APPENDIX 1

FRAMEWORK ON ARREARS MANAGEMENT

This translation, prepared by the Central Bank of Cyprus, is unofficial. The official text of the Framework should be the text in Greek language as published in the Official Gazette of the Republic.

PART I – GENERAL PROVISIONS

Title and scope of application.

1. (a) This Framework will be referred to as the Framework on Arrears Management (hereinafter referred to as the "Framework").

(b) The Central Bank of Cyprus (CBC) requires ACIs to implement efficient and effective structures, processes and tools to support arrears management and execute fair, adequate and sustainable debt restructuring.

(c) The Framework provides a uniform approach for ACIs dealing with arrears management. Its purpose is to provide the key principles for a fair and expeditious resolution to the restructuring efforts for borrowers in financial difficulties across the banking sector in the Republic of Cyprus.

(d) ACIs are required to comply with the principles and requirements contained in this Framework.

(e) These principles and requirements are, however, non-exhaustive and shall only be used as a benchmark for the minimum standards required. Each ACI shall also evaluate the relevance and applicability of each provision of this Framework in relation to its own specificities and based on the principle of proportionality.

Definitions.

2. For the purposes of this Framework, the terms and definitions of the present Directive apply.

PART II – METHODOLOGY FOR AUTHORISED CREDIT INSTITUTIONS ON ARREARS MANAGEMENT

General framework of arrears management.

3. (1) ACIs adopt the five key pillars, described in the figure below, when dealing with arrears and handling borrowers in financial difficulties. These are:

(a) the adherence to the Code of Conduct on the Handling of Borrowers in Financial Difficulties, as described Appendix 2 (hereinafter referred to as "the Code");

(b) the development of a robust arrears management strategy;

(c) the utilisation of relevant, effective and sustainable debt restructuring techniques and options;

(d) the establishment of a robust organisation and operating model to handle increasing arrears volumes; and

(e) the monitoring of arrears management performance against key objectives and taking corrective measures as and when required.

(2) In order to ensure that the ACIs have the adequate capability and capacity to handle the increasing volume of arrears over the coming years and that they adhere to the five pillars above, ACIs shall undertake a critical internal assessment of their current arrears management strategy, policies and procedures and benchmark them to the provisions outlined in this Framework. ACIs shall thus, identify the gaps, determine areas of improvement, including systems and infrastructure, and develop an action timeplan to implement the necessary changes to comply with this Framework. The said assessment shall be subject to review by the CBC.

PART III – CODE OF CONDUCT ON THE HANDLING OF BORROWERS IN FINANCIAL DIFFICULTIES

Code of Conduct on the Handling of Borrowers in Financial Difficulties.

4. (1) The Code is intended to provide ACIs with a common base for dealing with borrowers in financial difficulties.

(2) The Code is intended to support and facilitate a meaningful interaction between ACIs and borrowers, with the ultimate goal of achieving a fair and sustainable restructuring, where possible. To this effect, the Code clearly outlines, inter alia, the responsibilities of the ACIs in the arrears management process. It, also, makes a clear distinction between cooperative and non-cooperative borrowers with the focus on a consensual and voluntary restructuring.

PART IV – ARREARS MANAGEMENT STRATEGY (AMS)

Arrears Management Strategy.

5. Each ACI shall develop a comprehensive arrears management strategy outlining how it will deal with arrears in each primary category of credit facilities that it serves.

The strategy shall include:

(a) A clearly defined approach for each of the main category of credit facilities it serves.

(b) An operational plan covering the main components of arrears management including Segmentation, Policy and Debt Restructuring Solutions, Organisation and Capabilities, Processes and Systems and Measurements.

Components of strategy.

6. (1) Each ACI shall develop comprehensive and detailed AMS to effectively manage arrears and deal with borrowers in financial difficulties in a systematic, organised and professional manner and submit to the CBC for assessment.

(2) The AMS shall include the following components:

(a) To address the following situations:
- pre-arrears credit facilities;
- credit facilities in arrears;
- credit facilities' restructuring and modifications.

(b) Be aligned with the overall objectives and strategy of the ACI;

(c) Be specific, measurable and achievable (i.e. commensurate with the manpower and complexity of operations);

(d) Be tailored to the specifics of each category of credit facilities;

(e) Provide relevant, adequate and sustainable restructuring solutions;

(f) Promote a fair, collaborative and case-by-case approach in dealing with borrowers in financial difficulties;

(g) Be clearly communicated to the employees and other relevant persons or bodies; and

(h) Be flexible and subject to regular review in order to adapt to the changing economic conditions and arrears trends.

Portfolio segmentation.

7. (1) Portfolio segmentation is a key part of any AMS as it enables the ACIs to adopt and tailor different restructuring solutions to different segments of the loan book. The ability of ACIs to segment and analyse their loan book in granular detail constitutes a basic principle of the arrears management process. ACIs shall place great emphasis on the development of the appropriate systems for portfolio segmentation in order to ensure proper implementation and review of the AMS.

(2) As a minimum, ACIs shall:

(a) Apply the segmentation exercise to each relevant portfolio and sub-portfolio;

(b) Define the portfolio segments based on relevant characteristics (e.g. purpose of credit facility, currency, performance, location of property, borrower's arrears behaviour, etc);

(c) Analyse and assess arrears, troubled areas and trends for each sub-portfolio;

(d) Breakdown each sub-portfolio (e.g. SME loans) into discrete cohorts (e.g. cooperative and viable borrowers with more than 30 days past due (dpd)) as follows:

(i) Level of arrears:
- Pre-arrears (0 dpd);
- Early Arrears (<30 dpd);
- Arrears of 30+ dpd (medium to serious arrears);
- Arrears of 60+ dpd;
- Arrears of 90+ dpd.

(ii) Key risk segments:
- very high;
- high;
- medium; and
- low.

