Rules on Management of Problem Loans

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مؤسسة النقد العربي السعودي

Saudi Arabian Monetary Authority

Contents

Rules on Management of Problem Loans

1. General Requirements

1.1 Introduction

In exercise of the powers vested upon Saudi Arabian Monetary Authority (SAMA) under the charter issued by the Royal Decree no. 23 on 23-05-1377AH (15 December 1957G) and the Banking Control Law promulgated by Royal Decree no. M/5 dated 22/2/1386AH. SAMA is hereby issuing the enclosed Rules on the Management of Problem Loans aimed to develop the practices followed by banks while dealing with loans showing signs of stress along with the loans already specified as non-performing.

These rules should be read in conjunction with SAMA rules on Credit Risk Classification and Provisioning.

Also, SAMA issued the Guidelines on Management of Problem Loans as good practices to support banks in implementing these Rules.

1.2 Objective of the Rules

The objectives of these rules are as follows:

i. To ensure banks put in place a conceptual framework which would facilitate rehabilitation of viable borrower, thereby supporting economic activity.

ii. To ensure banks look into aspects of customer conduct and fair treatment whilst dealing with problem loans, especially in instances involving the MSMEs.

iii. To ensure banks have adequate controls over non-performing and problem loan management and restructuring processes, including documented policies and procedures.

1.3 Scope of Implementation

These rules are applicable for all banks licensed under Banking Control Law.

1.4 Definitions

The following terms and phrases, where used in these Rules, should have the corresponding meanings, unless the context requires otherwise:

Problem loans: Loans that display well-defined weaknesses or signs of potential problems. Problem loans should be classified by the banks in accordance with accounting standards, and consistent with relevant regulations, as one or more of:

a) non-performing;

b) subject to restructuring on account of inability to service contractual payments;

c) IFRS 9 Stages 2; and exhibiting signs of significant credit deterioration or Stage 3;

d) under watch-list, early warning or enhanced monitoring measures; or

e) where concerns exist over the future stability of the borrower or on its ability to meet its financial obligations as they fall due.

Non-performing loans:	As stipulated in BCBS 403 “Guidelines – Prudential treatment of problem assets – definitions of non-performing exposures and forbearance” endorsed by SAMA through circular no. 381000099757 dated 23/09/1438AH.
Watch-list:	Loans that have displayed characteristics of a recent increase in credit risk, and are subject to enhanced monitoring and review by the bank.
Early Warning Signals:	Quantitative or qualitative indicators, based on liquidity, profitability, market, collateral and macroeconomic metrics.
Cooperating borrower:	A borrower which is actively working with a bank to resolve their problem loan.
Viable borrower:	Is that, wherein the loss of any concessions as a result of restructuring, is considered to be lower than the loss borne due to foreclosure.
Viability Assessment:	An assessment of borrower’s ability to generate adequate cash flow in order to service outstanding loans.
Covenant:	A Borrower’s commitment that certain activities will or will not be carried out.
Key performance indicators:	Indicators through which bank management or supervisor can assess the institution’s performance.

Collateral:	Are those, whose value can be considered whilst computing the recoverable amount for workout cases or foreclosed cases, on account of meeting the stipulated conditions laid out in these rules, as would be applicable based on the nature of the collateral.
Failed restructuring:	Any restructuring case where the borrower failed to repay the revised contractual cash flows as agreed upon with the bank and has transitioned into default.

Further to the above, Banks should adopt all requirements relating to i) Restructuring, ii) Identification of forbearance; iii) Identification of financial difficulty; iv) Identification of concession; and v) Stage allocation for forborne loans, as stipulated under SAMA Rules on Credit Risk Classification and Provisioning.

2. Problem Loan Prevention and Identification

2.1 Early Warning Signals

Banks should develop a clear, robust and demonstrable set of policies, procedures, tools, and governance around the establishment of Early Warning Signals (EWS) which are fully integrated into the bank's risk management system.

The established EWS should be comprehensive and relevant to the specific portfolios of the Banks, and should enable Banks to proactively identify potential difficulties, investigate the drivers of the borrowers stress, and act before the borrower's financial condition deteriorates to the point of default.

