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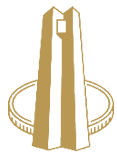

SOUTH AFRICAN RESERVE BANK
Prudential Authority

Ref.: 15/8/1/3

To: All banks, branches of foreign institutions, controlling companies, eligible institutions and auditors of banks or controlling companies

Proposed Directive issued in terms of section 6(6) of the Banks Act 94 of 1990

Prudential treatment of distressed restructured credit exposures

Executive summary

Effective credit risk management must include systems and processes that enable banks, controlling companies and branches of foreign institutions (hereinafter collectively referred to as 'banks') to continuously assess, monitor and manage the quality of credit assets. In this context, banks must be consistent and have credible categorisation schemes that distinguish credit exposures based on differences in credit quality. This, in turn, requires consistent definitions of various asset quality metrics.

In this regard, a bank's board of directors (board) and senior management are responsible for ensuring that the bank has effective systems and processes in place to consistently identify, monitor and manage any deterioration in the credit quality of its credit exposures. This also includes responsibility for ensuring that the identification and reporting of the credit quality of credit exposures in the statutory returns is done consistently across all credit exposures.

Distressed restructured credit exposures is one of the categories the Prudential Authority (PA) uses to monitor the quality of credit exposures on which banks grant various concessions to counterparties experiencing financial difficulties.

Regulation 67 of the Regulations relating to Banks (Regulations) defines distressed restructured exposures for banks using the internal ratings-based (IRB) approach to calculate their risk weighted assets (RWA) and required capital and reserve funds for credit risk.

The purpose of this proposed directive is to specify the minimum requirements relating to the definition and reporting of distressed restructured credit exposures. It also clarifies the interpretation of regulation 67 of the Regulations which is aligned to International Financial Reporting Standards (IFRS).

This proposed directive is intended to replace Directive 7 of 2015 (dated 12 May 2015).

1. Introduction

1.1. Regulation 67 of the Regulations defines a restructured credit exposure as a credit exposure in respect of which the bank grants a concession owing to a deterioration in the obligor's financial condition[1] or a distressed financial situation.

1.2. This definition of restructured credit exposure has significant implications for both the definition and classification of credit exposures in default as outlined in regulation 67 of the Regulations. This is because default is defined to include, among other things, credit exposures on which "*the bank has consented to a distressed restructuring of the credit obligation, which restructuring is likely to result in a reduced financial obligation".*

1.3. Therefore, the act of restructuring a credit exposure is essentially a deviation from the original terms and conditions agreed between the bank and its client. This deviation takes the form of concessions that include, but are not limited to, the following:

1.3.1. extending the term of the loan;

1.3.2. rescheduling the dates of principal and interest payments;

1.3.3. payment holidays, including the postponement of principal, interest or fee amounts;

1.3.4. easing of covenants of the agreement;

1.3.5. offering a revised interest rate that is lower than the effective interest rate the bank will offer to a counterparty with similar risk characteristics; and

1.3.6. changing an amortising loan to an interest payment only loan.

1.4. Importantly, distressed restructuring is about avoiding default and a loss that is *likely* to result from this default. In essence, banks grant concessions to maximise their chances of recovering all that is due under the loan agreement, considering the changed financial circumstances of the counterparty.

1.4.1. The word *likely* in this context is instructive, for two reasons:

1.4.1.1. Firstly, financial distress logically implies a deterioration in the counterparty's credit quality. This, in turn, increases the likelihood that the counterparty will not be able to repay all the contractually due amounts, potentially suggesting a default event, and with that, the likelihood that the bank will experience a loss. Therefore, the bank would restructure the loan agreement based on its assessment that the counterparty is more likely to repay all contractually due amounts under less stringent terms and conditions. This assessment may, however, not yield the desired outcome given the uncertainties regarding the client's performance under an amended loan agreement and less stringent terms and conditions.