(iii) Viability of borrowers:
- Cooperative and viable borrowers;
- Cooperative but unviable borrowers;
- Non-cooperative borrowers.

(iv) Collection score: using credit rating and internal behaviour data, where possible;

(e) Determine the potential treatment(s) required for each cohort;

(f) Define specific short-, medium- and long-term restructuring options as per the requirements of Part V below, for each sub-portfolio, narrowed down to each cohort;

(g) Perform scenarios / sensitivity analysis and estimate possible portfolio evolutions (including sub-portfolio and cohorts) and the relevant capital requirements, where required;

(h) Monitor the evolution of each sub-portfolio and cohort based on pre-defined Key Performance Indicators (KPI) as per Part VII below;

(i) Based on the results and evolution of the sub-portfolios / cohorts, review the strategy and approaches on a systematic way and in periodical manner.

Strategy monitoring.

8. (1) ACIs shall periodically, and at least annually, test the robustness of the AMS and its underlying hypothesis and assumptions and submit their revised strategy to the CBC.

The assessment of ACIs shall take into consideration any changes related to the environment within which the ACI operates, including:

(a) internal factors (e.g. strategic changes, structural changes, portfolio evolution); and
(b) external factors (e.g. the market conditions).

(2) In order to adequately monitor and review its AMS , the ACI shall:

(a) Define the process to measure the robustness of the AMS;
(b) List the relevant Key Success Factors (KSF) for efficiency and effectiveness and perform regular assessment of the KSF to ensure adequate implementation at all steps of the process;
(c) Define reporting requirements and formats;
(d) Establish the frequency monitoring of the AMS and content of relevant reports; and
(e) Define the internal audit processes to ensure compliance of the ACI with the defined AMS.

(3) The report of the internal auditor on the compliance of the AMS with this Framework shall be submitted to the CBC.

Other main components of the Arrears Management

9. (1) The other main components of the AMS are described in Parts V to VII and include:

Strategy.

(a) Restructuring Options of credit facilities;
(b) Processes and Systems;
(c) Organisation and Capabilities; and
(d) Measurements.

(2) A comprehensive set of Restructuring Options of Credit Facilities is essential to any ACI to enable it to provide relevant, appropriate and sustainable solutions to troubled borrowers. These options shall provide for an array of short-, medium- and long-term solutions as applicable to the specificities of each troubled borrower.

(3) The establishment of appropriate Processes and Systems ensures that the ACI can handle the arrears cases, current and future, in its portfolio.

(4) Continuous measurement by the ACI of the efficiency and the effectiveness of the arrears management activity is essential in order to evaluate the AMS and adapt its model in order to cope with the requirements of this Framework, with the ultimate aim of the improvement of the loan book of the ACI.

PART V – RESTRUCTURING OF CREDIT FACILITIES

Pre-emption.

10. To effectively deal with pre and early arrears, ACIs are required to implement tools and mechanisms to identify, communicate and manage borrowers with the risk of running into financial difficulties. These include:
(a) Modelling exercises for early identification of borrowers with financial difficulties;

(b) Guidelines for the staff on how to manage pre and early arrears and effectively deal with borrowers in financial difficulties; and
(c) Written resources for borrowers in financial difficulties (e.g. websites, brochures) explaining the procedures related to restructuring.

Define options and solutions.

11. (1) ACIs shall develop and implement suitable restructuring framework of credit facilities with a view to providing viable borrowers with restructuring solutions that are robust and sustainable in the long term and thus enhance the safeguarding of the assets of the ACI. To this end, ACIs shall ensure that the restructuring framework:

(a) is aligned with the AMS;

(b) provides for assessment on a case-by-case basis;

(c) provides for the proposal of a range of fair and sustainable restructuring options to borrowers;

(d) is focused on the development and implementation of long-term restructuring solutions but, where appropriate, may allow for a combination of long-, medium- and/or short-term arrangements;

(e) combines traditional and non-traditional restructuring solutions;

(f) is customised according to the category of the credit facilities (e.g. housing loans, consumer loans, SME/business loans, corporate loans, CRE loans) and the segment particularities (e.g. investment property finance); and

(g) may include collateral / property sales programmes, if and when relevant;

A number of restructuring options of credit facilities that ACIs may incorporate in their framework to consider when assessing the financial situation of troubled borrowers are described in Section III of this Framework.

(2) ACIs shall communicate the restructuring framework of credit facilities, including the measures, options, guidance and tools for decision making to all pertinent units and relevant employees and provide adequate training to them.

(3) ACIs shall adapt their restructuring framework to incorporate additional measures that may be presented by the CBC when evaluating the options of the ACI.

Restructuring tools and processes.

12. Each ACI shall establish and implement necessary the tools and processes that facilitate the implementation of restructuring solutions of credit facilities.

These include, but are not limited to:

(a) Decision trees, designed to assist the persons responsible of the restructuring in categorising borrowers, determining and implementing the appropriate and sustainable strategies for a specific category of borrower in a consistent manner, based on pre-defined and approved criteria;

(b) Specific list of restructuring options ("Restructuring Toolkit") that have been approved by the ACI and is available for use;

(c) Tracking system, designed to facilitate the identification and segmentation of borrowers and credit facilities based on similar criteria and enable implementation of systemic strategies where possible.

Arrears management policies (including pricing policy on debt restructuring).

13. (1) ACIs shall ensure that their current credit and arrears management policies and procedures are updated to ensure adherence with the principles and requirements of this Framework.

