

From the Banking Regulation & Supervision Agency:**NON-PERFORMING EXPOSURES WORKOUT GUIDELINES****SECTION ONE****Purpose, Scope, Rationale and Definitions****Purpose, scope and rationale**

- 1- The purpose of these guidelines is to describe the expected good practices for banks to identify, monitor and work out forborne exposures (FBEs) and non-performing loans, and to manage foreclosed assets.
- 2- These Guidelines were prepared based on article 93 of the Banking Law dated 19/10/2005 and numbered 5411, article 7/A of the Regulation on the Procedures and Principles of the Audits to be Conducted by the Banking Regulation and Supervision Agency published on the Official Gazette dated 22/07/2016 and numbered 26236, article 20 of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions published on the Official Gazette dated 22/06/2016 and numbered 29750 and article 19/A of the Regulation on the Loan Transactions of Banks dated 01/11/2006 and numbered 26333.
- 3- Non-performing exposures (NPEs) workout includes banks' management and mitigation activities for forborne exposures and non-performing loans. The following provisions are implemented to the extent they fit the scale, portfolio and product structure of the bank in working out the NPE portfolios of banks.
- 4- The Sections Two and Three of these Guidelines are implemented by banks with 5 per mille ratio of gross non-performing loans to total gross non-performing loans of the industry. Year-end data is used to calculate the mentioned ratio.
- 5- Even if the ratio specified in paragraph four is below 5 per mille, if a portfolio consisting of loans lent to a specific geographical region, a specific sector or a risk group, has a significant share in the bank's non-performing loans, the Agency may require banks to implement the Sections Two and Three of these Guidelines also for such portfolios.
- 6- If, as a result of audits and assessments conducted by the Agency, conditions are identified indicating an increase in credit risk, such as high or increasing rise in NPEs or foreclosed assets or low provisioning, the Agency may require banks to implement the Sections Two and Three of these Guidelines.
- 7- The Sections Four, Five, Six and Seven of these Guidelines are implemented by all banks.
- 8- Banks implement these Guidelines in proportion to their size, corporate structure and the scope and complexity of their activities.

Definitions

- 9- For the purposes of these Guidelines, the following definitions apply:

- a) Foreclosed asset: Financial or non-financial foreclosed assets obtained through legal procedures, through bilateral agreement with the borrower or through other types of

collateral transfer from the borrower to the bank,

- b) Non-performing loans: The loans defined in the article 5 of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions,
- c) Immovable property: The immovable properties defined in article 21 of the Communique on Credit Risk Mitigation Techniques published on the official Gazette dated 06/09/2014 and numbered 29111,
- ç) ICAAP: The internal capital adequacy assessment process mentioned in the Regulation on the Internal Systems and Internal Capital Adequacy Assessment Processes of Banks published on the Official Gazette dated 11/07/2014 and numbered 29057,
- d) Cure period: The process defined in article 6 of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions,
- e) Probation period: The minimum period required for excluding FBEs from the scope of FBE or NPE,
- f) Operational restructuring: The changes deemed necessary as a result of assessment of the borrower's repayment capacity, to increase the expected benefit from restructuring, such as liquidation of the borrower's activities not directly related to the core business, change in the management structure, disposal of assets or affiliates, and improving the shareholding structure,
- g) Portfolio: A group of exposures with similar credit risk characteristics,
- ğ) Risk appetite: The risk appetite defined in the article 3 of the Regulation on the Internal Systems and Internal Capital Adequacy Assessment Processes of Banks,
- h) NPE lifecycle: The period of time from the date on which the loan is classified as an FBE or a non-performing loan under the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions, to the date when the loan is excluded from the scope of forbearance and/or classified as performing loans or the loan is fully recovered or written off or transferred to third parties or otherwise liquidated,
- i) NPE workout framework: The policies, processes, controls and systems for the workout of NPEs,
- i) Non-performing exposures (NPEs): FBEs and non-performing loans,
- j) Liquidation cost: All cash outflows incurred during collateral execution or liquidation, including legal costs, transfer expenses, taxes, maintenance costs of the collateral, other expenses and all cash inflows until liquidation,
- k) Movable property: Physical properties fulfilling the requirements in article 23 of the Communique on Credit Risk Mitigation Techniques,
- l) Management body: The management body defined in the article 3 of the Regulation on the Internal Systems and Internal Capital Adequacy Assessment Processes of Banks,
- m) Forborne exposures (FBEs): The forborne exposures defined in the article 7 of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions,

- n) Restructuring: The restructuring defined in the article 7 of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions.

SECTION TWO

The NPE strategy

Developing the NPE strategy

10- Banks should establish an NPE strategy with a period of three years by setting realistic targets for the workout of NPEs over a reasonable period of time. The NPE strategy should lay out the bank's approach and objectives regarding effective management to increase recoveries and ultimately a reduction in NPE stocks in a clear, credible and feasible manner for each relevant portfolio. When developing and implementing the NPE strategy for retail portfolios, banks should consider legislative provisions aimed at protecting consumers, and duly inform the borrower of the NPE, explain the methods to apply if the loan is not repaid and record the communication with the borrower.

11- The NPE strategy should consist of assessment of the operating environment and external conditions, designing the schedule over short-, medium- and long-term time horizons, implementation of the operational plan as part of the NPE strategy and fully embedding the NPE strategy into the management processes.

12- Before establishing their NPE strategy banks should consider their internal capabilities, the external conditions, the operating environment and the capital implications of the NPE strategy for the effective workout of NPEs.

13- The NPE strategy should encompass, at a minimum, time-bound quantitative NPE targets and foreclosed assets targets, supported, where appropriate, by a corresponding operational plan. The development of the NPE strategy should be informed by a self-assessment process and an analysis of the strategic options for the implementation of the NPE strategy.

14- Banks' NPE strategies and operational plans should be approved by the management body and reviewed at least annually until the end of September.

15- Banks should also report the realizations, targets and material deviations from realizations under the NPE strategies and operational plans, together with appropriate remediation actions to be put in place, to the Agency annually until the end of September.

Internal capabilities self-assessment

16- Banks should perform a comprehensive self-assessment to evaluate the actual situation and the steps to be taken internally to address any gaps in the internal capabilities to manage NPEs.

17- Banks should perform self-assessment annually to achieve the targets in their NPE strategy. Banks' self-assessments should take the following into consideration as a minimum.

- a) The magnitude and drivers of their NPEs:
- (1) the size and evolution of NPE portfolios at an appropriate level of granularity, which requires an appropriate grouping of the exposures, as outlined in the Section Three of these Guidelines,
 - (2) the drivers of NPE inflows and outflows, by portfolio where relevant

- (3) other reasons
- b) The outcomes of NPE actions taken by the bank in the past:
 - (1) the types and nature of the actions
 - (2) the reasons and effectiveness of the actions.
- c) Potential actions for NPEs include the following without limitation:
 - (1) early identification of NPEs,
 - (2) restructuring activities,
 - (3) impairments and write-offs,
 - (4) Collateral valuation,
 - (5) recovery, legal process and foreclosure,
 - (6) management of foreclosed assets, where relevant,
 - (7) reporting and monitoring of NPEs and of the effectiveness of NPE workout solutions.

ç) operational capacity, including processes, tools, data quality, IT/automation, staff/expertise, decision-making, internal policies and any other relevant area for the implementation of the strategy regarding the activities mentioned in paragraph (c).

18- Banks should report the outcome of the self-assessment to the bank's board of directors.

External conditions and operating environment

19- Banks should assess and consider the current and likely future external operating environment and the following external conditions when establishing the NPE strategy.

- a) The macroeconomic conditions, including the conditions of the real estate market or other relevant sectors, taking into account sector concentrations in NPE portfolios,
- b) Expectations with regard to acceptable NPE levels and their coverage,
- ç) market conditions that may affect investor demand in terms of NPE sales,
- c) The maturity of the NPE servicing industry,
- d) The regulatory, legal and judicial framework including the average duration of proceedings related to NPE workout, the potential/average financial outcomes, the potential influence of rankings of different types of exposures, collateral and guarantees on the outcomes, legal provisions aimed at protecting consumers, in particular for residential mortgage exposures, and the average total costs related to legal proceedings,
- e) The tax implications of impairments and NPE write-offs.

