BANK RESERVE ACCOUNTING

DBS Group Holdings Ltd

If you need to understand why banks focus so much on matters such as provisions, NPLs, recovery and loan classification, this is a great place to start. DBS and PricewaterhouseCoopers make some sense of it in this special section.

DBS

BANK RESERVE ACCOUNTING

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1. INTRODUCTION

With this Primer, DBS seeks to provide analysts, investors and financial commentators with a guide to bank loan accounting, including loan/loss classification methodology; the extent of management's discretion in assigning ratings; differences arising from operating in multiple jurisdictions and the value of collateral/security provided and its relationship to loan grading.

2. KEY RATIOS RELATING TO PROVISIONS AND NON - PERFORMING LOANS - THE CAPITAL ADEQUACY RATIO

Bank regulators impose minimum levels of capital requirements on banks to reduce the risk of insolvency. These minimum levels are generally expressed in relative terms, as a proportion of the bank's risk-weighted assets. Singapore banks are required to maintain a capital adequacy ratio of 12% as compared to the Basle minimum ratio of 8% applicable to most jurisdictions. The capital adequacy regulations set by the MAS are broadly tailored from the Basle Accord.

In theory, setting the minimum required capital ratio involves a complicated estimation process and, since banks and their circumstances differ, the required ratio should also differ between banks. The Basle minimum ratio rules are thus open to regulators in different jurisdictions to impose differential requirements.

Moreover, the application of capital adequacy regime requires the measurement of a number of factors such as capital, assets and risk. This is inevitably dependent on accounting procedures, including policies for loan loss provisioning, which are subject to variation among banks. A bank's capital adequacy ratios are directly related to its decisions on loan loss provisioning, and consequently, capital adequacy regulations have a direct effect on loan loss provisioning. In consequence, the capital adequacy rules have the potential to alter a bank's competitive position. Loan loss provisions have a direct effect on measured capital adequacy, and so these decisions are linked.

Differential loan loss provisioning practices may impact the competitiveness of banks in a number of ways. First, the level of provisioning affects the quantum of capital available to support the bank's lending. Second, loan loss provisioning has a direct impact on disclosed profitability and hence retained earnings. Third, particular loan loss provisioning policies may influence the perceived riskiness, and therefore the cost of capital, of a bank.

The application of a common capital adequacy ratio across a number of countries may have competitive implications because of differences in accounting procedures for loan losses between countries. This will favour banks in those countries with more permissive accounting rules. There may also be differences between countries in the way the Basle rules are interpreted and implemented. In addition there is the problem of the quality of the capital used by banks to meet the capital adequacy requirements. Since higher quality capital (e.g. equity) is likely to be more expensive than lower quality capital (e.g. subordinated debt), banks may have an incentive to use low quality capital where possible to provide the extra capital required to meet the capital ratio.

3. CREDIT

Credit refers to the whole spectrum of lending that a bank enters into from short-term money market loans to long-term project financings.

Two important principles govern any bank's lending activities. The first is the principle of stewardship. Banks are fiduciaries. By lending, they put at risk depositor's money. Management must therefore exercise a high degree of prudence and integrity in their lending decisions. The second is the principle that a bank must make a reasonable level of return on its lending to cover costs and reward its shareholders for the risk that they have taken in standing behind the depositors. Striking an acceptable balance between these two principles is the art of good lending and the essence of sound banking.

Although the detailed methods of recording and accounting for credit and its related income vary from bank to bank, according to the particular needs and systems, certain principles are generally accepted. In general, loans are recorded in the balance sheet at cost, less amounts written off and after deducting specific and general provisions for irrecoverable amounts. In this context, cost means the original principal amount of the loan plus accrued or unpaid interest, less repayments of principal made up to the dates of the financial statements. DBS follows this practice.

Of the alternative treatments available, DBS does not value any loan which it originates on a discounted cash flow basis. In addition, secondary market debt trading is not a major business activity and as such no loans on the bank's portfolio are valued on a Mark to Market basis.

4. BAD AND DOUBTFUL DEBTS

A loan is bad or doubtful when the borrower cannot repay. The incidence of bad and doubtful loans is a particularly sensitive aspect of a bank's operations. If the losses are material they can reduce the capital resources of the bank and affect its ability to grow and develop its business. If large losses are disclosed in the financial statements, it may lead to a loss of confidence in the bank's management and a reduction in its credit ratings. This will result in an increase in the bank's cost of borrowing and make it more expensive to raise capital. As such, provisions for bad and doubtful debts at DBS are one of the most important and complicated of all its accounting policies.