(2) ACIs shall implement a fair and sustainable pricing policy with regard to restructured credit facilities. The objective of the pricing policy should be to minimise costs, fees and interest rates for borrowers that are subject to restructuring of their credit facilities. In a restructuring situation, the emphasis should always be on the repayment of the principal. The restructuring policy shall provide for:

(a) the charging of a reasonable and fair interest rate on credit facilities that are in arrears;

(b) careful consideration of the impact of the level of interest rate on the repayment ability of the borrower when restructuring any credit facility in arrears;

(c) the charging of the minimum possible charges, fees and out of pocket expenses in the total debt restructuring assessment;

(d) adaptation of the pricing policy to each sub-portfolio / cohort;

(3) ACIs shall, at least on a bi-annual basis, review and revise, where deemed necessary, their pricing policy, and submit detailed information on the said policy to the CBC.

PART VI – ORGANISATIONAL STRUCTURE AND OPERATING MODEL

Target organisation and operating model.

14. (1) ACIs shall clearly define the blueprint of the organisational structure, level of resources and capabilities and systems and processes required to effectively implement and monitor the AMS.

(2) ACIs shall implement a robust operating model that encompasses all systems, policies, processes and procedures in order to support the effective and efficient management of arrears of borrowers with financial difficulties.

(3) The operating model:
- (a) shall align with the ACI's policy framework and strategy;
- (b) may comprise a single integrated process in order to ensure efficiency and cost savings;
- (c) shall address all relevant areas of the organisation (e.g. workforce, operations etc); and
- (d) shall focus on outcomes and the effectiveness of arrears management activities.

(4) With regards to the policies and procedures, the ACI shall, as a minimum set:

(a) The policy on restructured credit facilities that adhere to this Framework;

(b) Governance and authority structures for restructuring of credit facilities and the specific areas of responsibility for dealing with borrowers in financial difficulties;

(c) Definitions, including criteria and tests where relevant, for:

- (i) Types of default;
- (ii) Types of arrears;
- (iii) Viability/Sustainability.

(d) Guidelines for the assessment of credit facilities in arrears, including calculation of the reasonable living expenses when performing the assessment of individual borrowers' financial position;

(e) Guidelines for the handling of arrears and restructuring of credit facilities in the event of multiple creditors (relevant information are presented in Sections II and IV of this Framework);

(f) Early warning mechanisms and borrower handling procedures and the operational processes per sub-portfolio/cohort;

(g) Form, content and speed of communication with borrowers in financial difficulties (including pre-arrears cases);

(h) Process for information gathering (i.e. type, frequency, validation and archiving);

(i) Data / information analysis and assessment, both in physical and electronic form;

(j) Guidelines for defining non-cooperative borrowers and respective treatment;

(k) Types of alternative repayment measures available;

(l) Tools and mechanisms to facilitate decision making (e.g. decision trees);

(m) Guidelines to enable a flexible approach towards handling of borrowers' complaints;

(n) Measurement and monitoring including rewards and accountabilities, and reporting mechanisms, including frequency and purposes;

(o) Policies for staff dealing with restructuring of credit facilities, including training policies.

Organisational structure and human capital.

15. ACIs shall establish an appropriate organisational framework for the sound management of arrears and borrowers in financial difficulties. The organisation framework shall ensure that:

(a) human resource is adequate and appropriately trained; and

(b) all tasks and responsibilities are clearly defined and allocated amongst the Board of Directors, Management and relevant functions and personnel involved in the management of arrears, the handling of borrowers in financial difficulties and the restructuring of troubled but viable cases.

Organisational review and resource design.

16. ACIs shall perform a thorough assessment of their internal capabilities in relation to arrears management, debt restructuring and expertise in the different sectors of the market. The assessment shall include, but not be limited to:

(a) Assessment of the existing organisational structure and procedures with regard to the management of arrears and the handling of borrowers in financial difficulties.

(b) Quantification of resources: Determine the currently available internal and external resources, the level and type of headcount required for each function, evaluate the appropriateness of the existing staff and assess relevant in-house availability for reallocation;

(c) Appraisal of human resources: Assess the required knowledge, expertise and current performance of staff as well as identification of the skills gap and the specific needs for workforce improvements and resourcing;

(d) Upgrading of human resources: Evaluate methods for up-skilling of existing workforce and plan required training. This shall also take into consideration:

(i) Level of experience and expertise required for each sub-portfolio / cohort;

(ii) The current and forecasted needs; and

(iii) The responsibilities and any necessary level of specialisation.

Resource planning.

17. (1) Resource planning is aimed at determining the most optimal, efficient and effective combination of resources required by the ACI to manage arrears, current and future, and deal with borrowers in financial difficulties.

(2) ACIs shall assess potential gaps in resources and define resource plans for the short-, medium- and long-term, taking into account strategic, operational and economic rationales (e.g. the forecasted evolution of the portfolio and arrears profile).

(3) The measures required to upgrade the current organisation and capabilities with the needs defined. These may include:

(i) Internal planning: to find the relevant and competent people from within the organisation;

(ii) High potential assessment and retention programmes: to ensure preservation and motivation of key workforce;

(iii) Job description accuracy: to be reviewed and amended, as and when required;

(iv) Training planning of workforce: to address training requirements for up-skilling;

(v) Planning of outsourcing: to identify potential third parties, that may provide services regarding the assessment of existing workforce.

(vi) Management planning: to ensure that existing management is capable and qualified in that area.

Arrears Management Unit.

18. (1) ACIs shall establish an independent, centralised Arrears Management Unit (AMU) with function that specialises in the various categories of credit facilities with a view to effectively monitor arrears and troubled cases as well as restructurings of borrowers in financial difficulties. The AMU is distinct from the Debt Recovery Unit which typically deals with non-viable borrowers.

(2) The level of centralisation and the corresponding structure of the AMU shall be determined by the specificities of each ACI having due regard to the principle of proportionality.

(3) While creating the AMU, the ACIs shall:

(a) Clearly outline the reasoning and rationale (i.e. strategic, technical, operational and economical) for the chosen AMU structure;
(b) Clearly define the criteria for referral of the monitoring of a troubled case to the AMU;
(c) Ensure that the AMU operates as an independent entity, separate from the credit function and relationship function, and;
(d) Establish and communicate the approach that the AMU should adopt for each asset class (for example, when it is appropriate to use a "cradle to grave" approach, where one case manager is responsible for the entire workout lifecycle, and when an "assembly line" approach, where different case managers are assigned based on the severity of arrears).