Banks should organize their EWS process in the following three stages:

i. Identification of EWS:

Banks' EWS should, at a minimum, take into account indicators that point to potential payment difficulties. Individual banks should undertake an internal assessment as to which EWS are suitable for each of their lending portfolios taking into account a combination of the following:

a. Economic environment: Banks should monitor indicators of the overall economic environment, which are relevant for determining the future direction of loan quality, and not only the individual borrower's ability to pay their obligations but also collateral valuations.

Examples of economic indicators, based on the nature of the respective portfolios, can include GDP growth, Inflation/deflation, and unemployment, as well as indicators that may be specific to certain sectors/portfolios, e.g. commodity or real estate.

b. **Financial indicators:** Banks should establish a process in order to get frequent interim financial reports (or cash-flow/ turnover details for MSME) from their borrowers (e.g., quarterly for material loans to listed entities and semi-annual for all others), to ensure that EWS are generated in a timely manner.

   Examples of financial indicators, based on the nature of the respective portfolios, can include Debt/EBITDA, Capital adequacy, Interest coverage – EBITDA/ interest and principal expenses, Cash flow, Turnover (applicable for MSME).

c. **Behavioral indicators:** Banks should institute behavioral warning signals to assess the integrity and competency of key stakeholders of the borrower. These indicators will help in the assessment of how a borrower behaves in different situations.

   Examples of these indicators are: regular and consistent attempts at delaying financial reporting requirements; reluctance or unwillingness to respond to various communications, any attempt at deception or misrepresentation of facts, excessive delays in responding to a request for no valid reason.

d. **Third-party indicators**: Banks should organize a reliable screening process for information provided by third parties (e.g. rating agencies, General Authority of Zakat and Tax, press, and courts) to identify signs that could lead to a borrower's inability to service its outstanding liabilities.

   Example of these indicators are: Default at other financial institutions / any negative information, insolvency proceedings for major supplier or customer, downgrade in external rating assigned and trends with respect to external ratings.

e. **Operational indicators:** Banks should establish a process where any changes in the borrower's operations are flagged as soon as they occur.

   Examples of these indicators, based on the nature of the portfolio can include, frequent changes of suppliers, frequent changes of senior management, qualified audit reports, change of the ownership, major organizational change, management and shareholder contentiousness.

Banks should establish a comprehensive set of EWS that provide banks with an opportunity to act before the borrower's financial condition deteriorates to the point of default, and enable them to proactively identify and flag other loans that have similar characteristics, i.e. multiple loan facilities extended to the same borrower, or borrowers in same sector that may be affected by the overall economic environment, or loans with similar type of collateral.

ii. Corrective action:

Banks should have a proper written procedures to be followed in case any of the established EWS is triggered. The response procedure should clearly identify the roles and responsibilities of all the sections responsible for taking action on the triggered EWS, specific timelines for actions along with, identification of the cause and severity of the EWS.

iii. Monitoring:

Banks should have a robust monitoring mechanism for following up on the triggered EWS, in order to ensure that the corrective action plan has been executed to pre-empt potential payment difficulties of the borrowers. The level and timing of the monitoring process should reflect the risk level of the borrower.

3. Non-performing loans (NPL) Strategy

3.1 Developing the NPL Strategy

i. Banks should develop and implement an NPL strategy that is approved by the Board of Directors or its delegated authority.

ii. The NPL strategy should layout in a clear, concise manner the bank's approach and objectives, and establish annual quantitative targets over a realistic but sufficiently ambitious timeframe, divided into short, medium and long-term horizons. It should serve as a roadmap for guiding the allocation of internal resources (human capital, information systems, and funding) and the design of proper controls (policies and procedures) to monitor interim performance and take corrective actions to ensure that the overall goals are met.

iii. The NPL strategy should consider all available options to deal with problem loans, where banks review the feasibility of such options and their respective financial impact. These include hold/restructuring strategies, active portfolio reductions through either sales and/or writing off provisioned NPLs that are deemed unrecoverable, taking collateral onto the balance sheet, legal options and out-of-court options.

iv. Banks should follow the principle of proportionality and materiality, while designing the NPL strategy, where adequate resources should be exhausted on specific segments of NPLs during the resolution process, including MSME's.