Capital implications of the NPE strategy

20- In preparing the NPE strategy, banks should perform an impact analysis on the potential effects of each practice related to the workout of NPEs on capital adequacy, the amount of loan, profit or loss, and the impairment. Bank should establish strategic processes to work out problems that may arise under various conditions and the underlying assumptions. The assumptions made in the impact analysis and the strategic processes should be in line with the risk appetite framework and the internal capital adequacy assessment process.

21- Banks should ensure that adequate capital should be available in the capital plans

specified in the article 54 of the Regulation on the Internal Systems and Internal Capital Adequacy Assessment Processes of Banks for sustainable workout of NPEs.

Implementation of the NPE strategy

22- The NPE strategy should include various options to achieve the objective over the short, medium and long term. In order to successfully operationalize the NPE strategy, banks should consider the following options under different conditions:

- a) Forbearance measures suitable for the borrower, taking into consideration the borrower's financial and operational conditions,
- b) Active portfolio reductions taking into consideration sales, securitization or write-off options,
- c) Change of type of exposure or collateral, including foreclosure, debt to equity swapping, debt to asset swapping or collateral substitution,
- ç) Legal options taking into consideration insolvency proceedings or out-of-court solutions such as arbitrage or arbitration tribunals.

23- Banks should identify medium- and long-term options for NPE workouts that may not be achievable in the short term and specify in the operational plan the preparations to be made by the bank.

Targets

24- Before commencing the short- to medium-term target-setting process, banks should determine a reasonable long-term NPE level, both at portfolio level and at aggregate level, taking into account historic data, practices or international benchmarks.

25- Banks should include clearly defined, realistic yet ambitious quantitative targets in their NPE strategy that will lead to a concrete reduction in NPEs and foreclosed assets at least in the medium term. While expectations about changes in macroeconomic conditions, when based on solid external forecasts, can play a role in determining target levels, they should not be used as the sole driver.

26- When setting their targets, banks should take into consideration time horizons (short-term - 1-year, medium-term - 3-year, and long-term targets), portfolios (such as retail loans, mortgage loans, consumer loans, SME loans, and corporate loans), and NPE workout options (restructuring, changing of loan/collateral type, NPE sales, or write-offs).

Operational plan

27- Banks NPE strategies are implemented in the framework of an operational plan approved by the management body. The operational plan should clearly define how the bank will implement its NPE strategy over a time horizon of three years.

28- The NPE operational plan should contain at least:

- a) Clear time-bound objectives and goals related to NPE workouts,
- b) Workout methods activities to be carried out on a portfolio basis,
- c) Corporate governance structures indicating the roles and responsibilities and including the reporting mechanisms for the NPE workout methods and expected outcomes,
- ç) quality standards to ensure successful outcomes,

- d) staffing and resource requirements,
- e) granular and consolidated budget requirements for the implementation of the NPE strategy,
- f) plans for communication with internal and external stakeholders.

29- The operational plan should have a specific focus on internal factors that could present impediments to the successful delivery of the NPE strategy, and include solution proposals.

30- The implementation of the operational plan should rely on policies and procedures suitable to banks' corporate structure.

31- Material deviations from the operational plan should be reported to the management body and the Agency with appropriate remediation actions to be put in place.

Embedding the NPE strategy to the risk management processes

32- All the strategic and operational processes related to the preparation of the NPE strategy and its implementation in accordance with an operational plan should be incorporated into the policies, strategies and processes related to corporate governance and risk management, ensuring that the concerned units within banks work in coordination.

33- The content of the NPE strategy, the processes related to its implementation, and the roles and responsibilities for the implementation of the operation plan should be clearly defined and documented, the involved staff should be informed in this regard, and reporting systems should be established to be used for tracking the implementation processes and their outcomes.

34- Banks' NPE strategy should be taken into consideration in their risk management processes, determining their risk limits, the internal capital adequacy assessments, and the preparation and implementation of their prevention plans.

35- The processes related to the formulation and implementation of the NPE strategy and operational plan is closely followed by the management body.

SECTION THREE

NPE Governance

Steering and decision-making

36- Bank should establish a suitable administrative and operational structure to ensure effective and sustainable workout of NPEs.

37- Banks management bodies should;

- a) Approve annually and regularly review the NPE strategy and operational plan in line with the overall risk strategy.
- b) Oversee the implementation of the NPE strategy.
- c) Define quantitative and qualitative objectives for NPE workout activities.
- ç) Monitor on a quarterly basis the progress made in comparison with the targets defined in the NPE strategy and the operational plan.
- d) Define decision-making processes for NPE workout.
- e) Approve NPE-related policies and processes, review them at least annually and proceed with any necessary amendments, ensuring that the policies and processes are

completely understood by the staff.

- f) Ensure sufficient internal controls on NPE management processes, with a special focus on activities linked to NPE classifications, impairments, write-offs, collateral valuations and the enforceability and sustainability of workout solutions.
- g) Have sufficient knowledge, experience and expertise with regard to the management of NPEs.

NPE workout units

38- In order to prevent any conflict of interest and establish the expertise required for the workout of NPEs, banks should establish dedicated NPE workout units (NPE WUs) that are independent functions from loan origination activities and have their own borrower relations and decision-making processes, and position them within the organization in consideration of these matters.

39- Potential conflicts of interest between the loan origination units and the NPE WUs should be minimized within the corporate structure and as part of internal controls.

40- Banks should have in place documented policies and processes for all the activities to be conducted by the NPE WUs, including information flow between the loan origination units and the NPE WUs, and create work flowcharts for them.

41- Banks should consider designing automated processes for NPE WUs for homogeneous retail NPE portfolios. For corporate NPE portfolios, where relevant, and depending on the sectoral concentration of the NPEs, banks should consider a relationship management approach. For sole traders and SMEs, a combination of automated elements and a relationship management approach should be considered.

Alignment with the NPE life cycle

42- NPE WUs should be set up to ensure that NPE workout activities and borrower engagements are tailored to the phases of the NPE life cycle¹. Banks should set up different NPE WUs for the different phases of the NPE life cycle and also for different portfolios, and assign sufficiently numbered and specialized staff for this.

43- Banks should consider the following phases in the NPE life cycle, taking into account also the specificities of the loans and the structure of the delays in the payments:

- a) Early arrears up to 90 days past due: The borrower should be engaged and the workout strategy most suitable to the borrower's approach to collaboration, the borrower's circumstances and the type of collateral should be determined. Before determining the most suitable workout strategy, forbearance measures with a short-term time horizon may be applied with the aim of stabilizing the financial position of the borrower and provided that the borrower can make the payments accordingly, and provided that the loan classification criteria specified in the legislative provisions are adhered.
- b) Late arrear more than 90 days past due: The forbearance arrangements to be implemented in this phase should only be implemented if the bank is of the opinion that the borrower can make the payments. In considering whether a restructuring option is viable, banks should have regard to legislation aimed at protecting consumers, to the extent applicable. A forbearance arrangement should be monitored for at least one year in consideration of the risk status.
- c) Liquidation and debt recovery: If no viable forbearance solution has been found due to

¹ This should also include arrears up to 90 days past due, FBEs and foreclosed assets that are not classified as NPEs and which play an important role in the NPE workout processes.

the borrower's financial circumstances or cooperation level, banks should perform a cost-benefit analysis of different liquidation options, including in-court and out-of-court procedures, having regard also to the interests of the borrower. Banks that are engaged in the use of external experts for the liquidation process should include them in their internal control processes to ensure an effective and efficient liquidation process. The debt recovery policy to be established by the bank for implementation and processes should contain guidance on liquidation processes.

Grouping exposures

44- Banks should establish policies for grouping loans with common risk properties, portfolios with common risk properties, and customized workout processes and workout teams for each portfolio in accordance with the Guidelines on Calculating the Expected Credit Loss Provision Pursuant to TFRS 9 for developing practices dedicated to NPEs. NPE portfolios should be analyzed with granularity, resulting in clearly defined borrower sub-portfolios. For these analyses, banks should develop appropriate management information systems and sufficiently high data quality.