[1] Throughout this proposed directive, a distinction is made between distressed restructured, as defined in regulation 67 of the Regulations, and what is referred to as business-as-usual (BAU) restructures. Therefore, unless specifically stated otherwise, restructures will mean all restructures, including distressed and BAU restructures.

1.4.1.2. Secondly, a counterparty could still be up to date and performing in line with the terms and conditions of the loan agreement at the time of the restructure event.

1.4.2. It follows that reduced financial obligation, in this case, will result from the bank having consented to amendments of the loan agreement, leading to relatively less stringent terms and conditions that do not require the full repayment of the outstanding amounts that are contractually due to the bank.

1.5. A key distinguishing characteristic of distressed restructuring, as referred to in the Regulations, in contrast to any other form of restructuring or what banks often refer to as business-as-usual (BAU) restructures, is the underlying reason for the restructure. Simply put, a restructure results in a distressed restructured credit exposure if it is performed in response to financial distress of the counterparty.

1.5.1. For instance, the bank may extend the term of a loan, not because the counterparty is experiencing financial distress, but rather to refinance a bullet payment that was part of the original loan agreement. Such refinancing arrangement is part of its BAU credit granting processes and something the bank would ordinarily offer to any of its counterparties not in financial distress. Similarly, dates of principal and interest payments may be adjusted, not due to financial distress but rather because of changes in the cashflow and/or income structure of the counterparty (e.g. a counterparty previously received monthly income but now receives it yearly).

1.5.2. The financial distress may be temporary, in which case the bank may offer temporary concessions. The financial distress may also be permanent, in which case the bank may offer permanent concessions. Regardless of whether concessions are temporary or permanent, the net effect is similar: the loan is restructured for financial distress reasons. This gives rise to the risk of loss, and therefore the bank adjusts the terms and conditions of the loan agreement to offer less stringent terms and conditions, with the aim to prevent this loss.

1.6. The PA observed inconsistent approaches used by banks to identify and report distressed restructured credit exposures. The PA also observed different influences and reliance on IFRS 9 in the interpretation and implementation of the reduced financial obligation requirement. These inconsistencies are reflected in the quarterly form BA 210, with some banks, for instance, reporting all their restructured credit exposures as distressed restructures and others only what they regard as their distressed restructured credit exposures, distinct from BAU restructures.

1.7. The interpretation of the reduced financial obligation requirement has also been a source of diverse and inconsistent interpretation among banks using the IRB approach.

1.8. Accordingly, this proposed directive is intended to address inconsistencies noted in the identification, treatment and reporting of distressed restructured credit exposures by:

1.8.1. specifying a minimum set of indicators of financial distress which banks must use when identifying and classifying credit exposures as distressed restructured credit exposures;

1.8.2. articulating a link between the regulatory and IFRS 9 treatments of distressed restructured credit exposures;

1.8.3. providing guidelines for an appropriate interpretation of regulation 67 of the Regulations (i.e. default treatment), specifically the reduced financial obligation requirement, for banks using the IRB approach; and

1.8.4. providing clarity on reporting requirements for the completion of the quarterly form BA210.

2. Proposed Directive

2.1. In accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks are hereby directed as follows:

2.1.1. A bank must put in place the relevant policies that outline criteria for identifying and reporting distressed restructured credit exposures, in line with the provisions of this proposed directive, read with the relevant requirements specified in the Regulations. These policies must also outline the relevant approval process and appropriate delegated authority for approving any distressed restructures.

2.1.2. It is the ultimate responsibility of the board of the bank and its senior management to ensure compliance with the requirements of this proposed directive and other relevant internal policies relating to the identification, classification, management and reporting of distressed restructured credit exposures.

2.1.3. The board and senior management of the bank, through relevant internal committees, must exercise an oversight responsibility on the overall management of distressed credit exposures and all relevant practices used by the bank to assist counterparties who are experiencing financial distress.

2.1.4. The bank must also put in place a monitoring mechanism to continuously monitor the volumes and values of distressed restructured credit exposures as well as the migration of exposures across the various arrears categories, for example the classification of a restructured credit exposure at the end of the probation period when the counterparty is no longer in financial distress.

