[BSP CIRCULAR NO. 247, June 02, 2000]

CLASSIFIED LOAN ACCOUNTS

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.
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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 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 uncancelled annotation or lien or encumbrance

B. **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;