Human resources

45- Banks should have in place an appropriate organizational framework relative to their business model and taking into account their risks, including risks stemming from NPEs. Banks should therefore devote an appropriate and proportionate amount of management attention and resources to the workout of NPEs and to internal controls on related processes.

46- Based on the findings of the bank's self-assessment on developing the NPE strategy as referred to in the Section Two of these Guidelines, banks should regularly review the adequacy of their internal and external NPE workout resources and address any human resourcing gaps in a timely fashion. Banks should consider if it is appropriate to choose to use external outsourcing for NPE workout activities while holding the final responsibility for the processes. In the event that outsourcing is used, banks should ensure that such outsourcing is arranged in accordance with the applicable legislation.

47- Staff allocated to key NPE workout tasks should have specific NPE expertise and experience. Banks should implement adequate training for the concerned staff, including training on consumer protection legislation and in support of in-house expertise on NPE workout.

Technical resources

48- Banks should ensure that all NPE-related data is centrally stored in IT systems, and is complete and up to date.

49- The technical infrastructure required for NPE workout should enable NPE WUs to perform the following without limitation:

- a) Access all the relevant data and documentation, including;
 - (1) Current NPE and early arrears up to 90 days borrower information, including automated notifications,
 - (2) Exposure, collateral and guarantee information linked to the borrower's risk group,
 - (3) monitoring tools with the IT capabilities to track forbearance performance and effectiveness,
 - (4) Status of workout activities and borrower interaction, as well as details on forbearance measures agreed,

- (5) Foreclosed assets,
 - (6) Tracked cash flow of the loan and collateral,
 - (7) Sources of underlying information and complete underlying documentation,
 - (8) Where relevant, central data sources including government and private registers,
- b) Efficiently process and monitor NPE workout activities, including;
- (1) Automated workflows throughout the entire NPE life cycle,
 - (2) Warning signals incorporated to execution and monitoring processes,
 - (3) Automated quantitative reporting throughout the NPE workout life cycle as a basis for the analyses to be provided to the Agency, the management body and other relevant managers,
 - (4) Performance analyses of workout activities,
 - (5) Development of NPEs according to portfolios and sub-portfolios with similar credit risk characteristics, and borrowers,
- c) Define, analyze and measure NPEs and related borrowers;
- (1) Measure impairments of NPEs,
 - (2) Perform NPE portfolio analyses and store outcomes for each borrower,
 - (3) Calculate the current net value of the NPE according to its size for each workout solution to perform a benefit-cost analysis and to assess its impact on the bank's capital.

50- The adequacy of the technical infrastructure, including data quality, should be assessed by an independent internal audit function or an independent audit company on a regular basis.

Control framework

51- Adequate and effective internal control processes should be implemented to ensure full compatibility between the bank's NPE strategy and operational plan, and the overall business strategy and risk appetite.

52- The control functions should regularly submit to the management body written reports on NPE management, highlighting major identified deficiencies. These reports should include, for each identified deficiency, the relevant risks involved, an impact assessment, and corrective measures to be taken.

53- The management body should take into consideration the findings of the control function and ensure that suitable measures are implemented. The developments concerning the findings and measures should be regularly monitored and reported.

54- The processes concerning the workout of NPEs should be incorporated into the control framework by creating a triple defense line. The powers and responsibilities of the different units involved in the NPE workout process should be assigned and documented clearly to avoid gaps or overlaps.

First line of defense controls

55- The first line of defense for NPE workout consists of operational units, particularly the bank's NPE WUs.

56- In order to ensure that adequate control mechanisms are implemented effectively, banks should have internal policies in place on the NPE workout processes. The managers of the operational units are responsible for ensuring that these internal policies are implemented,

including through their incorporation into IT procedures. Annex 4 to these Guidelines sets out key elements of NPE framework-related policies that should be implemented by banks.

Second line of defense controls

57- The second line of defense for NPE workout consists of risk management and compliance functions. To adequately perform their control processes, the second defense line functions require independence from NPE WUs and executive units, and should have sufficient resources.

58- Establishing a separate second defense line dedicated to NPEs is not compulsory and it may also be performed by the credit risk control function.

59- The controls performed by the second line of defense to determine whether the NPE workout is functioning as required, should be continuous and have a special focus on the following:

- a) Monitoring and measuring of NPE-related risks on a granular and aggregate basis, including in relation to internal/regulatory capital adequacy,
- b) Reviewing the performance of the NPE workout and its elements (such as the unit managers and staff, servicing processes, NPE reduction targets and early warning mechanisms),
- c) Assuring quality in NPE classification, monitoring, forbearance, impairments, write-offs, collateral valuation and NPE reporting,
- ç) Reviewing the alignment of NPE-related processes with the bank's internal policies and regulations, most notably related to NPE classification, provisioning, write-offs, collateral valuations, forbearance and early warning mechanisms.

60- The second defense line should provide guidance on the process of designing and reviewing NPE-related policies and procedures and be involved in their design and review before they are approved by the management body.

Third line of defense controls

61- The third line of defense is comprised of the independent internal audit function. The internal auditors should have sufficient NPE workout expertise to perform periodic control activities on the efficiency and effectiveness of the NPE workout framework.

62- The internal audit unit should perform regular assessments to monitor adherence to internal NPE-related policies and regulations of the bank.

63- In determining the frequency, scope and scale of the controls to be carried out, banks should take into account the level of NPEs and whether significant irregularities and weaknesses have been identified by recent audits.

64- The internal audit unit should make recommendations regarding the findings of the audits.

Monitoring of NPEs and NPE workout activities

65- The monitoring systems should be based on the NPE targets approved in the NPE strategy and related operational plan. A framework should be developed for basic performance indicators regarding NPEs to enable the management body and the other managers to assess the progresses made in terms of the NPE workout.

66- Banks should identify and monitor the NPE-related key performance indicators (KPIs). The NPE-related KPIs, should include, but not necessarily be limited to the following, with the details provided in Annex 2:

- a) NPE metrics,

- b) borrower engagement and cash collection,
- c) restructuring activities,
- ç) liquidation activities,
- d) other (such as NPE-related profit and loss items, foreclosed assets, outsourcing activities)

NPE metrics

67- Banks should closely monitor the levels of NPEs, foreclosed assets and early arrears up to 90 days past due.

68- Banks should carry out such monitoring activities at the borrower, portfolio or sub-portfolio levels, considering aspects such as the sector, borrower segment, geographical area, type of exposure, level of collateralization and the type of collateral provided, and debt-service ability.

69- Banks should monitor the level of impairments of NPEs in order to provide the management body with comprehensive information on coverage. The analysis should include data on the aggregate level as well as for different portfolios. In creating NPE portfolios, aspects such as collateral status, type of exposure, type of collateral and guarantees, geographical area, and time since NPE classification should be taken into consideration. The course of the coverage rates should also be monitored and the management body should be informed on significant changes.

70- Banks should benchmark indicators related to the NPE ratio and coverage against the available indicators of peers in the sector.

71- Key figures on NPE inflows and outflows should be included in periodic reporting to the management body, including early arrears up to 90 days past due.

72- Banks should consider if it would be useful to establish migration matrices to track the flow of exposures into and out of non-performing classification.

73- Banks should estimate the migration rates and the quality of the performing exposures month by month, so that actions can be prioritized and taken promptly to inhibit deterioration of portfolio quality. Migration matrices can be further broken down by exposure type, by sector or by other sub-portfolio to identify whether the driver of the flows can be attributed to a specific sub-portfolio.

74- In their monitoring activities, banks should use internal information (such as from the internal rating systems) and external information (such as from rating agencies and central data sources including government and private registers) with the details provided in Annex 3 and should refer to a particular period of time or an observation period.

Borrower engagement and cash collection

75- Operational performance indicators should be used to assess the performances of NPE WUs. Such operational performance indicators should enable the assessment of the adequacy and effectiveness of the options used for the NPE workout. The following can be taken into consideration as indicators in performance assessments, although not required:

- a) Comparison of planned and realized borrower communication,
- b) Conversion rate of borrower communication into payment or payment commitment,
- c) Cash collection realized through direct collection or collateral sale, wage garnishment at a certain ratio or collection through legal proceedings, and the ratio of such amount to the loan,

ç) Long-term and total forbearance measures with the borrower.

