30 Apr 2015 | Banking sector update ***Maintain* NEUTRAL**

MORE STRINGENT GUIDELINES ON CLASSIFICATION AND IMPAIRMENT PROVISIONS FOR LOANS

BNM recently revised its guidelines on classification and impairment provisions for loans. We view the changes as more stringent as it will now require all facilities/loans which have been rescheduled and restructured (R&R) and tagged as R&R in CCRIS to be immediately classified as impaired loans.

These new regulations will supersede the following two guidelines:

i. Classification and Impairment Provisions for Loans/Financing dated 9th Nov 2011 and

ii. Classification and Impairment Provisions for Loans/Financing – Maintenance of Regulatory Reserves dated 4th Feb 2014.

The changes are highlighted in bold below.

Table 1: Changes to classification of loans as impaired

Banks will need to classify a loan as impaired if its falls under any of the following 3 circumstances:

No	Existing	Revised
i.	Where principal and interest repayment of a loan has been overdue for 90 days or 3 months	No change
ii.	Where principal and interest repayment of a loan has not been overdue for 90 days or 3 months but exhibit credit weaknesses	No change
iii.	-	**When a loan has been rescheduled and restructured (R&R) and tagged as R&R in CCRIS.**

Source: BNM

Table 2: Other key changes from the revised guidelines

No	Existing	Revised
i.	R&R facilities can only be reclassified as non-impaired loans when repayments based on the revised or restructured terms have been observed continuously for a period as determined by the bank's policy on R&R facilities.	**R&R facilities can only be reclassified as non-impaired loans when repayments based on the revised or restructured terms have been observed continuously for a period of at least 6 months or a later period as determined by the bank's policy on R&R facilities.**

ii.	For R&R facilities where the amount is overdue for 90 days or 3 months or less, these account shall be classified as impaired if they exhibit any weakness that render such classification according to the bank's credit risk grading framework.	**Except for circumstances highlighted below in Table 3, all R&R facilities shall be classified as impaired loans.**

Source: BNM

Table 3: Exceptional circumstances where R&R facilities will not be classified as impaired loans

i.	R&R facilities involving a moratorium of loan repayments where borrowers are affected by natural disasters which may involve banks granting of moratorium on loan repayments. The moratorium period granted must not exceed 6 months from the date of the borrower's application for moratorium;
ii.	The loan has been rescheduled or restructured by Agensi Kaunseling dan Pengurusan Kredit (AKPK); and
iii.	Retail loans where banks elected not to increase the loan instalment amount following an increase in Base Lending Rate where the increase is less than RM50 per month

Source: BNM

- The revised guidelines on classification and impairment provisions on loans will be effective 1st Apr 2015.
- We expect the changes to result in upticks in impaired loan ratios of banks in the near term as R&R facilities will be required to be classified as impaired loans with the exception of the circumstances highlighted in Table 3.
- However, even in the event that R&R facilities are to be classified as impaired loans, this does not necessarily lead to additional provisioning for loan losses for banks as it will depend on the adequacy of security coverage. For well collateralized facilities, no provisioning for loan losses will be required.
- Banks would have already assessed the financial conditions considering all the relevant circumstances of the borrower's repayment ability before allowing any loans/facilities to be restructured and rescheduled. In any case, we believe that most borrowers that have approached banks for R&R have the intention to continue to service their borrowings. In such cases, impaired R&R facilities can be reclassified back to non-impaired loans when the borrowers have continuously service their repayments after R&R for at least 6 months or a later period as may be determined by the bank's policy.
- Classification of R&R as impaired loans is likely to result in banks' loan loss coverage (LLC) ratios to decline. Meanwhile, for AMMB, Public Bank, Hong Leong Bank and BIMB which have LLC ratios of well above 100%, these banks are in a more comfortable position in terms of loan loss coverage.