Independence of the Arrears Management Unit.

19. (1) In order to ensure a fair and impartial approach to arrears management and restructuring of credit facilities of borrowers in financial difficulties, ACIs shall ensure that the AMU functions as an independent body.

(2) The personnel operating within the AMU may not have any association or affiliation with the credit functions that might infringe their independence and should not have been involved in the loan origination. The level of collaboration between the two functions is limited to the transfer of client knowledge from the credit / relationship function to the AMU.

(3) If shared resources do exist between the AMU and the credit function, then the ACI shall implement relevant processes and mechanisms to maintain the integrity and fairness of the restructuring process.

Alignment of policies, procedures and resources.

20. (1) ACIs shall ensure that all policies, procedures and resources are aligned with their current and forecasted strategic needs and objectives.

(2) To this effect, ACIs shall:
(a) Establish appropriate governance structures and control mechanisms to monitor, identify and rectify any inconsistencies in a timely and effective manner;
(b) Assign tasks and responsibilities and establish accountabilities, measurable objectives (i.e. Key Performance Indicators (KPI)) and benchmarks to evaluate and assess the AMU, team and individual performance;
(c) Clearly define and communicate performance standards, develop training and awareness programmes and establish processes to recognise and reward achievements.

Process efficiency.

21. (1) ACIs shall ensure process efficiency in the management of arrears and handling of borrowers in financial difficulties through the implementation of best policies, procedures and practices.

(2) These include:

<u>(a) Lean thinking</u>: ACIs shall ensure that they implement policies and procedures to enable application of lean concepts and techniques in operational processes to maximise time and cost efficiency, both for the ACI and the borrowers, during the restructuring process. Some examples of lean measures are decision trees, standardised checklists, inter alia, for gathering information, and pre-defined analytical models, such as cash flow sensitivity analysis.

<u>(b) Caseload management</u>: The management at each ACI shall be responsible for determining the optimal number of cases handled by each team and individual case officer. The management shall also be expected to define control criteria, establish automated processes for the monitoring and reporting, where possible, and implement preventive and corrective measures (e.g. removal of low-value activities, batching, re-allocation of resources, automation of processes) to avoid any disruptions in the process.

<u>(c) Sharing of best practices</u>: ACIs shall make available throughout the organisation a forum for sharing best practices on arrears management and restructuring. Management shall encourage knowledge sharing amongst employees and update policies and procedures on a regular basis to ensure alignment with international best practices.

<u>(d) Culture of continual improvement</u>: Management shall take the necessary measures to facilitate improvements in arrears management and restructuring of borrowers in financial difficulties. ACIs shall put in place mechanisms shall be in place to enable timely and effective implementation of corrective measures and improvements as and when required (e.g. specialized training, modification of processes).

(3) ACIs shall evaluate process efficiency based on the criteria relevant to their business and portfolio particularities. ACIs shall submit to the CBC their policies, practices and procedures in the area of arrears management and restructuring of credit facilities and shall demonstrate thereto that they have implemented them appropriately and that they apply them consistently.

Management Information Systems.

22. ACIs shall develop a comprehensive database and MIS to:

(a) efficiently and effectively manage arrears, troubled loans and borrowers in financial difficulties;
(b) perform the required analysis on the loan book that enables segmentation and performance assessment;
(c) incorporate an early warning system enabling the uniform pre-emption of potentially problematic credit facilities based on pre-defining indicators; and
(d) facilitating the filtering of the loan portfolio into facilities that may be sold or pledged when required.

(2) ACIs shall evaluate their MIS periodically and at least annually, in order to timely execute necessary improvements.

(3) ACIs shall ensure that the MIS capabilities are sufficient to meet the specified needs and requirements. As a minimum, MIS shall enable the ACIs to:

(a) detect early warnings;
(b) assess the borrower's financial position and its repayment ability;
(c) manage revenues and cash flows from collateral;
(d) monitor evolution of portfolio(s) / sub-portfolio(s) / cohorts;
(e) measure performance and compliance of the borrower based on specific targets and pre-defined criteria;
(f) identify, pre-empt and monitor troubled cases;
(g) assess restructuring scenarios;

(h) prepare automatic reporting on loan performance for Senior Management and Board of Directors; and
(i) reporting to CBC.

Data quality.

23. ACIs shall implement relevant processes and controls to assess and report on the completeness and accuracy of data and information they receive. To this effect, ACIs shall:
(a) Define priorities and criteria for data gathering and maintenance;
(b) Establish mechanisms, on the basis of the proportionality principle preferably automated, for the periodic review and reporting of data, and the monitoring of covenants and compliance.
(c) Implement quality control mechanisms to ensure completeness, correctness and consistency of data and information between internal systems.

Data retention policy.

24. (1) ACIs shall implement a data retention policy that lays down the requirements for storage, retention and accessibility of all supporting and legal documentation with respect to arrears management and of credit facilities restructuring, including communication with borrowers.

(2) The data retention policy shall provide that data archiving and record-keeping requirements for troubled cases is more stringent in order to ensure that all parties involved in the restructuring are able to easily retrieve and review documentation and information regarding restructuring processes and decisions.

Process effectiveness.

25. ACIs shall ensure that process effectiveness is achieved in the arrears management process, and that the outcomes from this activity are sustainable, especially in relation to the level of re-defaults of the restructured credit facilities which shall be kept at a minimum level. ACIs shall also monitor the robustness of cure rates in order, inter alia, to timely implement necessary corrective measures that aim at minimising re-default situations, particularly in areas that the ACI can control (e.g. proper case assessment).

Monitoring organisation and operations.

