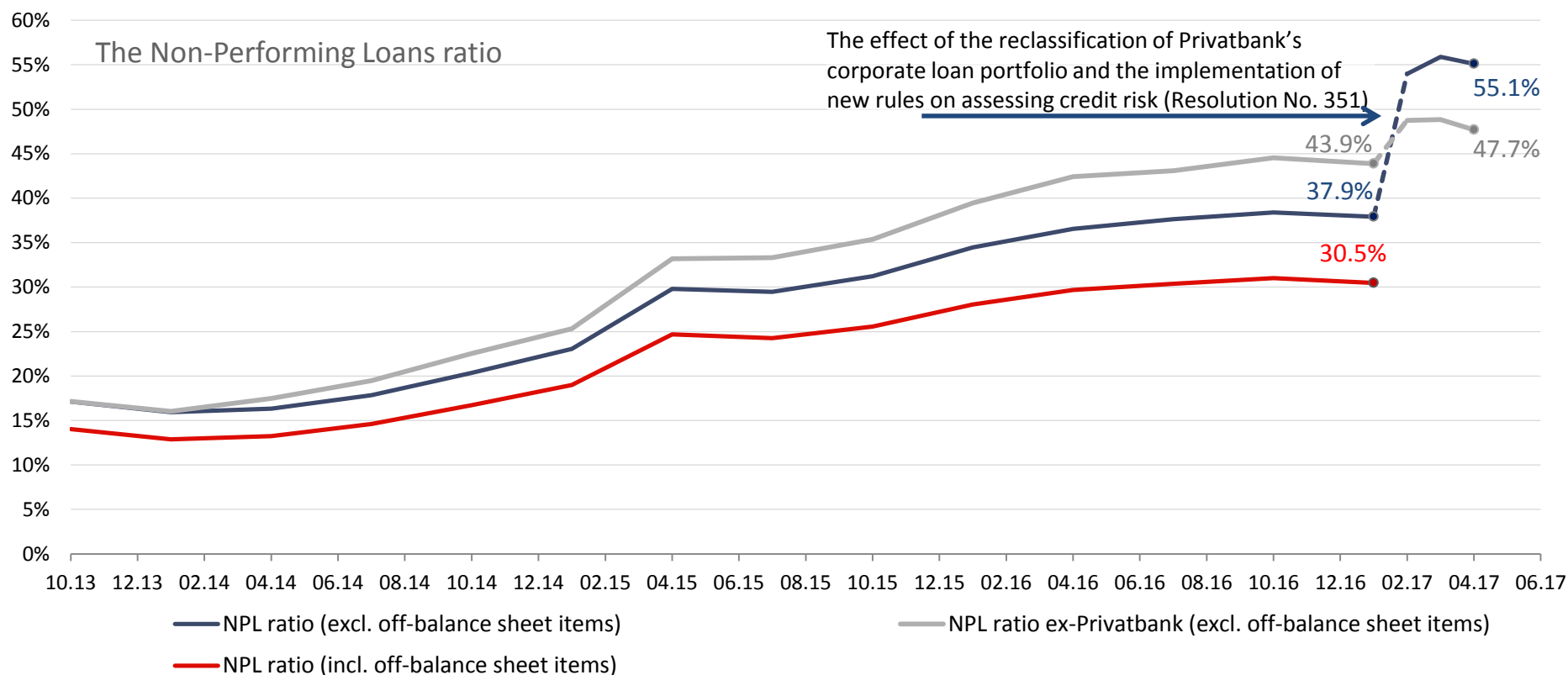
<sup>1</sup> Financial Soundness Indicators. IMF – <https://www.imf.org/external/np/sta/fsi/eng/fsi.htm>;

<sup>2</sup> Financial Soundness Indicators. IMF 2007 – <http://www.imf.org/external/pubs/ft/fsi/guide/2006/pdf/rus/guide.pdf>.



# The new approach for calculating the Non-Performing Loans ratio

## Eliminating off-balance sheet items makes the Non-Performing Loans ratio more informative



### Drivers of the one-off increase in the NPL ratio:

- The recognition of non-performing loans by Privatbank after its nationalization (+15.1 pp)
- Changes to the definition of NPLs (+2.1 pp)
- Exclusion of off-balance sheet items (+7.4 pp)



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# Annexes





## Annex 1. Unconditional default attributes ([Art. 165 the Resolution No. 351](#)<sup>1</sup>)

- The provisions for impairment of the financial asset extended to the borrower exceed 50% of the debt
- Amendments are made to the agreement's clauses for: a partial forgiveness of the debt, capitalization or replacement with another asset of accrued and unpaid interest for over 90 consecutive calendar days (including related to debt restructuring), prolongation of use of the asset provided to the borrower failing to repay the debt without selling collateral, despite the absence of a delay in repayment as of the date of the assessment of credit risk (not related to restructuring)
- The borrower filed for bankruptcy or has been declared bankrupt (the procedure on liquidating (terminating) a legal entity has been initiated), or the bank initiated bankruptcy proceedings against the borrower/counterparty
- The bank decided to convert a part of or the total amount of debt into the capital of the borrower (except as provided by the law of Ukraine on financial restructuring)
- The borrower's external ratings according to the international rating scale, confirmed by leading rating agencies (companies), is downgraded to the level of "default"
- An asset is replaced by another asset two or more times
- One of the borrower's assets is written off against the bank's provisions, or has been sold by the bank with a loss of 20% or more of the debt
- The sale of bank assets/assignment of the right to claim on assets with deferred payment of more than 7 calendar days to the buyer which: (1) On the credit risk valuation date has paid to the bank less than 30% of its value/failed to pay for an asset; and/or (2) Pays for an asset in one payment at the end of the term of the asset sales agreement or pays a larger share of the asset value close to the end of the term of the asset sales agreement
- A delay of more than 90 calendar days under discounted bills or factoring operations
- The securities issuing borrower has been put on the list of issuers with signs of a fictitious nature
- The availability of debt securities, for which the redemption of the nominal value or interests is delayed more than 7 calendar days
- The financial statements of a corporate borrower are missing, have not been disclosed, are unreliable, do not comply with Ukrainian legislation, have received an adverse audit opinion/have no audit opinion due to refusal by an auditor

<sup>1</sup> [The full list is provided in Art.165 of Resolution No. 351.](#)



## Annex 2. “Soft” default attributes ([Art. 166 the Resolution No.351<sup>2</sup>](#))

- A debt repayment by the borrower (except debt under loans for certain activities) in an amount which is less than the income recognized by a bank
- A change of the terms and conditions of an agreement related to:
  - Debt restructuring due to financial difficulties of the borrower provided that: the borrower’s class is no higher than 8 (for corporate borrowers) or 4 (for other borrowers); and or the borrower has delayed repayment of debt for more than 30 calendar days
  - If not for the change, the asset would be deemed non-performing (NPL)
  - A decrease in the interest rate of over 30% compared to the initial terms and conditions of the agreement, which was not driven by a change in market conditions
- A corporate borrower lacks their own/rented fixed assets or other property required for activity that generates cash flows in an amount sufficient for the repayment
- The bank has no information on the ultimate beneficial owners (controlling entities) of the corporate borrower
- The corporate borrower lacks the personnel required for the implementation of operational activities
- The absence of a corporate borrower at the location indicated by the borrower

<sup>2</sup>[The full list is provided in Art.166 of the Resolution No. 351.](#)