3.2 Implementing the NPL Strategy

i. Banks should ensure that the components of the NPL strategy are communicated to relevant stakeholders across the bank, and proper monitoring protocols are established, together with performance indicators.

ii. The NPL strategy should be backed by an operational plan detailing how the NPL strategy will be implemented. This should include clearly defining and documenting the roles, responsibilities, formal reporting lines and individual (or team) goals and incentives geared towards reaching the targets in the NPL strategy.

iii. Banks should put in place mechanisms for a regular review of the strategy and monitoring of its operational plan effectiveness and its integration into the bank's risk management framework.

4. Structuring the Workout Unit

i. Banks should establish a dedicated Workout Department/Section/or Unit to manage all workout related cases in order to effectively manage NPL resolution process. The Workout Department/Section/or Unit should be independent of the Business/Loan Originating Units to avoid any potential conflicts of interest.

ii. Banks should ensure that, Workout Unit is properly staffed with resources having the required skill sets to manage workout situations, strong analytical, legal, financial analysis skills, and proper understanding of the workout process.

4.1 Performance Management

i. Banks should establish proper and well-defined performance matrices for Workout Unit staff that should not be based solely on the reduction in the volume of non-performing loans; An appraisal system and compensation structures tailored for the NPL Workout Unit should be implemented and in alignment with the overall NPL strategy, operational plan and the bank's code of conduct.

ii. In addition to quantitative elements linked to the bank's NPL targets and milestones (with a strong focus on the effectiveness of workout activities), the appraisal system should include qualitative measurements such as; level of negotiations competency, technical abilities relating to the analysis of the financial information and data received, structuring of proposals, quality of recommendations, and monitoring of restructured cases.

iii. The importance of the respective weight given to indicators within the overall performance measurement framework should be proportionate to the severity of the NPL issues faced by the bank.

5. Approaching Restructuring Cases

5.1 Viability of restructuring

Banks should implement a well-defined restructuring policy aligned with the concept of viability that recognizes in a timely manner those borrowers who are non-viable. The policy should ensure that only viable restructuring solutions are considered, which should contribute to reducing the borrower’s balance of credit facilities.

Long-term restructuring measures should only be considered viable where the following conditions are met:

i. The bank can demonstrate, based on reasonable documented financial information, that the borrower can realistically afford the restructuring solution.

ii. Outstanding arrears are addressed as part of the restructured terms. That does not necessarily mean full repayment, and should not conflict with the potential reduction in the borrower’s balance in the medium to long-term that could be required to align with the borrower’s loan service capacity.

iii. In cases, where there have been previous restructuring solutions granted in respect of a loan, the bank should ensure that additional internal controls and early warning signals are implemented, so that the subsequent restructuring treatment meets the viability criteria. These controls should include, at a minimum, approval of a designated Senior Management Committee.

Short-term restructuring measures should only be considered viable where the following conditions are met:

i. The bank can demonstrate, based on reasonable documented financial information, that the borrower can realistically afford the restructuring solution.

ii. Short-term measures are to be applied temporarily where the bank has satisfied itself and is able to attest, based on reasonable financial information, that the borrower demonstrates the ability to repay the original or agreed modified amount on a full principal and interest basis commencing from the end of the short-term temporary arrangement.

iii. The solution approved is not perceived to lead to multiple consecutive restructuring measures in the future.

The bank's assessment of viability should be based on the financial characteristics of the borrower and the restructuring measure to be granted at that time.

Whilst evaluating borrower’s viability, due consideration need be made, that any increase in pricing (for instance, over and above driven by risk-based pricing principles) with respect to the borrower’s outstanding facilities, does not make the resultant installments, unserviceable.