26. (1) ACIs shall lay down the policies and procedures for the regular evaluation of the internal capabilities of the ACI's including reporting requirements.

(2) To perform adequate measurements, the ACIs shall define precise Key Success Factors (e.g. number of performing / non-performing restructurings, quality of restructuring measures implemented, level of re-arrears, etc).

(3) ACIs shall assess the availability, appropriateness and effectiveness of resources at least on a bi-annual basis under normal economic environment and at least annually under stressed economic environment.

(4) ACIs shall also perform an annual review of the efficiency of processes and systems utilised for arrears management and restructuring, including in relation to compliance, quality assurance and full risk assessment.

Operations.

27. ACIs shall implement relevant safeguard measures to ensure that all tools and processes are efficiently and effectively in operation and that sustainable solutions are delivered to the borrowers in arrears and/or in financial difficulties. These include:

(a) Regular credit reviews on sample portfolios or segments to assess the standard of case management, with the objective of embedding best practice.
(b) Quality assurance exercises to ensure all quality and compliance requirements are being met. QA reports shall be submitted to Senior Management at least on a monthly basis;
(c) Establishing and communicating KPIs to measure process efficiency (e.g. level and speed of communication, quality of information received, approved business plans, amounts of cases in arrears, time to restructure, etc).
(d) Establishing and communicating KPIs to measure process effectiveness (e.g. cash collected, restructurings performed, additional security received, etc.);
(e) Automated monitoring of processes and KPIs through MIS;
(f) Implementation of manual reporting mechanisms for items which cannot be automatically monitored to avoid omissions;
(g) A full risk assessment of all watch list cases on a quarterly basis with reporting to be available for the CBC, as and when requested;
(h) Establishing the criteria for other risk assessment (e.g. key risk segments, high / medium risk borrowers, extent and frequency); and
(i) Specific focus on analysing broken promises and re-defaults to determine causes and potential remedies.

PART VII – MEASUREMENTS

Monitoring of credit risk.

28. ACIs shall implement internal systems and processes, in alignment with the CBC Directives and Circular Letters, which will effectively identify and monitor credit risk and assess arrears management performance. For any inefficiencies with regard to the arrears management performance, the CBC may impose sanctions to ACIs, which may include, inter alia, restrictions on bonuses.

Performance metrics.

29. ACI shall cascade their AMS into specific performance metrics (e.g. KPIs) and implement the relevant scorecard and systems to ensure effective control, monitoring and reporting.

Output metrics.

30. ACIs shall implement processes and systems to provide activity and output metrics (e.g. amounts collected, restructures with no arrears after *x* months, cure rates, etc).

Cash collection effectiveness.

31. ACIs shall implement processes and systems to enable the accurate measurement of the effectiveness of cash collection.

Internal audit.

32. ACIs shall lay down the mechanisms and processes in relation to credit review and internal audit. The credit review and internal audit reports shall be made available to the CBC on request.

Review of restructured cases.

34. (1) For cases that have been restructured, ACIs shall carry out a review on at least a bi-annual basis to ensure that all conditions are being met, all milestones are being achieved and there have been no significant deviation from in the forecasted financial circumstances of the borrower.

(2) ACIs shall lay down effective processes and mechanisms in order to enable timely reaction in the event that the restructuring conditions and/or milestones are not being met and/or the financial situation of the borrower has materially changed. ACIs shall cascade the processes including legal and other measures to be undertaken for cases where sustainable viability cannot be achieved or the borrower is no longer cooperating.

PART VIII – APPEALS PROCESS

Appeals process.

35. (1) ACIs shall establish an internal independent appeals process and shall submit a detailed implementation plan to the CBC.

(2) While developing the appeal process, the ACIs shall ensure that:
(a) The appeals process is aligned to the provisions of the Code;
(b) the Appeals Committee as established, is independent of the credit granting, monitoring and restructuring functions, in order to handle claims and complaints of borrowers with respect to restructuring impartially and without any conflict of interest;
(c) Specific policies and procedures concerning claims, the appeals process for borrowers and the operation of the Appeals Committee are published and communicated to borrowers upon initiation of the restructuring process;
(d) All relevant supporting information and documentation is made available to borrowers to enable them to file claims or appeals;
(e) All relevant supporting information and documentation is made available to the Appeals Committee to enable it to make an adequate assessment of the complaint and reach a fair compromise between the ACI and the borrower;
(f) All necessary control processes to effectively monitor procedures and decisions have been established;
(g) Adequate safeguard mechanisms to ensure impartiality in the appeals process have been developed and are being implemented; and
(h) A robust archiving system to accurately track and store claims and appeals, in line with safeguard requirements, has been implemented.

(3) ACIs shall, periodically, communicate the progress of the appeals process to the CBC, including submitting a summary of the claims / complaints examined.

SECTION I: ASSESSMENT OF REASONABLE STANDARD OF LIVING

ACIs shall develop a policy that ensures fairness, appropriateness and equality and communicate it to all employees involved in the restructuring of credit facilities. For this purpose, ACIs shall implement guidelines for determining what constitutes a reasonable standard of living and reasonable living expenses to be applied in particular when assessing the debt-servicing capacity of a borrower in financial difficulties during the restructuring process. These guidelines shall capture at least the following:

(a) the financial assessment shall take into account the prevailing economic, social and legal particularities;

(b) the restructuring approach shall ensure respect and fairness to borrowers as well as consistency between borrowers;

(c) when determining a reasonable standard of living, every effort should be taken to avoid excessive or unjustifiable luxury lifestyles, but, at the same time, it shall be such that it allows the borrower to have an appropriate house and the necessary equipment for survival;

(d) the restructuring shall not lead to undue hardship but, whilst striking the right balance, shall be based on respect of the physical, psychological and social needs of, the troubled borrowers;

(e) ACIs shall respect the individual's legal rights;

(f) the assessment shall take into account the need for people to be able to maintain active their involvement in the society, as other citizens do;

(g)The financial assessment shall take into account the individual situation of the borrower, including the household composition (e.g. number of adults, number of dependants), the essential need for a car, the variable costs encountered (e.g. paid childcare, children education), any specific needs (e.g. medical needs, physical disabilities), and any discretionary expenses specific to the individual situation; and

(h) the guidelines shall be fully transparent and shall contribute to initiating discussion with the borrowers;

SECTION II: APPROACH TO MULTIPLE CREDITORS

Borrowers may have various debts with multiple creditors, which can take diverse forms and may include, inter alia, other ACIs and other types of creditors (e.g. trade creditors, workers, tax authorities, etc) that may be secured or unsecured. Such multiplicity of creditors may lead to complexity in finding a sustainable debt restructuring solution for the borrower . .