2.2. In some cases, distressed restructured credit exposures may be initiated at the request of the counterparty. In other cases, it may result as a proactive measure by the bank to assist counterparties that may be experiencing financial distress.

2.3. In both cases, the process of identifying and consenting to a distressed restructured credit exposure must be supported by an assessment of the counterparty's current financial position and affordability considerations under the amended terms and conditions of the loan agreement. This assessment must, in turn, be supported by credible documentation of the counterparty's financial status, overall current debt obligations and how this is likely to impact the counterparty's performance under the amended terms and conditions of the distressed restructured credit exposure.

2.4. Importantly, a bank must not restructure any credit exposures for financial distress reasons with the intention of obscuring a deterioration in the credit quality of a counterparty.

2.5. **Indicators of financial distress**

2.5.1. In deciding if a restructured credit exposure must be classified as a distressed restructured credit exposure, a bank must determine whether the credit exposure is being restructured due to the financial distress of the counterparty.

2.5.2. Financial distress in this regard must be identified at a credit exposure level, at which the bank grants the concession. To that end, the bank's internal systems must be sufficiently granular to enable the identification and flagging of financially distressed counterparties.

2.5.3. When a bank classifies its credit exposure to a counterparty as a distressed restructured credit exposure, then it must classify all its credit exposures to the same counterparty as distressed restructured credit exposures.

2.5.4. In general, indicators of financial distress will include, but are not limited to:

2.5.4.1. a credit exposure that is in arrears[2] (excluding technical arrears[3]) at the time of the restructure;

2.5.4.2. a credit exposure that is in arrears at any point during the past six months prior to the restructure;

2.5.4.3. a credit exposure that is not in arears at the time of the restructure, but it is probable that the counterparty will be past due in the foreseeable future if the bank does not grant a concession;

2.5.4.4. a restructure of a counterparty's debt obligations on account of changed financial circumstances, which cause the bank to offer revised terms and conditions which the bank will ordinarily not grant as part of its BAU credit granting process; and

2.5.4.5. the counterparty not being able to obtain an effective interest rate at least equal to the current market interest rate for similar loans to a counterparty that is not experiencing financial distress.

2.5.5. The behaviour of revolving credit facilities is different from that of amortising loans. For instance, outstanding balances on revolving facilities fluctuate because of drawdown features. This contrasts with amortising loans, where the outstanding balance is repaid over a prespecified term. Moreover, revolving facilities have minimum capital and interest repayment schedules that often fluctuate based on the outstanding balance. This contrasts with amortising facilities where capital and interest repayments are often in the form of fixed prespecified instalment schedules over the term of the loan.

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[2] 'In arrears' for the purpose of this proposed directive will mean a payment or portion of a payment that is one day past due in terms of the contractual due date.

[3] 'Technical arrears' for the purpose of this proposed directive will mean any account that is classified as being 'in arrears' for technical reasons such as operational errors or the bank's information technology system not updating the relevant information on time.

2.5.6. Accordingly, banks must consider the following non-exhaustive factors to decide whether a distressed restructured revolving facility must be classified in default:

2.5.6.1. The bank consents to a limit increase in cases where a credit assessment of the counterparty evidences financial distress. Financial distress may be exhibited by, for instance, a significant deterioration of behavioural credit scores/risk ratings over the past 12 months, and a consistent pattern of missed repayments and arrears during the same period.

2.5.6.2. Concessions are granted to the counterparty due to financial difficulty.

2.5.7. In addition to the indicators listed in paragraph 2.5.4, banks must also consider other indicators that are specific to retail and wholesale[4] exposures. These indicators include, but are not limited to:

Wholesale credit exposures

2.5.7.1. The counterparty voluntarily applies for, or is subject to, liquidation.

2.5.7.2. The counterparty voluntarily enters into or applies for business rescue as provided for under the Companies Act 71 of 2008.