Most banks make both specific and general provisions against bad and doubtful loans. These provisions have traditionally been computed separately, but are really elements of the same overall considerations. The overall provision should represent the aggregate amount by which management considers it necessary to write down its loan portfolio in order to state it in the balance sheet at its estimated ultimate net realisable value. This value should thus represent the total amount that the bank expects to recover over time in the normal course of repayment or recovery.

Moreover, the overall provision can be determined using different approaches. Under the traditional approach, which DBS adopts, management takes the view that the specific element relates to particular loans that have been identified as bad or doubtful, writing them down to estimated net realisable value at the balance sheet date. The general element relates primarily to loans that have not been separately identified as bad or doubtful, but are known from experience to be present in any loan portfolio. The general element may also reflect identified loans about which the bank has some concern, but for which it is not clear from the evidence available that a specific provision is needed, or for which it is not possible in the circumstances to determine a reasonable estimate of the extent of any specific amounts to be provided. A bank's ability to develop a flexible general element is important in a deteriorating situation, such as the recent Asian Crisis, where management knows there are problems within its portfolio but cannot necessarily identify them with great specificity. In such circumstances, a bank's general provisions will rise faster than the specific element, which will catch up once the problem loans have presented themselves and been identified customer by customer.

An alternative approach blurs the distinction between the specific and general elements of the provision and this is favored by a number of North American banks. With the advent of sophisticated loan grading and credit risk management techniques, it has become feasible for banks to derive a provision on a formula basis by applying pre-determined factors to all the loans within a portfolio, based, among other things, on historical default experience and problem loan resolution rates.

DBS' practice, in common with a number of global banks, is to record provisions in its overseas subsidiaries based on local regulatory requirements for local reporting purposes, and then, if necessary, for the DBSH financial statements to top-up any potential shortfalls when DBS' own internationally acceptable internal standards are applied to its overseas portfolio. As such, the DBSH Group consolidated financial statements reflect provisioning based on DBS standards. Local subsidiary accounts reflect only those provisions that are necessary to comply with local regulatory requirements. Historically, this means that provisions in the DBSH financial statements are higher as DBS' standards are more stringent than the standards applied in other Asian jurisdictions in which it operates.

At DBS, the charge made to the profit and loss account to write off bad loans or create new specific provisions in the year takes into account the specific and general provisions that were held at the beginning of the year. The charge against profits thus represents those specific provisions and write offs in the year that are not already covered by the opening balance of provisions together with such amount as is needed to restore the general element of the provisions to the level judged necessary at each succeeding year-end by management.

4.1 Specific element of the provision

In determining the extent of the specific element of the provisions, management considers the amount of the loan and its other commitments to the borrower, the payment history of the borrower, the borrower's business prospects, the security of the loan [how easily it could be realised and for how much] and the costs to obtain repayment.

Any security that the bank holds for a loan is of considerable importance in determining the extent of a provision, since it may significantly mitigate or eliminate any potential loss that might otherwise be foreseen.

At DBS, a loan will qualify for a specific provision upon classification upon which a percentage of the difference between loan principal and its related security value [the unsecured portion] will be provided. The actual percentage

TABLE 1

GRADE ASSIGNED TO LOAN	CRITERIA	PROVISION LEVEL	EXAMPLES OF COLLATERAL VALUATION
Substandard	• Fully secured or • Expected loss is less than 50% of the unsecured amount.	For Substandard cases which are fully secured. • No provision is required for the principal amount. • Interest provision is 100%. For Substandard cases with security shortfall. • Principal provision is 10% to <50% of unsecured amount. • Interest provision is 100% In addition, a general provision is made on the outstanding principal.	• For properties, a discount is applied to the valuation to arrive at forced sale value. • For shares/deposits, which are marked to market, no discount is applied. • For debentures, discount factors generally range from 1/3 to 2/3 of book value of assets.
Substandard/Loss	• Primary source of repayment is collateral which is inadequate to fully cover the loan.	• 100% of unsecured principal amount. • Interest provision is 100% In addition, a general provision is made on the outstanding principal.	
Doubtful	• Indeterminable security value but expected to be significant. Expected loss is 50% to less than 100% of the loan.	• 50% to less than 100% of loan principal amount, determined on a case by case basis. • 100% provision on interest. In addition, a general provision is made on the outstanding principal.	Not applicable.
Loss	• Loan recovery is assessed to be insignificant, with no security available as alternative recourse.	• 100% of loan principal and interest. In addition, a general provision is made on the outstanding principal.	Not applicable.

provided will depend on management's judgement and whether the loan is graded Substandard, Substandard/Loss, Doubtful or Loss. The quantum of the provision is directly impacted by the security value and this in turn, may be discounted in certain circumstances to recognise the impact of forced sale or quick liquidation.