Banks should undertake the viability assessment irrespective of the source of restructuring, for instance, borrowers using restructuring clauses embedded in a contract, bilateral negotiation of restructuring between a borrower and the banks, public restructuring scheme extended to all borrowers in a specific situation.

5.2 Code of Conduct

Banks should develop a written Code of Conduct for managing problem loans, the Code of Conduct should define a robust problem loan resolution process to ensure that viable borrowers are provided a chance for reaching a workout solution, rather than invoking outright enforcement actions.

The Code of Conduct should be based broadly on but not limited to following:

i. **Communication with the borrower**: Banks should establish a written procedure around initiating communication with the borrowers along with the content, format, and medium of communication that is aligned with relevant Laws and Regulations, in the event that a borrower fails to pay in part or in full the installments as per the agreed repayment schedule.

ii. **Information-gathering**: Banks should establish a written procedure with proper timelines to collect adequate, complete and accurate information on the borrower’s financial condition from all available sources, in addition to standardized submissions such as quarterly/year-end financial statements, business/ operating plans obtained/submitted by the borrowers.

iii. **Financial assessment of the borrower:** Banks should ensure that proper analysis is performed on the information gathered relating to the borrower, in order to assess the borrower’s current repayment capacity, the borrower’s credit record, and the borrower’s future repayment capacity over the proposed workout period. Banks should ensure that reasonable efforts are made to cooperate with the borrower throughout the assessment process with the objective of reaching a mutual agreement on an appropriate workout solution.

iv. **Proposal of resolution/solutions:** Based on the assessment performed for the borrowers, banks should provide borrowers who are classified as cooperating a proposal for one or more alternative restructuring solutions, or if none of such solutions is agreed upon, one or more resolution and closure solutions, without this being considered as a new service to the borrower.

    In presenting the proposed solution or alternative solutions, banks should be open to comments and queries on the part of borrowers, providing them with standardized – to the extent possible – and comprehensive information to help them understand the proposed solution or, in the case where there is more than one proposed solution, the differences across the proposed alternatives.

v. **An objection-handling process:** Banks should establish a clear and objective process for handling objections raised by the borrowers, and the process should be communicated to the borrowers. The process should highlight the appropriate forums for appeals and the timeframe for their closure.

    Banks should develop standardized forms to be used by borrowers in case they want to raise an appeal. The forms should specify the list of information and required documents necessary to review the appeal, along with timelines for the submission and review of appeals.

vi. **Workout fee:** Banks should establish clear policy and procedure relating to charging fee for workout solution reached with borrowers. Banks should ensure that the policy and practice provide for impact analysis of the fee on borrower cash-flows, i.e. that increased cost is not going to further deteriorate the financial condition of the borrower. The rationale for charged fees should be clearly documented and transparency must be ensured through proper and clear communication with the borrower on fees charged by the banks.

The Code of Conduct should be reflected in all pertinent internal documentation with reference to problem loan resolution and be effectively implemented.

6. Workout Plan

i. Banks should develop a workout plan agreed between the viable borrower and the bank in order to return the non-performing borrower to a fully performing status in the shortest feasible time-frame, matching the borrower’s sustainable repayment capacity with the correct restructuring option(s).

ii. The workout plan needs to be approved by a designated Management Committee based upon the bank’s delegation of authority matrix.

iii. Banks should establish and document a policy with clear and objective time-bound criteria for the mandatory transfer of loans from Loan Originating Units to the Workout Unit along with the specification of relevant approvals required for such transfers.

iv. The policy should include details on areas where proper collaboration is required between the Workout Unit and Loan Originating Units especially in scenarios where the borrowers are showing signs of stress but still being managed by the Loan Originating Units.