2.5.7.3. The counterparty's listed shares have been delisted or are in the process of being delisted, or are under threat of being delisted from an exchange due to non-compliance with the listing requirements or for financial or other reasons.

2.5.7.4. 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 obligations in accordance with the contractual terms of the existing agreement for the foreseeable future. These estimates may be based on an analysis of the counterparty's internally assigned and up-to-date credit risk ratings, external credit ratings and other relevant quantitative and qualitative information, collected on a best effort basis.

2.5.7.5. Other indicators that may indicate financial distress include significant losses over sustained periods, sustained losses in market share and competitive position, and management instabilities.

Retail credit exposures

2.5.7.6. The counterparty applies for debt counselling as provided for under the National Credit Act 34 of 2005.

2.5.7.7. 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 obligations in accordance with the contractual terms of the existing agreement for the foreseeable future. These estimates may be based on the counterparty's behavioural scores and other relevant quantitative and

[4] Wholesale credit exposures covers credit exposures classified in the following regulatory asset classes: corporates (including specialised lending and SME corporates), public sector entities, local government, sovereign (including central government and central bank), banks and securities firms.

qualitative indicators collected (e.g. from credit bureaus) that list the counterparty's credit obligations, debt payment capacity as well as debt-to-income, debt service coverage and bureau scores.

Exclusions

2.5.8. The PA acknowledges that not all restructures that banks perform should be regarded as distressed restructures.

2.5.9. Accordingly, banks' internal policies must make a clear distinction between BAU restructures and distressed restructures. These policies must be applied consistently over time and across all credit exposures.

2.5.10. Unless the loan is in arrears, the following will not be regarded as distressed restructuring:

2.5.10.1. changes in payment frequency, date or reduction of term with a commensurate increase in the agreed instalment;

2.5.10.2. revisions to terms and conditions based on changes in a counterparty's business activities, the industry in which it conducts business or the nature of its revenues. These changes must not be due to financial distress, but a reflection of changes in the counterparty's business conditions which give rise to different banking needs (e.g. changes in revenue streams of a counterparty which may necessitate a change in the payment schedules of its loans from monthly to quarterly); and

2.5.10.3. when a bank offers a counterparty revised and relatively more favourable terms and conditions, for instance for competitive reasons, to prevent a counterparty from switching to competitors. Importantly, these revisions must be in line with the concession the bank ordinarily grants to counterparties that are not in financial distress as part of its BAU credit granting processes.

2.5.11. Where a bank applies a blanket approach by, for example, classifying all or portions of its restructured exposures as distressed restructured credit exposures, this must be well documented in its credit or impairment policies, and reporting in the form BA 210 must be in line with this internal blanket approach. The PA must be notified in writing when a bank chooses to apply this approach.

2.6. **Criteria for distressed restructured credit exposures to exit the probation period**

2.6.1. A probation period for a distressed restructured credit exposure must commence immediately after the distress restructure event.

2.6.2. The probation period must last for a minimum of 12 months. Therefore, a distressed restructured credit exposure will not be regarded as being distressed (hereafter referred to as rehabilitated) unless it has stayed in the probation period for a minimum of 12 months.

2.6.3. The start of the probation period will depend on the distressed restructured credit exposure's payment schedule. For distressed restructured credit exposures with monthly payment schedules, the probation period must begin on the date that the payments under the amended loan agreement and revised terms and conditions

are due to begin. For distressed restructured credit exposures with payment schedules that are not monthly, the beginning of the probation period must be the effective date of implementation of the amended loan agreement and revised terms and conditions.

2.6.4. When the terms and conditions of a distressed restructured credit exposure are amended again during the probation period, this must trigger a restart of the probation period.

2.6.5. To conclude that the distressed restructured counterparty has rehabilitated, the bank must objectively determine whether the counterparty has resolved its financial difficulties and that the amended loan agreement, and revised terms and conditions will result in the amortisation of the credit exposure over the revised and remaining term of the loan.