Creditors, in case of ACIs, shall collaborate and be transparent during the debt restructuring process, having due regard to the following:

(a) creditors acting independently and solely in their own interest may aggravate the difficulties for the borrower and lead to further problems in the servicing of their credit facilities.

(b) In order to avoid the multiple impacts of bankruptcy on all creditors, the interests of both secured and unsecured creditors shall be considered in the development of a restructuring solution that is thus viable and sustainable;

(c) collaboration between the broader group of creditors is beneficial if it provides for burden sharing arrangements and minimisation of the overall costs.

ACIs are recommended to incorporate in their policies international best practices in this respect, such as, for example, the "Eight Principles" approved by INSOL[1] International in 2000 for multi-creditors workouts. These principles are described, in brief, below:

First principle: Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to cooperate with each other, to give sufficient though limited time (a “standstill period”) for information about the debtor to be obtained and evaluated, and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.

Second principle: During the standstill period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor, but are entitled to expect that during the standstill period their position relative to theother creditors will not be prejudiced.

Third principle: During the standstill period, the debtor should not take any action that might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the standstill commencement date.

Fourth principle: The interests of relevant creditors are best served by coordinating their response to the debtor. Such coordination may be facilitated by the set up of one or more representative coordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.

Fifth principle: During the standstill period, the creditors should require the debtors to provide, and to allow relevant creditors and their professional advisors reasonable and timely access to all relevant information relating to their assets, liabilities, business and prospects, in order to enable the proper evaluation of the financial position and the development of sustainable proposals for all participating creditors.

[1] Thomas Laryea, International Monetary Fund, 26 January 2010, Approaches to Corporate Debt Restructuring in the Wake of Financial Crises, IMF Staff Position Note, pp. 17-18

Sixth principle: Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill, should reflect applicable law and the relative positions of relevant creditors at the standstill commencement date.

Seventh principle: Information obtained for the purposes of the restructuring process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.

Eighth principle: If additional funding is provided during the standstill period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

SECTION III: DEBT RESTRUCTURING OPTIONS

Out-of-court debt restructuring [2]

Out-of-court restructuring of credit facilities involves changing the composition and/or structure of assets and liabilities of borrowers in financial difficulty, without resorting to judicial intervention, and with the objective of promoting efficiency, restoring growth and minimizing the costs associated with the borrower's financial difficulties. Restructuring activities may include measures that restructure the borrower's business (operational restructuring) and/or measures that restructure the borrower's finances (financial restructuring). The borrower and the ACI may protect their respective interests more effectively if a contractual arrangement for debt restructuring is implemented.

ACIs shall identify the reasons creating the financial difficulties of the borrower, perform the financial assessment and then develop appropriate restructuring options that may be of a short, medium or long-term nature or a combination thereof.

Some of the options in the contents of debt restructurings are set under the headings "short-term solutions" and "long-term solutions".

ACIs and borrowers may seek legal and/or any other advice on any of the debt restructuring solutions.

Short-term solutions

Short-term solutions are defined as restructured repayment solutions of duration of less than five years. In the case of construction of commercial property and project finance, a short-term solution may not exceed 3 years.

The contract for restructurings should provide for at least an annual review by the ACI in order to allow for adjustment of the contractual terms in accordance with unanticipated changes in the economic environment and / or the borrower's financial situation.

ACIs may incorporate the following options in their short-term restructuring solutions:

I. *Interest only*: During a defined short-term period, only interest is paid on credit facilities and no principal repayment is made. The principal amount thus remains unchanged and is converted into a new repayment structure at the end of the interest-only period, subject to the then repayment ability as forecasted on a best effort basis..

II. *Reduced payments*: Decrease the amount of repayment instalments over a defined short-term period in order to accommodate the borrower's new cash flow situation and then continue with the repayments on the basis of a projected, on a best effort basis, repayment ability. This option may be combined with other options to compensate for the temporary lower repayments, e.g. term extension, higher balloon payment. The reduced repayment instalments may be:

- *Higher than interest*: Each instalment provides for the full payment of the interest due for the period plus an amount to be allocated to the amortisation of the principal amount.
- *Lower than interest*: The instalment is lower than the interest due for the period so the portion of the interest that is accrued but not paid is capitalised into the principal amount (typically added to the outstanding principal balance for future payment). This option may only be used is exceptional cases e.g. in periods of unemployment, substantially reduced earnings or during business restructuring.

[2] From the study of Out-of-court Debt Restructuring of the members of the World Bank's Insolvency and Credit/Debtor Regimes Initiative and based on the World Banks Principles.

III. *Arrears and/or interest capitalisation*: The capitalisation of arrears and/or of accrued interest arrears to the principal; that is for bearance of the arrears and addition of any unpaid interest to the outstanding principal balance for repayment under a rescheduled program. This technique is utilised in cases of insufficient cash flow to settle the arrears and/or interest but when the forecasted cash flow is deemed adequate to repay the capitalised balance over the remaining extended loan term.