6.1 Negotiating and Documenting Workout Plan

Banks should develop a process for negotiating and documenting the workout plan with a viable borrower. The process should cover the following components:

i. Developing the negotiating strategy:

Banks should have a proper process to manage the negotiations with viable borrowers on the potential workout solutions, the process should cover the following:

a) Identify minimum information required to objectively assess the borrower's capacity to repay the proposed restructured solution.

b) Assess the strengths and weaknesses of both the bank's and the borrower's positions and then develop a negotiating strategy to obtain objectives of a successful restructuring for a viable borrower.

c) Where deemed essential, encourage less sophisticated borrowers to seek the advice of counsel or financial advisor to ensure they fully understand the terms and conditions of the proposed restructured solution.

d) Develop covenants appropriate to the level of complexity and size of the transaction, and comprehensiveness of the information available.

ii. Communicating with the borrower during the workout process:

Communication with borrowers should be as per the procedures outlined in the bank's code of conduct. This should include; timelines for responding to borrower's requests/complaints, identify who within the bank is responsible/authorized to issue various types of communications to the borrowers, documenting process for all communications to/from the borrowers, signing/acknowledgement protocols with timelines, approval requirements for all workout proposals, templates to be used for communication with the borrowers.

iii. Resolution of disputes:

Banks should follow the objection handling process for managing disputes with the borrowers in cases where the bank and the borrower fail to reach an agreement. This should include providing the borrower with prompt and easy access to filing an appeal, along with all necessary information to review the appeal, and a timeline for its closure, it should also be ensured that the dispute is being reviewed independently of the individual or team against whom the appeal has been filled.

6.2 Monitoring the Workout Plan

i. Banks should develop proper policies and procedures for establishing a monitoring mechanism over restructured loans in order to ensure the borrowers continued ability to meet their obligations. Banks monitoring mechanism should analyze the cause of any failed restructuring, and the analysis should be used for improving the workout solutions provided to borrowers.

ii. Banks should define proper and adequate key performance indicators (including workout effectiveness) comparable with their portfolios and should be monitored on a periodic basis along-with regular detailed reporting to the executive management.

7. Collateral

Banks should ensure proper collateral management and apply the following requirements throughout the credit process irrespective of the performance on the loan.

7.1 Governance

i. Banks should develop policies and procedures in order to ensure proper management of collateral obtained to mitigate the risk of loss associated with the potential default of the borrowers. Collateral policies and procedures should be approved by the Board of Directors or its delegated authority and should be reviewed at least every three years or more frequently if the bank deems is necessary based on the changes in the relevant regulatory requirements or business practices. Collateral policies and procedures should be fully aligned with the bank's risk appetite statement (RAS).

ii. Consistent with SAMA's requirements on valuation of real-estate collateral, banks should institute an appropriate governance process with respect to valuers and their performance standards. Banks should monitor and review the valuations performed by internal or external valuers on a regular basis, as well as develop and implement a robust internal quality assurance of such valuations.

iii. The internal audit function of banks should regularly review the consistency and quality of the collateral policies and procedures, the independence of the valuers selection process and the appropriateness of the valuations carried out by valuers.

7.2 Types of Collateral and Guarantees

Banks should clearly document in collateral policies and procedures the types of collateral they accept and the process in respect of the appropriate amount of each type of collateral relative to the loan amount. Banks should classify the collaterals they accept as follows:

i. **Financial collateral** - cash (money in bank accounts), securities (both debt and equity) and credit claims (sums owed to banks).

ii. **Immovable collateral** - immovable object, an item of property that cannot be moved without destroying or altering it – a property that is fixed to the earth, such as land or a house.

iii. **Receivables** - also referred to as accounts receivable, are debts owed to a company by its customers for goods or services that have been delivered or used but not yet paid for.

iv. **Other physical collateral** - physical collateral other than immovable property.

v. **Treating lease exposures as collateral** - exposure arising from leasing transactions as collateralized by the type of property leased.

vi. **Other funded credit Protection** - cash on deposit with, or cash assimilated instruments held by, a third party bank should come under this category.

vii. **Guarantee** - is a promise from a bank, corporate, any other entity or individual, that the liabilities of a borrower will be met in the event of failure to fulfil contractual obligations.