If no such indicators exist or are available, operational performance should be monitored by measuring the effective results against the targets set in the bank's NPE operational plan.

Forbearance activities

76- To resolve or limit the negative impact of NPEs, banks should explore the possibilities with regard to granting forbearance measures. If forbearance is implemented, banks should monitor their efficiency and effectiveness.

Liquidation activities

77- If no forbearance solution can be implemented or it is understood that forbearance will provide no benefit, banks should initiate the liquidation activities regarding the concerned NPE. The liquidation activities of an NPE may involve foreclosing assets, debt to asset/equity swap, sale to an asset management company, disposal of credit facilities by transfer or securitization, or initiating legal procedures.

78- Liquidation activities should be regularly monitored to help inform banks' strategies and policies.

79- Banks should monitor the disposals and realized sales/transfer prices against net carrying amounts.

80- Banks should monitor the volumes and recovery rates of legal and foreclosure cases. Performance in this regard should be measured against set targets in terms of the number of months/years to the collection from the legal proceedings or to the disposition of the foreclosed asset, and the loss to the bank. In monitoring the actual loss rate, banks are expected to build historical time series for each loan portfolio to back up the assumptions used for impairment review purposes and stress test exercises.

81- For exposures covered by collateral, banks should assess the conditions and monitor the time period needed to liquidate the collateral.

82- Banks should also monitor the mean time period of completed legal processes and the mean recovered amounts from such processes, including the relevant recovery costs.

83- Cases where the debt can be swapped with an asset or equity of the borrower should be limited with highly saleable assets. Banks should ensure that such assets are objectively valued and should regularly monitor them.

Other monitoring items

84- Banks should monitor and report to their management bodies the amount of interest income stemming from NPEs. A distinction should be made between the interest payments on NPEs actually received and those not actually received. The evolution of loss allowances and the related drivers should also be monitored.

85- Banks should monitor the volume and rate of increase of foreclosed assets, the alternative cost incurred from holding such assets and the coverage of such assets with sufficient granularity. The performance of such assets should also be monitored and reported to the management body and other relevant managers on an aggregate level.

SECTION FOUR

NPE Recognition

Past due criterion

86- Banks should classify exposures as being past due in accordance with the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions.

Indications of unlikeliness to pay

87- Banks should identify indications of unlikeliness to pay in accordance with the paragraph 33 of the Annex-2 of the Communique on Calculating the Credit Risk with Approaches Based on Internal Rating published on the Official Gazette dated 23/10/2015 and numbered 29511.

88- Banks should monitor the repayment capacity of borrowers. The payment capacity of corporate borrowers should be assessed at least annually and at key reporting dates at which financial data is available. Banks should collect the latest financial information from corporate borrowers in a timely fashion. The non-provision or the unreasonably late provision of information may be seen as a negative sign with regard to the borrower's creditworthiness. In the case of non-corporate borrowers, banks should monitor payment performance and any signs of financial difficulties that may have an impact on repayment capacity.

89- For borrowers on a watch list or with a weak rating, more frequent review processes should be in place, depending on the materiality, the portfolio and the borrower's financial standing. The repayment capacity should be regularly assessed also for bullet repaid loans.

Forbearance

90- For the purpose of implementing forbearance measures, banks should be able to identify signs of possible future financial difficulties at an early stage. In order to do so, the assessment of the financial situation of the borrower should not be limited to exposures with apparent signs of financial difficulties. An assessment of financial difficulties should also be conducted for exposures with regard to which the borrower does not have apparent financial difficulties but in relation to which market conditions have changed significantly in a way that could impact the borrower's ability to repay (e.g., bullet loans the repayment of which will depend on the sale of immovable property or foreign currency loans).

91- The assessment of any financial difficulties on the part of a borrower should be based on the situation of the borrower only, disregarding collateral or any guarantees provided by third parties. When assessing the financial difficulties of the borrower at least the following circumstances should be considered:

- a) Facility is more than 30 days past due during the three months prior to the modification of the contract terms or its refinancing,
- b) Decrease the internal rating assigned to the borrower/increase in probability of default (PD) during the three months prior to the modification of the contract or its refinancing,
- c) Presence of the borrower on a watch list during the three months prior to the modification of the contract terms or its refinancing.

92- If the borrower requests modifications in the contractual conditions of their loans without facing any financial difficulties, banks should perform an assessment of the impact of such modifications in the contractual conditions on the borrower's payment performance and of the borrower's financial situation.

Classification of FBEs as non-performing

93- When assessing forbearance measures for performing exposures, banks should take into consideration whether such measures lead to a need to reclassify the exposure as non-performing. If non-performing exposures are restructured, such exposures should continue to be monitored as non-performing exposures for the period and under the conditions specified in the relevant provisions of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions.

94- When assessing if FBEs should be classified as non-performing, banks should assess if exposures:

- a) are supported by payment plans that are not supported by macroeconomic forecasts or by credible assumptions on the repayment capability or willingness of the borrower without limitation,
- b) include contract terms that provide a grace period, in such a way that its assessment for a proper classification is hindered.

Forbearance as performing exposures

95- Banks should reclassify NPEs, including FBEs, as performing in accordance with the relevant provisions of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions.

96- The content of forbearance arrangements should not hinder the classification of the exposures forborne in this context as non-performing. Passing of at least 1 year, which is one of the conditions for the reclassification of the exposure as performing as specified in clause (5) of article 7 of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions, will not lead to reclassification of the exposure as performing if regular payments were not made for 12 months and if there is any doubt on the timely payment of the future payments.

97- Banks should establish policies that include practices for assessing the financial standing of the borrower to determine those FBEs among NPEs that became performing exposures. Banks' policies should ensure an assessment of adherence to the conditions of exiting forbearance based on objective criteria including the repayment performance.

Consistent application of definition of non-performing

98- Banks should take the necessary measures for the harmonized implementation of the definition of non-performing in all subsidiaries.

99- Banks should document their criteria for reclassification of non-performing loans and keep them available for audits.

SECTION FIVE

Forbearance

Purpose of forbearance

100- The main purpose of forbearance should be to return the borrower to a sustainable performing repayment status, taking into account the amount due and minimizing expected losses. Banks should make sure that forbearance is not used to postpone impairments or to

delay an assessment of whether a loan can be recovered.

Points to be considered in forbearance

101- In their risk management, banks should take into consideration the forbearance definition in the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions and the other relevant provisions. Forbearance should aim to return the borrower to repayment taking into account the amount due and minimizing expected losses. Credit institutions should monitor the adequacy and effectiveness of forbearance activities.

Forbearance measures and their viability

102- If the borrower is determined to be suffering a temporary liquidity difficulty, the borrower can be proven to have fulfilled the previous obligations, and the opinion is reached that the borrower is willing to cooperate, banks will restructure the loans of the borrower.

103- Banks should consider using a combination of different forbearance measures, including both short-term and long-term time horizons in line with the nature and maturity of the credit facilities.

104- Forbearance agreements can include provisions that the bank reserves the right to change the provisions of the agreement if the borrower's conditions improve and it is objectively proven that this results in conditions to the advantage of the bank. If such provisions are included in the forbearance agreement, the forbearance agreement should clearly specify what changes the banks can make in the forbearance conditions if the borrower's conditions improve. In the forbearance agreements banks should also take into consideration the additional obligations that can be imposed on borrowers who fail to fulfill their obligations in the forbearance agreement.

105- If, as a result of the assessment of the borrower's repayment capacity, it is understood that operational structuring is needed in addition to forbearance to ensure that the borrower regains repayment capacity, banks may request the borrower to receive consultancy services regarding forbearance. If an agreement is reached with the borrower on forbearance, the bank will request a work schedule from the borrower, to be prepared for operational restructuring and as compatible with the term of the forbearance.