Issues in respect of loan grading are explored in Section 6 of this Primer.

Generally, the provision levels and basis of collateral valuation for the main classified grades at DBS are at Table 1. Management rarely overrides these guidelines. A loan is graded substandard or worse when:

- Payment of the principal and/or interest is 90 days or more in arrears.
- Debt rescheduling/restructuring takes place due to cashflow problems.
- Borrower is unable to repay the loan from normal sources of income.

4.2 General element of the provision

A bank with a large portfolio of loans will always find it difficult to identify all the bad and doubtful loans that exist at a balance sheet date and to estimate the extent of the

losses that they will produce. The information about its borrowers may not be completely up to date and there will always be factors relevant to the identification and evaluation of bad and doubtful loans of which the bank has not yet become aware such as deterioration in the value of fixed assets or other factors of production.

It will not always be possible or practicable where there are many small loans, to determine with certainty whether or when a loan has become bad or what level of specific provision would be "correct".

The general element of the provision is made to cover losses which, although not specifically identified, are known from experience to exist in any loan portfolio as well as the circumstances described above. The general provision covers instances where impairment has occurred by the balance sheet date and not future losses arising from future events. In determining an appropriate level of general provision, management considers the following:

- The identification of loans for which it is not clear that a specific provision is needed but where sufficient doubt exists for some general level of provisioning to be appropriate;
- The application of varying percentages to the different categories or grades of the loan portfolio, weighted towards those industrial and geographical segments that are considered to be particularly at risk;
- For banks whose assets are undiversified, the application of an absolute percentage to the total loan portfolio, based on past experience and future expectations of the incidence of bad and doubtful loans; and
- The adoption of a judgemental method using historical data adjusted to allow for subsequent experience and current market conditions.

The factors that management should consider in determining the overall level of the general provision are past experience, concentration, economic and political factors, past balance sheet provisions and exceptional events.

4.3 Country risk provisions

In addition to general and specific provisions, DBS also holds a country risk provision.

An issue that presents particular difficulties in the assessment of the specific and general elements of the provision for bad and doubtful loans is country risk. Country risk arises where borrowers are resident in, or otherwise dependent on, the economy of a particular country and may, due to foreign exchange shortages or restrictions, be unable to meet their obligations to the lending bank. The assessment of this risk involves a range of economic, political, social and other factors that are often difficult to isolate, analyse or predict. Political instability, strikes, changes in monetary policy and climatic conditions are all factors that may be relevant.

In assessing country risk, DBS considers whether the political instability of a country or the management of its economy is such that companies in the private sector might fail, despite their apparent strength. In addition, circumstances may exist where certain governments might prevent companies in their country from honoring their obligations.

DBS currently holds country provisions against Indonesia, Malaysia, Thailand, South Korea and The Philippines.

4.4 The Role of Regulators in Determining Provisions

In a number of Asian jurisdictions, the basis of determining provision levels is dictated by regulators or regulations and consequently may not meet internationally acceptable standards.

The DBSH financial statements are prepared using International Accounting Standards ["IAS"]. The bad and doubtful debt provisions included in their financial statements fall under these standards. Whilst the Monetary Authority of Singapore may provide detailed guidance on the computation of general, specific and country provisions, the bank's management and its external accountants have to be satisfied that the bank's provisions are in accordance with IAS and are comparable to other international banks. In this regard, in order to ensure that financial statements are prepared to meet IAS, DBSH may from time to time hold provisions that are in excess of those which would have been derived from regulatory guidance alone.

4.5 Sovereign Risk Provisions

Sovereign risk is the risk associated with lending to governments and quasi-government bodies. In assessing sovereign risk provisions a bank must consider the following:

- Whether a government can, by managing its country's economy, create the national resources and foreign

currency balances that are sufficient to meet the country's external debt obligations as they fall due. This requires an assessment not only of the quality of its economic management, but also of the economy itself and the actual or potential strains upon it;

- Whether, through taxation or borrowing, that government can obtain from domestic or international sources the funds it needs to settle its obligations; and
- Whether that government will in fact use the available funds to meet its obligations when they fall due.

There is a secondary market in problem country debt that provides a further basis for provisions if there is an intention to dispose of the debt. The liquidity and volatility of instruments traded in this market, and the degree of likelihood that it could in fact be used, must be taken into account when setting provisions.