2.6.6. In this regard, a distressed restructured credit exposure will be regarded as rehabilitated, and hence qualify for exit from the probation period, if the following criteria are met:

2.6.6.1. For retail credit exposures, all payments, as per the amended loan agreement, have been made in a timely manner, ensuring that the distressed counterparty is up to date at the end of the probation period. In most cases, this requirement will equate to 12 full consecutive monthly payments, or fewer payments for exposures with remaining terms shorter than 12 months. However, in cases where a distressed restructured counterparty misses any of the monthly instalments or makes partial payments, but subsequently makes additional payments to catch up prior to the end the probation period, then such a counterparty must also be regarded as rehabilitated.

2.6.6.2. For credit exposures that do not have monthly repayment schedules, the counterparty must be up to date with all its payments, as per the amended loan credit agreement, at the end of the probation period.

2.6.6.3. For wholesale credit exposures, the ultimate decision whether the underlying counterparty has rehabilitated must be taken by the bank's relevant committee, with the requisite authority to monitor and make the decision on the distressed restructured credit exposure. This decision must be based on the materiality of the distressed credit exposure as well as an objective assessment of the counterparty's financial circumstances and debt repayment capacity, given its existing debt obligations. This assessment must rely on credible quantitative and qualitative information, including but not limited to the distressed counterparty's internally assigned credit risk ratings, and where necessary, external credit ratings, financial statements and its performance during the probation period.

2.7. **Categorisation of distressed restructured credit exposures pre- and post-rehabilitation**

2.7.1. A bank may perform a distress restructure on a credit exposure that is classified in default, as performing or in arrears (past due).

2.7.1.1. If a bank consents to a distressed restructure of a credit exposure that is classified in default, then the distressed credit exposure must remain in default during the probation period.

2.7.1.2. If a bank consents to a distressed restructure on a credit exposure that is classified as performing, the bank must assess whether, after the distressed restructure, the credit exposure still meets the criteria to be classified as performing.

2.7.1.3. If a bank consented to a distressed restructure of a credit exposure that is in arrears, then the distressed restructure must migrate across the arrears buckets during the probation period. For example, if a distressed counterparty is in the 0–30 days overdue bucket at the start of the probation period, and subsequently misses an instalment anytime during the probation period, then the distressed credit exposure to that counterparty must be migrated to the 31–60 days overdue bucket. Similarly, if a distressed counterparty goes into the 90 days overdue bucket during the probation period, then the distressed credit exposure must immediately be classified in the >90 days overdue bucket. In addition, banks using the IRB approach must classify this distressed credit exposure in default in accordance with regulation of 67 of the Regulations.

2.7.2. A distressed counterparty that was either in arrears or in default at the beginning of the probation period may be reclassified as performing at the end of the probation period, if the distressed counterparty is rehabilitated in accordance with the rehabilitation criteria specified in paragraph 2.6.6. of this proposed directive.

2.7.3. A distressed restructured credit exposure that has not rehabilitated at the end of the probation period suggests various implications. In the main, it suggests that the distressed counterparty is still unable to honour all its debt obligations even under less stringent terms and conditions of the amended loan agreement. Accordingly, such a distressed credit exposure must be assessed for a significant increase in credit risk (SICR) in line with the requirements of IFRS 9 and paragraphs 2.8.3 and 2.8.4 of this proposed directive.

2.7.4. If the SICR assessment reveals that the distressed credit exposure is credit-impaired, then the credit exposure must be classified in default in line with paragraph 2.9.6 of this proposed directive.

2.7.5. However, if the distressed credit exposure is not credit-impaired but is in arrears, then the credit exposure must be classified and reported in the appropriate arrears bucket. In addition, the credit exposure must continue to be flagged and reported as a distressed restructured credit exposure. The distressed restructure 'flag' must only be removed if the credit exposure clears up its arrears status.