Assessment of the viability of forbearance measures in terms of the borrower

106- Banks should consider the following factors when assessing the viability of forbearance measures in terms of the borrower:

- a) Banks should be able to demonstrate - based on objectively verifiable evidence - that the borrower is suitable for forbearance and full or maximum repayment is expected if forbearance is implemented.
- b) The resolution of outstanding arrears is fully or mostly addressed and a significant reduction in the borrower's balance in the medium to long term is expected.
- c) If multiple forbearances are made, the latter forbearances should first be reviewed by the risk management function in terms of their viability and be approved by a decision-making body higher than the decision-making authority that approved the previous forbearances.
- ç) The forbearance measure does not result in recurring forbearance measures having been granted.

107- The assessment of viability should be based on the distinctive financial characteristics

of the borrower and the forbearance method planned to be implemented at that time.

Forbearance policy

108- Banks should develop a policy on their forbearance activities which should at least cover the following:

- a) the processes and methods for implementing the forbearance measures, including responsibilities and decision-making,
- b) a description of the available forbearance measures, including those embedded in contracts,
- c) information requirements for assessing the viability of forbearance measures,
- ç) documentation of approved forbearance measures,
- d) the process and metrics for monitoring the adequacy and effectiveness of forbearance measures.

109- Banks should regularly review their forbearance policies and options based on the collective monitoring of the performance of different forbearance measures, including the examination of potential causes and instances of re-defaults.

Efficiency and effectiveness of forbearance activities

110- Banks should measure the efficiency of the process for granting forbearance measures and monitor the duration of the decision-making process and the volumes of forbearance measures at each stage of the granting process.

111- Banks should monitor the effectiveness of forbearance measures related to both performing and non-performing loans at the level of the forbearance measures and the portfolio types. This monitoring should measure whether the modified contractual obligations of the borrower are met and the exposure is performing. The following metrics by portfolio and by type of forbearance measure should be used:

- a) Forbearance cure rate and rate of exposure being reclassified as non-performing: banks should conduct a vintage analysis and monitor the behavior of FBEs from the date of modification to determine the cure rate. This analysis should be conducted separately for cured exposures with and without forbearance measures.
- b) Cash collection rate: banks should monitor cash collected from FBEs.
- c) Write-off: in case of write-off, banks should monitor the collections from such exposures.

112- Banks should monitor indicators using a breakdown including the duration of arrears, the type of the exposure, the size of the exposure, the probability of recovery, the total amount of exposures to the same borrower or the borrower's risk group, and the number of forbearance solutions applied in the past.

Minimum elements for assessing the borrower's repayment capacity

113- Before banks implement any forbearance, the staff to perform the assessment on the borrower's repayment capacity should have the expertise and experience required for the task, and should not have taken part in the loan origination processes of the borrower to be assessed. Any information to be used in the forbearance should be open for access and the necessary cooperation should be ensured for information flow between the relevant units in the bank.

114- The assessment of the borrower's situation should include the debt-servicing capacity and overall indebtedness of the borrower in consideration of relevant factors such as the liquidity, leverage, efficiency, profitability, cash flows and business plans of the borrower where applicable, and be based on sufficient (quality) information regarding the borrower's financial standing. An assessment of corporate borrowers is a more qualitative one and should also consider the medium- and long-term operational performance of the borrower company.

115- The information used in the assessment of the borrower and the results of the assessment should be documented in detail and be made available for audit for the purpose of understanding the borrower's current financial standing and its future income generation capacity.

Assessment of individual borrowers

116- In the assessment of individual borrowers' current and future loan repayment capacity and the most suitable forbearance measures, banks should assess the credit types of the borrower separately and jointly in consideration of the borrower's cash flows and collaterals. The assessment should take the following into consideration:

- a) Financial and non-financial information of the individual borrower (such as dependents, household needs, age, profession, sector, income, savings, expenses, assets),
- b) Total indebtedness of the individual borrower including unsecured loans,
- c) The delay and amount of the loan,
- ç) Past payment performance of the individual borrower,
- d) Assessment of the timing and reasons of the financial difficulties suffered by the individual borrower using historical data (such as salary decrease, job loss),
- e) An assessment that the payment plan for the loan repayment will be less than or equal to the income after all the expenses and guarantees are deducted,
- f) An assessment that the forbearance measures to be implemented will cover the needs and living standard of the individual borrower,
- g) Findings on the suitability of the forbearance measure to be implemented,
- ğ) Assessment on the current and future loan repayment capacity of the individual borrower, in consideration of potential future increases or decreases caused by macroeconomic conditions or reasons specific to the borrower,
- h) Time to retirement in consideration of the maturity of the loan,
- i) Relevant labor market indicators,
- j) Other foreseeable changes in the condition of the individual borrower.

117- In addition to the aforementioned, the assessments should take the following issues into consideration:

- a) Where the loan is refinanced by adding the interest to the principal, banks should assess, based on objective criteria, that the verified income and expense levels of the individual borrower are compatible with the reviewed loan repayment plan and period, and that individual borrower's performance adhered to the reviewed loan repayment plan in the 6 months prior to the provision of such refinancing.
- b) The individual borrower's age should be taken into consideration where the maturity is to be extended. If the individual borrower has the potential to be subject to mandatory retirement, an extension into the retirement period can be implemented

only where the bank is able to demonstrate and prove that the individual borrower can make the payments with a retirement pension or other verified sources of income.

- c) Where applicable, an assessment should also be made on the parties providing guarantee or surety.

118- For the forbearance of NPEs of individual borrowers, banks should document and make available for audit the following items without limitation:

- a) financial and non-financial information of the individual borrower (such as dependents, household needs, profession, income, expenses)
- b) variable elements of current income including irregular incomes (such as asset sales, premiums, bonuses, extraordinary incomes), and information and documents verifying them,
- c) assumptions used to reduce the variable elements of the current income to current value
- ç) Total indebtedness of the individual borrower,
- d) Most recent valuation report regarding the properties securing the loan,
- e) Information on other collaterals securing the loan (such as life insurance, unemployment insurance, guarantee and surety),
- f) Most recent valuation regarding other assets securing the loan,
- g) Documents verifying the current income,
- ğ) Relevant labor market indicators.

Assessment of corporate borrowers

119- If the corporate borrower has multiple credits, the bank should assess such loans separately in consideration of the corporate borrower's cash flows and loan collaterals.

120- The assessments should be proportional to the size of the corporate borrower and the credit facility.

121- Assessments on corporate borrowers in terms of the most suitable forbearance measures should take into consideration the corporate borrower's credit types separately and jointly.

122- The assessment on the total indebtedness including unsecured loans of the corporate borrower should use the information in central data sources including government and private registers. The assessment should at least take the following into consideration:

- a) Assessment of the timing and reasons of the financial difficulties suffered by the borrower using historical data,
- b) Findings on the suitability of the forbearance measure to be implemented,
- c) Assessment of the corporate borrower's business plan (such as SWOT analysis, financial ratio analysis, sectoral analysis),
- ç) historical analysis of the corporate borrower's financial data,
- d) Analysis of the cash flows provided by the borrower, in consideration of the following,
 - (1) All renewed items that can make maximum collection possible,
 - (2) The corporate borrower's business model,
 - (3) Past and future economic conjuncture,
 - (4) Assessment on whether the estimates and assumptions are reasonable,

- (5) Other payments of the corporate borrower (such as debts to banks, capital expenses, fines, taxes, social insurance deductions, retirement funds),
- (6) The corporate borrower's most recent audited/board-approved financial statements and cash-flow estimates,
- e) An assessment that the payment plan for the loan repayment will be less than or equal to the free cash flows foreseen based on the cash flow estimates,
- f) Where applicable, an assessment on the parties providing guarantee or surety.

123- For the forbearance of NPEs of corporate borrowers, banks should document and make available for audit the following items without limitation:

- a) The corporate borrower's most recent audited/board-approved financial statements,
- b) variable elements of current income including irregular incomes (such as asset sales, dividends from affiliates, extraordinary incomes), and information and documents verifying them,
- c) assumptions used to reduce the variable elements of the current income to current value
- ç) Total indebtedness of the corporate borrower,
- d) The borrower's business plan and cash flow estimate depending on the size of the corporate borrower and the maturity of the loan,
- e) Most recent valuation report regarding the properties securing the loan,
- f) Information on other collaterals securing the loan (such as life insurance, guarantee and surety),
- g) Most recent valuation regarding other assets securing the loan,
- ğ) Historical financial data of the corporate borrower,
- h) Relevant macroeconomic indicators (such as unemployment rate, GDP, inflation rate).