Table 4: Respective banks Collective Assessment Allowance and Regulatory Reserve (CA) ratio and loan loss coverage (LLC) ratio

	AMMB	Maybank	Public Bank	RHB Cap	Hong Leong	CIMB	AFG	BIMB	Affin
CA ratio (%)	1.78	1.00	0.67	1.00	0.93	1.26	0.92	1.48	0.74
Loan loss coverage (%)	106.0	95.6	128.1	61.1	129.7	82.7	94.2	170.4	75.6

Source: Companies/MIDFR

- Overall, we expect the changes to be slightly negative on banks' earnings.
- We understand that banks are still seeking clarifications from BNM on the revised guidelines. In the situation where borrowers have approached banks for R&R of their facilities due to the either of the following: i) decline in business revenue but still positive cash flows or ii) still positive cash flows for business but need funds to be invested into other assets/business, it remains uncertain if these facilities will be tagged as R&R or not in CCRIS and be classified as impaired loans.
- For Risk Weighted Assets (RWA), most banks (AMMB, AHB, AFG, BIMB, Public Bank, Hong Leong Bank) have adopted standardized approach while CIMB, Maybank and RHB are already on IRB approach for credit risk. Generally, risk weights are assigned based on nature of asset, credit risk rating of borrower and collateral. Loan-to-value ratios (LTV), collateral and provisions that have been set aside by the banks will be taken into consideration when assigning the risk weights. Generally under the standardized approach, risk weights are likely to be higher for loans after being classified impaired post R&R especially on unsecured portion of exposures net of provisions provided by banks. On an overall basis, we do not expect the impact to banks' capital position from the revised guidelines to be significant.
- On the requirements of maintenance of regulatory reserves for CA ratio of banks to be at least 1.2%, this will be effective beginning 31st Dec 2015. Banks with CA ratio lower than 1.2% (Refer Table 4) will be required to transfer from retained earnings to regulatory reserves to meet the shortfall in the ratio by end of Dec 2015. This will not have any adverse impact on banks earnings but CET-1 ratios are likely to drop while RWCR of banks will increase as collective assessment allowance and regulatory reserves are recognized as Tier-2 capital.
- Maintain NEUTRAL stance on the sector as we continue to see challenges to banks earnings from: i) slower loan growth, persistent NIM pressure, market volatility impacting treasury and IB income and lower ROEs reflecting softer market conditions. Our stocks picks are on Hong Leong Bank (TP: RM16.10), Maybank (TP: RM10.80) and RHB Cap (RM9.50). On the other stocks, we are NEUTRAL on Public Bank (TP: RM19.50), AHB (TP: 3.15), AMMB (TP: RM7.00), AFG (TP: RM4.70), CIMB (TP: RM6.20) and BIMB (TP: RM3.96).

	Rec.	Price @ 29/4	Target Price	EPS (sen)		PER		Net DPS		Net Div Yield		BV	BV	PBV	PBV
				15	16	15	16	15	16	15	16	15	16	15	16
AMMB	NEUTRAL	6.49	7.00	55.0	58.0	11.8	11.2	22.0	23.0	3.4	3.5	4.7	5.1	1.4	1.3
Maybank	BUY	9.30	10.80	75.0	82.0	12.4	11.3	45.0	49.0	4.8	5.3	6.0	6.5	1.5	1.4
Public Bank	NEUTRAL	19.70	19.50	121.0	131.0	16.3	15.0	56.0	60.0	2.8	3.0	7.9	8.6	2.5	2.3
RHB Capital	BUY	7.90	9.50	86.0	95.0	9.2	8.3	11.0	12.0	1.4	1.5	8.0	8.7	1.0	0.9
HLB	BUY	14.16	16.10	115.0	124.0	12.3	11.4	38.0	41.0	2.7	2.9	8.5	9.5	1.7	1.5
CIMB	NEUTRAL	6.04	6.20	49.0	53.0	12.3	11.4	19.0	21.0	3.1	3.5	4.8	5.1	1.3	1.2
AFG	NEUTRAL	4.79	4.70	37.0	40.0	12.9	12.0	22.0	24.0	4.6	5.0	2.9	3.1	1.6	1.5
BIMB	NEUTRAL	4.00	3.96	37.5	40.2	10.7	10.0	15.0	16.1	3.8	4.0	2.2	2.4	1.8	1.7
Affin	NEUTRAL	2.95	3.15	33.0	35.0	8.9	8.4	16.0	18.0	5.4	6.1	4.2	4.4	0.7	0.7

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected, by -15% or more, over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.
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