2.8. Distressed restructured credit exposures and significant increase in credit risk

2.8.1. It is not the intention of this proposed directive to deviate from the requirements of IFRS 9 or banks' internal policies and methodologies put in place to give practical effect to these IFRS 9 requirements. This implies, among other things, that this proposed directive does not specify, but rather relies on banks' approved policies and methodologies used for the staging[5] and estimation of expected losses of distressed credit exposures.

[5] Staging in this regard refers to the process of categorising exposures into the three IFRS 9 stages.

2.8.2. Distressed restructured credit exposures may result in revisions to the terms and conditions of the loan agreement. The renegotiation and modification of the contractual cashflows will often be the net outcome of the distressed restructure. Accordingly, in respect of distressed restructured credit exposures, the PA expects banks to comply with the requirements of IFRS 9 in respect of the modification of contractual cashflows.

2.8.3. In addition, financial distress is an indication of a potentially significant increase in the counterparty's credit risk. As a minimum, subsequent to performing/conducting the distressed restructure, the PA expects banks to assess the distressed credit exposure for a SICR in line with their impairment policies and their IFRS 9 methodologies. In the event that the SICR assessment confirms a SICR, banks must reclassify the loan to the appropriate stage.

2.8.4. However, a bank's impairment policy may trigger the movement of a distressed restructured credit exposure to either stage 2 or stage 3, regardless of the outcome of the SICR assessment. This approach will not be regarded as inconsistent with the provisions of this proposed directive.

2.9. **Definition of default under the IRB approach**

2.9.1. Regulation 67 of the Regulations in relevant parts defines default to include all credit exposures on which the bank consents to a distressed restructuring, which is likely to result in a reduced financial obligation, caused by, for example, the postponement of principal, interest or fees.

2.9.2. There are primary principles that the IRB banks must consider when assessing whether the distressed restructured credit exposure should be classified in default. For instance:

2.9.2.1. Is the amended loan agreement, and revised terms and conditions still in line with what the bank would ordinarily grant as part of its BAU credit granting processes? A deviation from BAU credit granting processes will occur, for example, if the bank ordinarily grants a term of a maximum of *x* years for a particular product, but the distressed restructure results in the bank granting an amended credit loan agreement with a revised term of $y>x$. Such a distressed restructure must be classified in default even if the amended loan agreement does not result in a reduced financial obligation.

2.9.2.2. Similarly, a deviation from BAU credit granting processes in terms of bullet payments will occur if the bank ordinarily grants a bullet amount that is *z* per cent of the total loan amount for a particular product, but the distressed restructure results in the bank granting a bullet payment of w>z. Such a distressed restructure must also be classified in default even if the amended loan agreement does not result in a reduced financial obligation.

2.9.3. A reduced financial obligation in this case must be interpreted to refer to instances where the amended loan agreement and the related revised terms and conditions will result, or are likely to result, in a loss for the bank. In essence, if the revised terms and conditions result in the bank not recovering the total amount due – both the interest and capital amounts – then the bank must classify the loan as being in default.

2.9.4. IRB banks must assess whether a loss is likely to result by firstly considering the principles outlined in paragraph 2.9.5. Secondly, if the net present value (NPV) of future cashflows expected under the amended loan agreement is less than the NPV of the future expected cashflows of the original loan agreement, then this will be evidence that the amended loan agreement will result in a reduced financial obligation. Accordingly, the distressed restructured credit exposure must be classified as being in default.

2.9.5. The following are some of the concessions granted to a distressed restructure that are likely to result in a loss and, therefore, the classification of the distressed restructured credit exposure in default:

2.9.5.1. the amended loan agreement reduces the instalment without an extension of the term;

2.9.5.2. the amended loan agreement reduces the interest rate, all other things being equal; and

2.9.5.3. the bank writes off a part of the credit obligation.

2.9.6. As a minimum, and without deviating from the requirements of IFRS 9 and banks' related impairment policies, IRB banks must classify all distressed credit exposures that are assessed to be credit-impaired, and classified in stage 3, in default.