124- In the assessment of corporate borrowers, the quality of the borrower's management, its lines of business, the flexibility of the demand for its products or services, its competitive status, specifics of its sector and the macroeconomic conditions are taken into consideration as a minimum. Such assessment should be renewed once every three years or upon a significant change in the borrower's management, sector or in the macroeconomic conditions. The assessment to be made based on the corporate borrower's financial data should be updated annually following the receipt of the corporate borrower's financial statements.

125- Depending on the corporate borrower's size and where multiple banks are creditors, banks may outsource the assessment of the corporate borrower if they have no experience regarding the concerned product/service/sector. In order to outsource the service, banks should establish documented policies for such processes including the management body approval. Such policies should clarify matters such as the minimum content of the proposal to be received from the relevant service providers and the assessment deadline.

Standardized forbearance products and decision trees

126- Banks should consider developing decision trees and standardized forbearance measures for portfolios of homogeneous borrowers. Decision trees may help in determining and implementing appropriate and sustainable forbearance strategies for specific portfolios of borrowers in a consistent manner based on approved criteria.

Comparison with other NPE workout options

127- Depending on the size of the NPE, banks should use a net present value approach to determine the most suitable and sustainable workout option for borrowers' varied circumstances, and should compare the net present value of the envisaged forbearance measure with the net present value of repossession, the liquidation of the current collateral and other available liquidation options. The parameters used in the calculation, such as the liquidation time horizon, discount rate, cost of capital and liquidation cost, should be based on observed empirical data.

Borrower cash-flow projection

128- The forbearance agreements for corporate borrowers and their related documents should include a borrower cash-flow projection detailing the targets for the loan repayment during the agreement term and be available for audit.

SECTION SIX

NPE Impairments and Write-Offs

Minimum Elements of NPE Impairments and Write-Offs

129- Banks should perform practices related to impairments and write-offs in accordance with the provisions of the TFRS 9 Standard and the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions, and in a timely fashion.

130- Banks should maintain detailed records of NPE write-offs performed on a portfolio-level basis.

131- Banks should have, document and adhere to policies containing robust methods and controls that take into consideration items such as external conditions and ongoing legal proceedings regarding the measurement of the NPE impairment provision, calculating the impairment and performing the write-off in a timely fashion.

132- These policies should also contain processes concerning write-offs and collections. The write-off policy should contain indicators used to assess recovery expectations and detailed information on exposures written off but still subject to processes aimed at recovery.

133- Impairment calculation, coverage and write-off of exposures should be performed in a timely fashion. For parts of exposures covered by collateral, the establishment of a minimum impairment level should take the type of collateral into account. Empirical evidence should be applied when calibrating the impairment and write-off processes. When assessing the recoverability of NPEs and in determining write-off practices, banks should pay particular attention to the issues listed below, as they may have higher levels of permanent uncollectability.

- a) Banks should assess the recoverability of NPEs at the portfolio level if the borrower has been in arrears for a prolonged period of time or if the loan collateral is low. If, following this assessment, it is concluded that there is no reasonable expectation of recovering an exposure or part of an exposure, a full or partial write-off should be performed.
- b) The possibility of very low recoveries from execution/bankruptcy processes should be

taken into consideration.

- c) A partial write-off may be justified when there is evidence that the borrower is unable to repay the amount of the exposure in full.

134- Banks should test the estimated provisions for loss and the realized losses through retrospective tests.

SECTION SEVEN

Collateral Valuation

General policies and procedures

135- A bank should have in place written policies and procedures governing the valuation of loan collaterals, that are fully aligned with the risk appetite framework.

136- The policies and procedures should cover the valuation of all immovable and movable property collateral irrespective of adherence to the minimum terms specified in article 21 and 23 of the Communique on Credit Risk Mitigation Techniques.

137- The policies and procedures should be approved by the management body and should be reviewed at least annually.

Monitoring and controls

138- Banks should monitor and review the collateral valuations.

139- Banks should develop and implement robust quality assurance policies and procedures for collateral valuations considering the following:

- a) The quality assurance process should be carried out by a function that is independent from the function conducting the initial valuation, loan processing, loan monitoring and the underwriting process.
- b) The independence of the appraiser selection process should be tested on a regular basis as part of the quality assurance process.
- c) An appropriate, similar sample of valuations should be compared with market observations on a regular basis.
- ç) Back-testing of valuations should be carried out on a regular basis.
- d) The quality assurance process should be based on an appropriate sample size.

140- The internal audit function should regularly review the consistency and quality of the valuation policies and procedures, the independence of the appraiser selection process and the appropriateness of the valuations.

Valuation of immovable property

141- Banks should value immovable property collaterals in the context of the Regulation on the Procedures and Principles of Credit Classifications and Their Provisions published on the Official Gazette dated 12/01/2017 and numbered 29945, the Regulation on the Banks Receipt of Valuation Services and the Authorization and Activities of Institutions to Provide Valuation Service and the Communique on Credit Risk Mitigation Techniques.

142- Banks should monitor and assess the performance of valuation institutions.

143- Valuation institutions should have expertise on the area of use and location of the

immovable property.

144- The collateral of an immovable property should not be valued by the same appraiser for three times consecutively.

145- Banks should also define procedures in their collateral valuation policies for determining if a significant decline in collateral value has taken place. Quantitative thresholds can be set for each type of collateral, based on the observed empirical data and any relevant qualitative bank experience to determine if a significant decline in collateral value has taken place.

146- Banks should have appropriate processes and systems in place to flag outdated valuations and to prepare new valuation reports.

147- Banks should have defined collateral valuation approaches for each collateral product type.

148- All immovable property collaterals should be valued on the basis of market value or mortgage lending value, as specified under article 62 of the Communiqué on Credit Risk Mitigation Techniques. Movable property should be valued at its market value.

149- Banks should periodically assess the liquidity of movable property collaterals. If there is material volatility in the market prices, the bank should demonstrate that the valuation of the collateral is sufficiently conservative.

150- Banks should conduct a sufficient legal review confirming the capacity of being liquidated.

Expected future cash flow

151- The cash flow estimate should be based on up-to-date and reliable information where the cash flows from both the collateral and the activities of the borrower are taken into consideration.

152- In addition to the collateral liquidation costs to be taken into consideration in estimating cash flows, the option of applying a discount to the updated valuation should be taken into consideration as appropriate. The discount should reflect the market liquidity and the liquidation strategy.

153- The property price at the time of liquidation should take into account current and expected market conditions.

154- Time-to-sale considerations in connection with the disposal of mortgaged properties should also be included, based on debt enforcement practices and experiences from judicial proceedings and on empirical evidence, and back-tested accordingly.

155- Banks should apply adequate market price discounts for the purposes of TFRS 9, for the calculation of regulatory capital and for risk control purposes. A market price discount may be close to zero only for highly liquid and non-distressed collateral types that are not affected by any significant correlation risks.

156- Banks should develop their own liquidation cost and market price discount assumptions based on observed empirical evidence. If insufficient empirical evidence is available, discount assumptions should be based on, at a minimum, the liquidity of the collateral, passage of time, and the quality and ageing of the appraisal. A more conservative market price discount should be applied if a bank faces the situation of a frozen property market.

Further considerations on estimating cash flow from property collateral liquidation

157- In estimating cash flow from property collateral liquidation, banks should use appropriate and credible assumptions. In addition, banks should pay attention to the requirements for valuing cash flow under TFRS 13 on fair value measurements. Bank should also;

- a) Determine the assumed time of disposal taking into account current and expected market conditions as well as the underlying legal framework regarding the disposal of mortgaged properties.
- b) Not base the estimated market value of property collateral on macroeconomic projections/assumptions that are too optimistic.
- c) They must ensure that income from property collateral is not assumed to increase from the current levels unless there is an existing contractual arrangement for such an increase. Moreover, current income from property should be adjusted downwards when calculating cash flow in order to reflect the expected economic conditions.
- ç) The collateral cannot be held above the market value assuming that the asset will be sold after the market recovers.