DBS does not hold any separate Sovereign Risk provisions. All such risks are assessed in the overall consideration of Specific, General and Country Risks.

5. ACCOUNTING TREATMENT OF BAD AND DOUBTFUL DEBTS

The book entries associated with provisions for bad and doubtful loans are relatively simple and do not require any explanation. However, some of the underlying principles require consideration.

5.1 Loan interest

A bank is normally entitled to receive income on a loan until it is repaid or, if the borrower becomes insolvent and no assets remain. The fact that a bank has classified a loan as doubtful does not remove its entitlement to income; it merely casts doubt on whether the bank will be able to collect it. In these circumstances, the bank should continue to charge the customer's account with interest, the matching entries having in the past either been to credit the profit and loss account and raise provisions as appropriate, or to credit the interest to a suspense account, which is then netted against the balance due from the customer in the balance sheet. DBS uses a combination of the two methods depending on circumstances. However, the latter approach, which is known as the suspense method, is less prominent at DBS. It is a matter of judgement when the collectibility of interest becomes doubtful. Some banks may use the fact that interest is overdue by some given period as a starting point for identifying when this happens, although this should not lead automatically to interest being considered doubtful. In the United States, banks are required to suspend interest when repayments of principal or interest become overdue by more than 90 days.

The use of the suspense method of accounting for unpaid interest reduces the levels of provisioning that would otherwise be made. To avoid distorting comparisons, many banks disclose the amount held in suspense and movements to and from suspense. When there is no longer any realistic prospect of recovering the unpaid interest, the balance in suspense should be written off in the same way as the provision.

Where cash is received from borrowers with non-performing loans, payments are applied to cover uncollected interest before reducing overdue principal amounts.

As noted above, U.S. banks typically stop accruing interest when loans are overdue by 90 days or more, or when recovery is doubtful. DBS continues to charge interest to a doubtful customer's account for collection purposes, the interest being recognised as income with full provisioning. This addition of interest continues until such time as its recovery is considered to be unlikely. Whilst this practice does not affect net income, in comparison with U.S. practice, it has the effect of increasing the reported level of non-performing loans and provisions.

5.2 Write-offs

It is a matter of judgement when a bad loan should be written out of the accounting records completely. In principle, an irrecoverable loan, or portion of a loan, should be written off when there is no realistic prospect of recovery and the bank's normal relationship with the borrower has ceased to exist. The decision on timing is important because, when the loan is written off, the absolute level of provisions disclosed in the financial statements falls. It is important, therefore, that the banks implement write offs on a systematic and consistent basis.

DBS may write off problem loans more slowly than is the practice in other jurisdictions including the U.S. As a result, DBS may report a somewhat higher level of loans than if it had followed such U.S. practice and also a higher level of non-performing and classified loans. Net income, however, is unaffected.

5.3 Recoveries

Recoveries are the amounts that a bank receives from loans that it has previously written off. A common practice is to credit such amounts to the profit and loss account as a reduction in the aggregate charge for bad and doubtful loans. If significant recoveries occur frequently, this may indicate that the bank's policy for writing off loans is too conservative and needs to be reconsidered.

5.4 Provisions for predicted loan losses

There can be a timing difference between the reporting of income from assets and the provisions that have subsequently to be raised when the same assets are impaired. Provisioning usually coincides with the interruption in the revenue stream when the asset moves from performing to non-performing. Therefore, there is a double reduction in profits. In contrast, when the business cycle improves with new loans being added to the books and non-performing loans become performing there is a double boost to income with both an increased interest margin and the release of provisions.

Some regulators have suggested that fluctuations in the profit cycle could be addressed by setting aside a provision against the "expected loss" at the time a loan is made or by deferring the recognition of part of the income from new lending. This concept has not been universally accepted by bankers or accountants and is not currently practised at DBS.

5.5 Funding costs of doubtful loans

Where the collectibility of part of a loan is identified as doubtful the bank will not only incur a loss due to the need to provide against, and possibly ultimately write off, part of the loan principal. If, as is likely, the borrower also fails to pay the full amount of interest, the bank will be receiving a reduced amount of income while still paying the full cost of the deposits or other resources which are used to fund the loan.

Historically, DBS does not make provision for future funding costs of doubtful loans. This situation can be contrasted with that in the U.S. where accounting standards now require banks to consider the net present value of a loan, subject to the availability of any security, when assessing the amount of any bad debt provisions, called allowances for loan losses. This is usually achieved by estimating the future cash flows, including interest, and discounting these at the interest rate implicit in the loan. If the net present value is less than book value, then a provision is required. This approach automatically recognises funding costs by building in the time value of money.