2.9.7. In addition, where the revised terms and conditions of the distressed restructured credit exposure result in a renegotiation or otherwise modification of the contractual cashflows, and such renegotiation or modification results in the recognitions of a modification loss, as defined in IFRS 9, then this must be regarded as evidence of reduced financial obligation and such a distressed restructured credit exposures must be classified in default.

2.9.8. All retail revolving facilities that are classified as distressed restructured credit exposures, in terms of paragraphs 2.5.5 and 2.5.6, must be classified in default. This blanket classification is informed by simplicity and consistency considerations.

2.9.9. For wholesale revolving facilities, the PA acknowledges that banks generally follow a case-by-case and a more holistic approach when assessing whether credit exposures to distressed wholesale counterparties should be classified in default, in line with regulation 67 of the Regulations. Accordingly, and in line with internal policies and governance processes, banks must assess whether revolving credit facilities to their wholesale counterparties, which are classified as financially distressed, should be classified in default. This assessment must consider, among other things, the following:

2.9.9.1. financial circumstances of the counterparty, and the likelihood of recovering all outstanding balances on the facility without granting concessions that deviate from BAU credit granting processes;

2.9.9.2. significant deteriorations of internally assigned credit risk ratings and all other relevant indicators of debt repayment capacity; and

2.9.9.3. other considerations relating to credit quality of the counterparty that may result in reassignment or an override of the counterparty's internally assigned credit risk rating to default.

2.9.10. If a bank consents to a distressed restructure immediately at the end of the probation period or while the distressed restructured credit exposure is still in its probation period, the bank must assess whether the loan meets the definition of credit impaired in line with IFRS 9 requirements. If the distressed restructured credit exposure is assessed to be credit impaired and the bank consents to a distressed restructure, during or immediately at the end of the probation period, then the distressed credit exposure must be classified in default.

2.9.11. To reiterate, a bank must not treat credit exposures as distressed restructures to obscure a deterioration of credit quality of their counterparties and, by implication, their classification in default. Accordingly, banks must put in place stringent internal policies and measures to prevent the misuse of distressed restructure practices to obscure a deterioration of counterparties' credit quality. Moreover, banks must put in place measures, for instance, to limit the number of times credit exposures can be restructured within time-specific periods, which banks must determine internally. Such internal measures must be sufficiently granular to account for differences in how banks approach distressed restructures across various product types and asset classes.

2.10. **Formalisation of the restructured loan agreement**

2.10.1. Paragraph (b)(iv) of the definition of a restructured credit exposure in regulation 67 of the Regulations states that the restructuring agreement must be in writing. For the purpose of this proposed directive, 'in writing' shall include:

2.10.1.1. paper-based or electronic documentation of the revised terms and conditions, signed physically or electronically by both parties;

2.10.1.2. verbally agreed changes to the original terms and conditions, which are digitally recorded and enforceable; and

2.10.1.3. electronic communication of the revised terms and conditions to the counterparty, for example by electronic mail (email) or short message service (SMS), which is enforceable.

2.10.2. It is essential that the legal position of the bank is protected when the terms and conditions of an agreement are revised. It follows that where there is uncertainty regarding the legal enforceability of a particular method of communication, the bank should obtain legal opinion to that effect.

2.10.3. When a bank decides not to formalise the revised terms and conditions in writing as specified by this proposed directive, footnote 1 to lines 22 to 42 (for banks using the standardised approach) and lines 257 to 284 (for banks using the IRB approach) of the form BA 210 states that the relevant credit exposure shall be regarded as credit-impaired.

2.11. **Reporting requirements**

2.11.1. Banks must report all distressed restructured credit exposures in the quarterly form BA 210.

3. Invitation for comment

3.1. All interested persons are hereby invited to submit their comments on the proposed directive to SARB-PA@resbank.co.za and RSD-CreditRisk@resbank.co.za, for the attention of Mr Eric Sithole and Mr Makgale Molepo, by no later than 19 July 2024.

Fundi Tshazibana

Fundi Tshazibana
Chief Executive Officer

Date: 07/06/24