IV. *Grace Period*: An agreement allowing the borrower a defined delay in fulfilling the repayment obligations usually with regard to the principal. This gives the borrower the capacity to resolve a temporary difficulty or setback. It may also be used, during the period of the restructuring process.

V. *Interest rate reduction*: Permanent or temporary reduction of interest rate (fixed or variable) into a fair and sustainable rate. Credit facilities with high interest rates are one of the common causes of financial distress. The financial difficulties of a borrower may partly derive from the fact that the interest rates are excessively high compared to the income of the borrower or from the fact that the evolution of interest rates, as opposed to a fixed rate, has resulted in the borrower receiving finance at an exorbitant cost, compared with prevailing market conditions.

ACIs shall recognise that a high interest rate may become the cause of severe economic distress and it may be to their interest to reduce the interest rate rather than risk a complete default of their loans.

Long-term solutions

Long-term solutions are defined as restructured repayment solutions of duration of five years and above and, for the construction of commercial property or project finance, of three years and above.

The contract for such restructurings should provide, for at least an annual review. The following are the main long term solutions that can be used by banks in out-of-court restructurings.

I. *Extension of maturity*: Extension of the maturity of the loan (i.e. of the last contractual loan instalment date) which allows a reduction in instalment amounts by spreading the repayments over a longer period. In the case of loans to individual borrowers, the extension period may not go beyond the retirement age or 70 years old at the latest, on the basis of a case-by-case assessment by the ACI.

An extension of the maturity date beyond the age of 70 may only be granted in remote, exceptional cases where there is valid evidence of a specific source of repayment at a specific point in time.

II. *Capture surplus cash*: Aims at securing cash flows, which may currently not be unencumbered and/or not pledged by the ACI. Surplus cash may be obtained, for example, from higher cash flows from operations, as well as from disposal of collaterals, or unencumbered assets.

III. *Additional security*: When additional liens on unencumbered assets are obtained as additional security from the borrower in order to compensate for the higher risk exposure and as part of the restructuring process. This typically aims at improving or curing Loan to Value (LTV) ratio covenants. Additional security may take many forms, such as a pledge on a cash deposit, assignment of receivables, a new/additional mortgage on immovable property.

IV. *Sale by agreement/assisted sale*: The ACI and the borrower may agree to voluntarily dispose of the secured asset(s) to partially or fully repay the debt. The ACI restructures any residual debt with an appropriate repayment schedule in line with the borrower’s reassessed repayment ability.

V. *Split mortgage*: Where a ACI agrees to split a borrower's unaffordable mortgage loan into
(a) an affordable mortgage loan, which the borrower repays, on the basis of the assessed repayment ability, and
(b) a remaining balance, which is set aside or "warehoused" for repayment at a later date.
An example of a structure is where the loan is split into two tranches, where the first tranche is right-sized to the assessed current repayment capacity of the borrower and the second tranche is warehoused by the bank, usually at the basic interest rate. The second tranche is paid in the future when the borrower's repayment capacity improves or from the proceeds of sale of the mortgaged or other property.

VI. *Trade down mortgage*: A mechanism that allows the distressed borrower with a mortgage on the primary residence or business premises to trade down to a lower value property. Any shortfall for the repayment of the existing loan with the revenues from the sale is carried forward as "negative equity" into a new mortgage loan for the acquisition of a new "less expensive property", i.e. a property of lesser cost than the realised sales proceeds. This option shall be evaluated on the basis of the level of trade down possible, by comparing the current value of the property and the loan outstanding, and on the basis of the new repayment capacity of the borrower. This option has the benefit of reducing the debt outstanding, to affordable payments by the borrower.

VII. *Forbearance of penalties in loan agreements*: Waiver, temporary or permanent, of violations of covenants in the loan agreements.

VIII. *Alteration of covenants*: The covenants included in a loan agreement may be unnecessarily restrictive and may impose a considerable burden on the borrower. The ACI may assess the discharge of the borrower from these covenants at the same time, shall monitor adequately the activities and financial soundness of the borrower.

IX. *Rescheduling of payments*: The existing contractual repayment schedule is adjusted to a new sustainable repayment program based on a realistic, current and forecasted, assessment of the cash flow generation of the borrower:

- *Partial repayment*: When a payment is made against the credit facility, eg from sale of assets that is lower than the outstanding balance. This solution is applied to significantly reduce the exposure at risk and to enable a sustainable repayment program of the remaining outstanding amount.
- *Balloon or bullet payments*: When the rescheduled repayment entails a large payment of the principal at the loan maturity or at a later maturity date in order to allow the borrower additional time. This option may only be used when the borrower can duly demonstrate future cash flow availability to meet the balloon or bullet payment.

X. *Strengthening of the debt security*: A restructuring solution may entail the pledge of additional security for instance, in order to compensate for the reduction in interest rates or to balance the advantages the borrower receives from the restructuring.

XI. *Rollover*: This is one of the less radical changes that a restructuring may entail, and consists of modifying the maturity date, providing for the same interest for the extended period of time granted for payment. During the design of such restructurings, it shall, inter alia, be seriously taken into consideration the adverse effect of any increase in the interest rate to the repayment ability and the viability of the borrower. For example, the principal outstanding may be refinanced into a new loan of similar terms for a defined additional period.

XII. *New loan facilities*: Providing new financing arrangements may be crucial for the recovery of a distressed borrower. Therefore, new loan facilities may be granted during a restructuring agreement, which may entail the pledge of additional security and in the case of inter-creditor arrangements the introduction of covenants in order to compensate for the additional risk incurred by the ACI that provides a new financing to a distressed borrower.