7.3 General Requirements for Collateral

Banks should ensure that the following requirements are incorporated with respect to the management of collaterals accepted by them:

i. Banks should properly document the collateral arrangements and have in place clear and robust procedures that ensure that any legal conditions required for declaring the default of a borrower and timely collection/ liquidation of collateral are observed.

ii. Banks should fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to their interest in the collateral. In connection therewith, banks should conduct sufficient legal review confirming the enforceability of the collateral arrangements in all areas of operations, for example, foreign branches and subsidiaries. They should re-conduct such review as necessary to ensure continuing enforceability.

iii. The collateral policies and procedures should ensure mitigation of risks arising from the use of collateral, including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the bank's overall risk profile.

iv. The financing agreements should include detailed descriptions of the collateral as well as detailed specifications of the manner and frequency of revaluation.

v. Banks should calculate the market and the forced sale values (incorporating haircuts) of the collateral at a minimum frequency to enable it to form an objective view of borrower or workout viability; such valuations should incorporate the cost and time to realise, maintain and sell the collateral in the event of foreclosure.

vi. Where the collateral is held by a third party, banks should take reasonable steps to ensure that the third party segregates the collateral from its own assets.

vii. While conducting valuation and revaluation, banks should take into account any deterioration or obsolescence of the collateral.

viii. Banks should have the right to physically inspect the collateral. They should also have in place policies and procedures addressing their exercise of the right to physical inspection.

ix. When applicable, the collateral taken as protection should be adequately insured against the risk of damage.

7.4 Specific Requirements for Each Type of Collateral and Guarantees

A) Financial collateral

Under all approaches and methods, financial collateral should qualify as eligible collateral where all the following requirements are met:

i. The credit quality of the borrower and the value of the collateral should not have a material positive correlation. Where the value of the collateral is reduced significantly, this should not alone imply a significant deterioration of the credit quality of the borrower. Where the credit quality of the borrower becomes critical, this should not alone imply a significant reduction in the value of the collateral.

   Securities issued by the borrower, or any related group entity, should not qualify as eligible collateral. Notwithstanding the aforementioned, a borrower's own issues of covered bonds qualify as eligible collateral, when they are posted as collateral for a repurchase transaction, provided that they comply with the condition set out in this paragraph.

ii. Banks should ensure that sufficient resources are devoted to the orderly operation of margin agreements with OTC derivatives and securities-financing counterparties, as measured by the timeliness and accuracy of their outgoing margin calls and response time to incoming margin calls.

B) Immovable property

i. Banks should clearly document the types of residential and commercial immovable property they accept in their lending policies.

ii. Immovable collateral should be classified in the following categories based on the underlying nature and behaviour:

   a) Investment properties;

   b) Owner-occupied properties;

   c) Development properties;

   d) Properties normally valued on the basis of trading potential.

C) Receivables

Receivables should qualify as eligible collateral, where all the following requirements are met:

i. Banks should have in place a sound process for determining the credit risk associated with the receivables, such a process should include analyses of a borrower's business and industry and the types of customers with whom that borrower does business. Where the bank relies on its borrowers to ascertain the credit risk of the customers, the bank should review the borrowers' credit practices to ascertain their soundness and credibility;

ii. The difference between the amount of the loan and the value of the receivables should reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual borrower, and potential concentration risk within the bank's total loans beyond that controlled by the bank's general methodology.

iii. Banks should maintain a continuous monitoring process appropriate to the receivables. They should also review, on a regular basis, compliance with loan covenants, environmental restrictions, and other legal requirements;

iv. Receivables pledged by a borrower should be diversified and not be unduly correlated with that borrower. Where there is a material positive correlation, banks should take into account the attendant risks in the setting of margins for the collateral pool as a whole;

v. Banks should not use receivables from subsidiaries and affiliates of a borrower, including employees, as eligible credit protection;

vi. Banks should have in place a documented process for collecting receivable payments in distressed situations. Banks should have in place the requisite facilities for collection even when they normally rely on their borrowers for collections.

D) Other physical collateral

Physical collateral other than immovable property should qualify as eligible collateral, when the conditions specified as general requirements for collateral are met.