158- At least the following should be documented when determining the value of the collateral:

- a) how the value was determined, including the use of appraisals, valuation assumptions and calculations,
- b) The determination of selling costs,
- c) The assumed timeline to recover,
- ç) the expertise and independence of the appraiser.

159- When the observable market price of the collateral is used to assess the recoverable amount of the exposure, this information source and the date should also be documented.

Back-testing

160- Banks should demonstrate via sound back-testing that the assumptions used when assessing the recoverable amount were reasonable and grounded in observed experience.

161- In this context, banks should regularly back-test their valuation history (last valuation before the exposure was classified as non-performing) against their sales history (net sales price of collateral). Depending on the size and business model of the bank, it should differentiate by collateral type, valuation model/approach, type of sale (voluntary/forced) and region for its back-testing process.

162- The back-testing results should be used to determine haircuts on collateral valuations supporting exposures remaining on the balance sheet.

IT and database requirements in respect of collateral

163- Banks should have databases and IT for transactions to enable the proper assessment, monitoring and control of credit risk, to respond to requests from management and supervisors, and to enable the provision of information in periodic reports and other timely and comprehensive documentation.

164- The databases and IT should include the following:

- a) sufficient depth and breadth, in that they cover all the significant risk factors,

- b) accuracy, integrity, reliability and timeliness of data diversity,
- c) common sources of information,
- ç) uniform definitions of the concepts used for credit risk control,
- d) traceability, such that the source of information can be identified,
- e) Flexibility to ensure that the information can be processed.

165- These databases should include all the information on the cases and transactions related to the properties and other collaterals.

Processes related to foreclosed assets

166- Banks should have in place a management policy that involves the storage, valuation and liquidation of foreclosed assets.

167- Banks should classify foreclosed assets in accordance with the relevant accounting standards. Such assets should be sold within a short timeframe and an active sales policy should be pursued.

168- Foreclosed assets should be valued in accordance with the procedures and principles specified in the Communique on Credit Risk Mitigation Techniques before the acquisition date. Foreclosed assets should be valued at the lower of the amount calculated as deducted from the credit debt, or the fair value of the repossessed asset, less the selling costs.

169- When banks decide to foreclose an asset still under construction and complete construction before selling the asset, they should demonstrate the merits of such a strategy.

170- When a foreclosed asset has exceeded the average holding period for similar assets for which active sales policies are in place, banks should consider this as an indication of impairment.

Annex 1: Sample Criteria for Grouping Retail NPEs

1- Natural / Legal Person

- a) Natural Persons
- b) Legal Persons
- c) Other (Foundations, funds etc.)

2- Days past due (dpd)

- a) Early arrears up to 90 days past due ($1 < dpd \leq 90$ dpd)
- b) Late arrears more than 90 days past due ($90 < dpd \leq 180$ dpd)
- c) Late arrear more than 180 days past due
- ç) Loans for which liquidation has been initiated or is in the process of being initiated by the bank

3- FBEs

- a) FBEs under close monitoring
- b) FBEs under non-performing monitoring
- c) Number of past forbearances

4- Exposure balance

- a) High value
- b) Low value

5- Risk level

- a) Very high
- b) High
- c) Medium
- ç) Low

6- Classification according to borrower's behavior

- a) Seasonal repayments
- b) Borrower's willingness for repayment

7- Purpose of credit facility

- a) Principal private residence loan
- b) Commercial property
- c) Personal loan
- ç) Overdraft account
- d) Leased exposures
- e) Credit card exposures
- f) Natural person, SME

8- Loan currency

9- Loan interest rate

10- Borrower outlook

11- Borrower's country of residence

- a) Resident
- b) Non-Resident

12- Location of the underlying loan collateral

- a) City center – outskirts
- b) Urban – rural

13- Type of the underlying loan collateral

- a) Land
- b) Building
- c) Movable property
- ç) Vehicle

14- Loan-to-value (LTV) ratio

15- Hardship cases

16- Borrower's creditworthiness

Annex 2: Sample Benchmarks for NPE Monitoring Metrics

1- NPE metrics

a) NPE stock and flow ratios and metrics

- NPE ratio
- $(\text{NPE Stock} + \text{Foreclosed assets} + \text{Performing forbore exposures}) / \text{Total loans}$
- Quarterly flow of NPEs (+/-)/total NPE stock
- Quarterly flow from performing exposure (PE) to NPE (flow from Group 1 and Group 2 to Group 3)
- Quarterly flow from performing FBE to NPE
- Quarterly flow from NPE to performing FBE
- Quarterly flow from NPE to PE
- Quarterly flow from performing FBE to group one exposures (flows from Group 2 to Group 1)
- Quarterly flow from group one exposures to performing FBE (flows from Group 1 to Group 2)

b) Impairments

- Quarterly increase in stock of loss allowances
- Quarterly level of reversal of impairments
- Quarterly change in stock of loss allowances (+/-)/total NPE stock
- Accumulated Total Provisions/total NPE stock
- Number of years since NPE classification of the loan
- Collateral status of the NPE

c) Loss budget

- Total loss incurred by the bank as a result of forbearance activity
- Difference between budgeted loss and actual loss

2- Collection activities

a) WU activities

- Number of borrower engagements leading to forbearance
- Number of borrower engagements leading to cash recovery
- Number of engagements with negative outcome
- Quarterly cash recovery from principal on NPEs/total NPE stock
- Quarterly cash recovery from interest on NPEs/total NPE stock

b) Cash recovery

- Recovery rate
- Cash recovery rate

- Quarterly cash recovery from capital and commission fees / total NPE stock
- Quarterly cash recovery from property-related liquidations / total NPE stock
- Quarterly cash recovery from non-property-related liquidations / total NPE stock
- Quarterly cash recovery from sale of NPEs / total NPE stock

3- Forbearance activities

a) Accounting write-offs

- Quarterly accounting write-offs (full and partial)
- Quarterly accounting write-offs (full and partial) / individually assessed stock of loss allowances
- Quarterly accounting write-offs (full and partial) / total NPE stock

b) Forbearance

- Value of NPEs currently in forbearance
- Value of forbearance solutions by characteristics
- Value of loans currently in forbearance / total NPE stock
- Value cash credits currently in forbearance
- Quarterly non-performing FBEs / total NPE stock
- Total non-performing FBEs / total NPE stock
- Value of non-performing FBEs currently experiencing financial difficulties

c) Re-default rate

- Re-default rate on non-performing FBEs
- Re-default rate on performing FBEs

c) Debt/asset swap

- Quarterly debt to equity swaps, also as a percentage of total NPE stock
- Quarterly debt to asset swaps, also as a percentage of total NPE stock

d) Legal activities

- Value and number of loans previously in legal activity
- Value and number of loans currently in legal activity
- Quarterly value and number of loans newly entering legal activity
- Quarterly value and number of loans exiting legal activity
- Average duration of legal procedures recently closed
- Average amounts recovered from legal procedures recently closed (including total costs)
- Loss rate on loans exiting legal activity

4- Sales from receivables

- Sales revenue according type of receivable / Net book value

- Sales revenue according type of receivable / Gross book value
- Sales revenue according type of collateral / Net book value
- Sales revenue according type of collateral / Gross book value
- Time to classify NPEs subject to sale as non-performing

5- Profits and loss (P&L) items stemming from NPEs

a) Interest from NPEs

- Interest payments stemming from NPEs, reflected onto the income statement
- Recovery rate of interest payments stemming from NPEs, reflected onto the income statement

Annex 3: Sample Benchmarks for Other Monitoring Metrics

1- Borrower information from external sources

- Debt and collateral increase in other credit institutions
- Past due or other non-performing classifications in other banks
- Guarantor default
- Debt in central data sources including government and private registers
- Legal proceedings
- Bankruptcy
- Changes in company structure (e.g., merger, transfer)
- External rating assigned and trend therein
- Other negative information regarding major customers or suppliers of the borrower