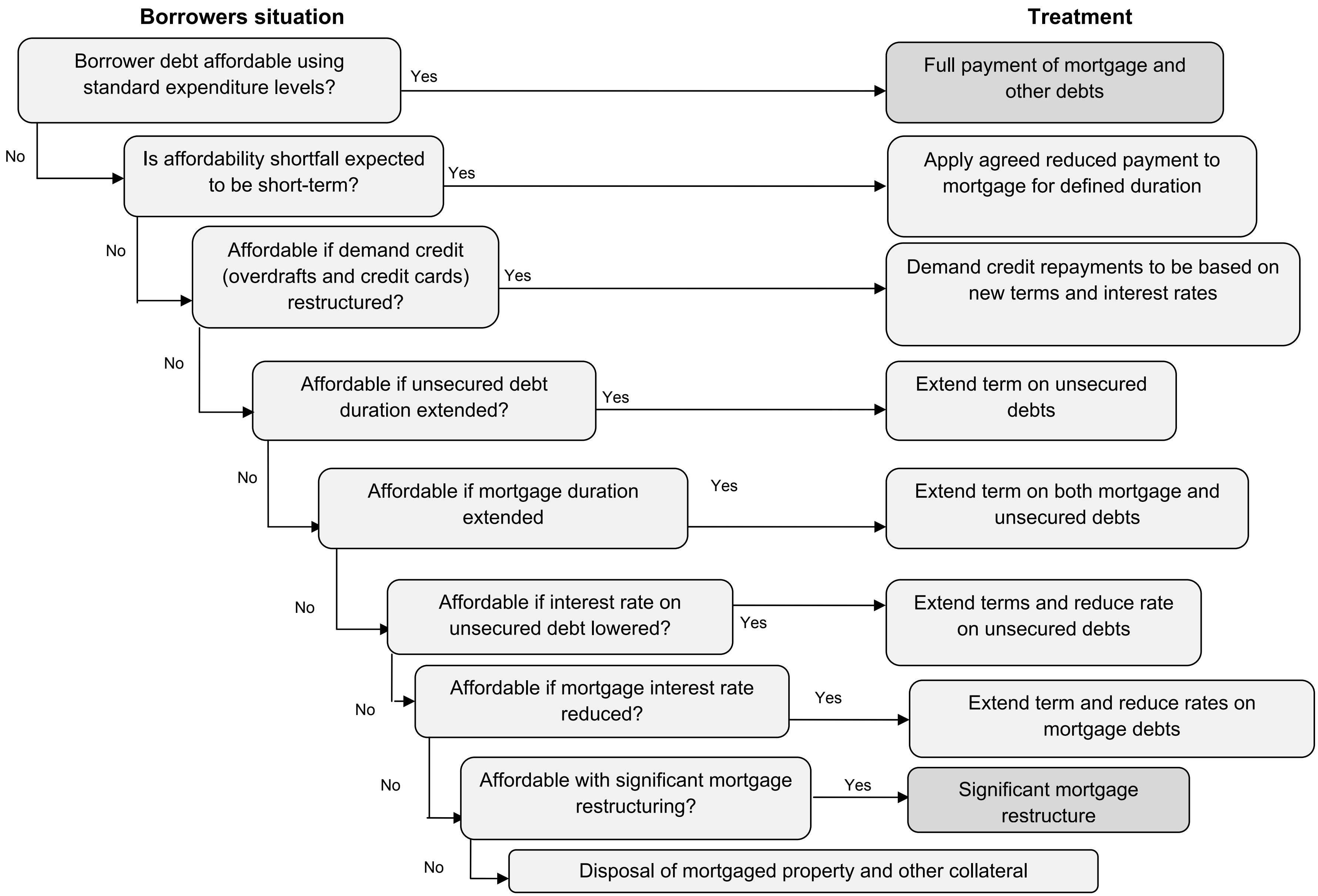
XIII. *Conversion of the currency in which debts are denominated*: The aim should be to align the currency of the debt to the currency of the cash flows. ACIs shall explain fully to borrowers the risks of foreign exchange and shall also refer to currency conversion insurance.

XIV. *Debt/equity swaps*: Typically occurs in corporate restructuring where part of the debt is set-off and an equivalent amount of equity is obtained by the ACI, with the remaining debt right-sized to the cash flows of the borrower. The objective is to minimise the current burden for the borrower and allow repayment to the ACI from repayment on the re-sized debt and from the eventual sale of the equity stake in the business. ACIs shall ensure the legality and clarity of the terms of such debt/equity swaps, eg call options of the company, put options of the ACIs, right to sell to third parties/pre-emption rights, as well as compliance with the Business of Credit Institutions Laws of 1997 to (No. 3) 2013 especially with regard to provisions relating to qualifying holdings, acquisitions in satisfaction of debt and concentration risks. This solution should be used only in exceptional cases and only where all other efforts for restructuring are exhausted.

XV. *Debt consolidation*: Entails the combination of multiple exposures into a single loan or a limited number of loans. This option is particularly beneficial in situations where combining collaterals and secured cash flows provide greater overall security coverage for the entire debt than individually. For example, by minimising cash leaks or by facilitating re-allocation of cash flow surplus between exposures.

XVI. Partial or total *debt write-off:* This corresponds to cancelling part or the whole of the amount of debt outstanding by the borrower. This option may only be used as a last stage where the ACI agrees to a “reduced payment in full and final settlement”, whereby the ACI accepts to write-off all of the remaining debt if the borrower repays a reduced amount of the principal balance within an agreed timeframe. ACIs may apply the debt forgiveness solutions only as a last resort in remote cases since the possibility of forgiveness can give rise to moral hazard. Knowing that debt forgiveness is a possibility of a restructuring may induce borrowers to engage in riskier projects and to behave irresponsibly.

SECTION IV: ILLUSTRATIVE EXAMPLE OF MULTIPLE DEBTS RESOLUTION WATERFALL[3]



[3] Source: *Central Bank of Ireland, Framework for a Pilot Approach to the Co-Ordinated Resolution of Multiple Debts owed by a Distressed Borrower,* Multiple Debts Resolution Waterfall model *, 8 May 2013, p.6*