E) Treating lease exposures as collateralized

Banks should treat exposures arising from leasing transactions as collateralized by the type of property leased, where all the following conditions are met:

i. The conditions set out for the type of asset/property leased to qualify as eligible collateral are met;

ii. The lessor has in place robust risk management with respect to the use to which the leased asset is put, its location, its age and the planned duration of its use, including appropriate monitoring of its value;

iii. Where this has not already been ascertained in calculating the Loss Given Default level, the difference between the value of the unamortized amount and the market value of the security is not so large as to overstate the credit risk mitigation attributed to the leased assets.

F) Other funded credit protection

Cash on deposit with, or cash assimilated instruments held by, a third-party institution should be eligible, where all the following conditions are met:

i. The borrower's claim against the third party institution is openly pledged or assigned to the lending bank and such pledge or assignment is legally effective and enforceable and is unconditional and irrevocable;

ii. The third party institution is notified of the pledge or assignment;

iii. As a result of the notification, the third party institution is able to make payments solely to the lending bank, or to other parties only with the lending bank's prior consent.

G) Guarantees

Credit protection deriving from a guarantee should qualify as eligible unfunded credit protection where all the following conditions are met:

i. The credit protection is direct and explicitly document the obligation assumed by the protection provider;

ii. The extent of the credit protection is clearly defined and incontrovertible;

iii. The credit protection contract does not contain any clause, the fulfillment of which is outside the direct control of the bank, that would:

   a) allow the protection provider to cancel the protection unilaterally;

   b) increase the effective cost of protection as a result of a deterioration in the credit quality of the protected loan;

   c) prevent the protection provider from being obliged to pay out in a timely manner in the event that the original borrower fails to make any payments due, or when the leasing contract has expired for the purposes of recognizing the guaranteed residual value;

   d) allow the maturity of the credit protection to be reduced by the protection provider.

iv. The credit protection contract is legally effective and enforceable, at the time of the conclusion of the credit agreement and thereafter i.e. over the life of the exposure;

v. The credit protection covers all types of payments the borrower is expected to make in respect of the claim. Where certain types of payment are excluded from the credit protection, the lending bank has to adjust, the value of credit protection to reflect the limited coverage;

vi. On the qualifying default of or non-payment by the borrower, the lending bank has the right to pursue, in a timely manner, the protection provider for any monies due under the claim in respect of which the protection is provided and the payment by the protection provider should not be subject to the lending bank first having to pursue the borrower.

7.5 Valuation Frequency

i. Banks should clearly document in collateral policies and procedures the frequency of collateral valuations. The policies and procedures should also provide for the following:

   a) Banks monitor the value of each type of collateral on a defined frequent basis.

   b) More frequent valuations where the market is subject to significant negative changes and/or where there are signs of a significant decline in the value of an individual collateral.

   c) Defined criteria for determining that a significant decline in collateral value has taken place. These will include quantitative thresholds for each type of collateral established, based on the observed empirical data and qualitative bank experience, taking into consideration relevant factors such as market price trends or the opinion of independent valuers.

   d) Revaluation of collateral for restructuring cases should be done only where necessary, and should be done in accordance with the requirements of these rules.

ii. Banks should have appropriate IT processes and systems in place to flag outdated valuations and to trigger valuation reports.

7.6 Specific Requirements for Valuers

Banks valuation process should be carried out by valuers who possess the necessary qualifications, ability and experience to execute a valuation and who are independent of the credit decision process.

Banks should ensure compliance with SAMA circular no. 371000061185 dated 28/05/1437AH on “Obligations of Real Estate Appraisal Clients Subject to SAMA

Supervision" and the revision made to the said circular through circular no. 65768/99 dated 25/10/1439AH along with all relevant regulatory requirements in that regard.

8. Regulatory Reporting Requirements

Banks are required to submit to SAMA on a quarterly basis all Restructuring Cases (Responses should only cover restructuring cases of "Problem loans" as defined in section 1.4 of these Rules) and Associated Fees as per the templates provided by SAMA. The reports should be submitted within 30 days of quarter end.

9. Effective Date

These Rules should come into force with effect from the 1st of July 2020.

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