2- Borrower information from internal sources

a) Corporates

- Negative trend in internal rating
- Unpaid cheques
- Significant change in liquidity profile
- Leverage level
- Number of days past due
- Amount payable
- Number of months with any overdraft balance /overdraft excess amount
- Profit before taxes / revenue
- Continued losses
- Negative own funds
- Decrease in turnover
- Reduction in credit lines related to trade receivables (e.g., year-on-year variation)
- Unexpected reduction in undrawn credit lines (e.g., undrawn amount/total credit line)

b) Individuals

- Negative trend in behavioral scoring
- Negative trend in PD and/or internal rating
- Mortgage loan instalment > x credit balance
- Decrease in the credit balance > 95% in the last 6 months
- Average total credit balance < 0.05% of total debt balance
- Forborne amount

- Related historic loss rates
- Decrease in payroll in the past 3 months
- Early arrears up to 90 days past due (e.g., 5–30 days past due, depending on portfolio and borrower types)
- Reduction in bank transfers in current accounts
- Increase in loan instalment over the payroll ratio
- Number of months with any overdraft exceeded

3- Portfolio-level information

a) Portfolio distribution

- Size distribution and concentration level
- Top 10 groups of connected clients and related risk indicators
- Asset class distribution
- Breakdown by industry, sector, collateral type, country, maturity, etc.

b) Risk parameters

- PD/LGD evolution overall and per portfolio
- PD/LGD forecasts and projections
- Expected losses
- Default exposure

c) Stock of loss allowances

- Stocks and flows of loss allowances overall and per portfolio
- Volumes of and trends in significant risk provisions for each loan

ç) NPE/forbearance status/foreclosure

- NPE volume by category (> 90 days past due, loss allowances, etc.)
- Forbearance volume and grouping of exposures (e.g., restructuring, recovery, deferrals)
- Foreclosed assets on credits
- NPE ratio without foreclosed assets
- NPE ratio with foreclosed assets

4- Classification according to borrower/sector type

a) Legal activities

- Value and number of loans in legal activity
- Value and number of loans currently in legal activity
- Quarterly value and number of loans newly entering legal activity
- Quarterly value and number of loans exiting legal activity
- Average duration of legal procedures recently closed

- Average amounts recovered from legal procedures recently closed (Including total costs)
- Loss rate on loans exiting legal activity

Annex 4: Basic NPE-Related Policies

- 1- Banks should develop, regularly review and monitor their adherence to policies related to the NPE management framework.
- 2- The following policies should be established, taking into account the principle of proportionality, aiming to implement the NPE strategy and operational plan of the bank.

Write-Off Policies

- 3- Banks should establish a write-off policy to ensure timely assessment of the recoverability of NPEs.
- 4- In establishing their write-off policy, banks should ensure its alignment with their strategic plans, take into consideration its potential effects on banks' capital, and set clear rules in this regard.
- 5- Controls related to write-off practices should be included in the internal control processes.
- 6- Banks' write-off policy should include the following without limitation:

- a) The write-off approach to be taken into consideration for a specific type of exposure or portfolio (the conditions under which write-off will be performed, including indicators that there are no reasonable expectations for the recovery of the exposure),
- b) Information and documents that constitute the basis of the write-off.

- 7- Banks should also determine suitable authorization limits regarding the implementation of write-off transactions.

Arrears Management Policy

- 8- Banks' policies for the management of arrears should arrange the following without limitation:
 - a) the structure and responsibilities of the NPE WUs, with clear handover triggers and a link to the grouping of exposures,
 - b) the procedure to be followed by the WU functions involved, to include at a minimum,
 - (1) the procedure and handover criteria to be followed for each stage of arrears, early arrears up to 90 days past due and late arrears more than 90 days past due,
 - (2) the procedure to be followed where a borrower is classified as non-cooperating and/or non-viable, and the criteria for the borrower to be classified as such,
 - (3) management of the relations with the borrower,
 - (4) monitoring tools and methods to be applied,
 - c) the human and technical resource requirements,
 - ç) the reporting processes to be produced internally for monitoring purposes and for regular updates to the management body.
- 9- Banks, when developing their arrears management policy, should also take into account

the applicable legislative provisions.

Forbearance Policies

10- Banks forbearance policies should arrange the following without limitation:

- a) the necessary financial and non-financial documentation to be requested from and provided by the different types of borrowers in order to demonstrate the borrower's repayment capacity on a principal and interest basis,
- b) the minimum key financial repayment capacity metrics and ratios, detailed on a portfolio-/product-/sector-specific basis, in order to fully assess the borrower's repayment capacity,
- c) sector-specific internal guidelines for establishing key financial metrics and ratios on a sector-specific basis,
- ç) the process for determining and implementing the most appropriate forbearance solution for a borrower;
 - (1) for retail customers, decision trees to be used in consideration of the applicable legislative provisions,
 - (2) clear instructions on how to assess the suitability of a forbearance treatment in borrowers for whom a decision-tree approach is not appropriate,
 - (3) in the case of borrowers understood to be non-viable or non-cooperating, time-bound methods for the transfer of these borrowers to the teams responsible for liquidation in the NPE WU,
- d) forbearance measures implementable in the short term and long term,
- e) clear instructions for the revaluation of collateral,
- f) the decision-making process, approval processes and procedures for each type of forbearance measure and size of exposure,
- g) the process and procedure for the monitoring of the forbearance solutions granted and borrower performance following the completion of a restructuring, including frequency of the review of the borrower, the re-default definition, the process for reassessment and requirements for reporting of re-defaults,
- ğ) the pricing policy for each forbearance measure and type of borrower.

Debt Recovery and Enforcement Policy

11- The teams responsible for debt recovery in NPE WUs should take the most appropriate actions in a timely manner to effectively reduce NPEs over a defined time horizon for borrowers lacking the capacity to fully pay their debt. The debt recovery policy, in accordance with the NPL strategy, should address, at a minimum:

- a) The range of available options for each collateral type, including but not limited to the following:
 - (1) voluntary asset sale,
 - (2) forced asset sale via receivers/court proceedings,
 - (3) foreclosure of asset,
 - (4) collection,

- (5) debt to asset/equity swap,
- (6) sale of loan to a third party,
- b) the procedure to be followed to select the most appropriate recovery option and the team of internal and external experts to be involved in taking the decision,
- c) in selection the recovery option; the existence of collateral, type of legal documentation, type of borrower, local market conditions and macroeconomic outlook, the legislative framework in place, and potential recovery rates for each option versus the costs involved for each option,
- ç) A clear definition of non-cooperating borrowers or a link to related policies including such a definition,
- d) clearly defined approval processes for each stage of the debt recovery process for the different recovery options available to the bank,
- e) the roles of second and third defense lines.

12- With respect to the liquidation of collateral, the following should be defined in the policy:

- a) the valuation approach to be followed in respect of the collateral, including the liquidation costs to be applied,
- b) involvement of internal or external experts,
- c) limits,
 - (1) the amount of assets that can be held by banks at any point of time, taking into account the credit limits specified in the article 54 titled Credit limits of the Banking Law dated 19/10/2005 and numbered 5411 and the industry concentration risk,
 - (2) the amount of foreclosed assets that can be acquired by banks within a certain time period.

13- Banks should consider the interaction with other banks for NPE borrowers with multiple creditors, usually corporate borrowers. Banks should develop a clear procedure for negotiating and interacting with banks or third parties to whom the borrower is indebted.

Collateral Policies

14- Banks should develop clear and consistent collateral policies including policies for foreclosed assets. These policies should comprehensively cover the management, valuation and reporting of all collateral types.

15- Banks should ensure a consistent approach to managing and valuing similar collaterals across the portfolio.

16- In order to develop and implement a sales strategy, banks should establish separate teams within the NPE WUs, responsible for undertaking the procedure to be followed after foreclosure and managing the relevant assets.

NPE Monitoring Policy

17- The NPE monitoring policy to be established by banks should include the types of actions required in response to the different types of findings, the escalation procedures within the hierarchy of roles and responsibilities, and the key elements, frequency and recipients of the reporting.

Outsourcing Policy

18- A dedicated policy should be established for the outsourcing of services to third parties if this is relevant. Such policy should include the required procedures for the selection of outsourcing partners, the required legal contract content, and the monitoring of the implementation and consequences of such contracts.