5.6 Asymmetrical Provisioning - Effect of Operating in Different Jurisdictions

With the acquisition of subsidiaries in 1997, 1998 and 1999, DBS has had to consider its basis of loan classification and provisioning methodology in jurisdictions outside Singapore. It is quite common for global banks to adopt different non-performing loan classifications and provisioning policies to fit each of the various jurisdictions in which they operate, yet to ensure that head office and holding company consolidated financial reporting practices follow a consistent set of guidelines.

DBS' practice, in common with a number of global banks, is to record provisions for its overseas subsidiaries based on local regulatory requirements, and then, if necessary, to top-up any potential shortfalls when DBS' own (internationally acceptable) internal standards are applied to its overseas portfolio. As such, the DBSH Group consolidated financial statements reflect provisioning based on DBS standards. Local subsidiary accounts reflect only those provisions that are necessary to comply with local regulatory requirements.

It is therefore possible that a loan may have a provision of 50% in the subsidiary books in order to meet local regulatory requirements but will be provided at 100% in the DBSH consolidated accounts if so required by DBS' own standards.

Subtle differences in loan classification and provisioning are noted by DBS in operating its overseas subsidiaries. Table 2 sets out some examples in jurisdictions in which DBS has a presence.

6 PRINCIPLES OF LOAN GRADING

Many banks have introduced loan-grading systems to classify their exposures into a number of different categories. Letters, numbers or words may represent the categories but in essence the characteristics are the same. DBS currently uses the categories found in MAS Notice 612 for grading its loans.

TABLE 2

	SINGAPORE	THAILAND	HONG KONG
Provisions against non-performing loans	Required provisions are fully made.	Not all estimated provisions required to be booked against NPLs until 31 December 2000.	Required provisions are fully made.
Contingents included in non-performing loans?	Yes.	No.	Yes.
Collateral values used to determine provisions required	Yes but no specific requirement for discounting.	Yes but discounting required to be made against market values.	Yes but no specific requirement for discounting.
Restructured loans	Unwritten rule of no upgrading of restructured loans until 1 year after successful restructuring and satisfactory debt servicing record.	Loans can be upgraded 3 months after successful restructuring, or even immediately subject to specific requirements being met.	Specific rules on restructuring under certain circumstances.
Classification of non-performing loans	• Uses qualitative and quantitative characteristics. • Borrower basis	• Largely determined using timeband; some qualitative elements taken into account. • Account basis	• Largely quantitative criteria; some qualitative elements taken into account. • Borrower basis

MAS Notice 612 dictates that all Singapore banks are required to conduct systematic review of all credit facilities granted, and to classify the loans according to five categories[1] - "Passed", "Special Mention", "Substandard", "Substandard/Loss," "Doubtful" and "Loss". Over the years, DBS has built on the principles of MAS Notice 612 and developed its own set of internal loan classification guidelines, which are consistently adopted across the entire Group, including overseas branches and subsidiaries.

Essentially, a loan is a not classified loan if the borrower is able to service its obligations from normal sources of income. A non-classified loan is graded as "Passed" or "Special Mention", and a bank is not required to disclose as non-performing or make any specific provisions against such loans. Non-classified loans are also known as performing loans.

For classified loans, i.e. those graded "Substandard", "Substandard/Loss," "Doubtful" or "Loss", DBS is required to provide for deterioration in credit quality after taking into consideration the realisable value of the collateral. Classified loans are also disclosed as non-performing loans in the DBSH financial statements.

In computing the level of specific provision for non-performing loans, collateral values are discounted[2].

6.1 Qualitative Grading

As described in MAS Notice 612, the loan grading process involves both quantitative and, perhaps unusually qualitative considerations. The latter is not a practice that is common amongst Asian banks and requires a degree of management

1 (a) *Passed - to indicate loans with good credit quality;*
(b) *Special mention - to indicate evidence of potential weakness in the borrowers' credit worthiness;*
(c) *Substandard - to indicate that normal repayment may be in jeopardy by reason of an adverse trend of severe financial weakness;*
(d) *Substandard / Loss - to indicate classified loans where there is insufficient collateral and the unsecured or loss portion needs to be fully provided;*
(e) *Doubtful - to indicate that full liquidation of outstanding debt appears questionable and the account suggests that there will be a loss, the exact amount of which cannot be determined as yet; and*
(f) *Loss - to indicate outstanding debt regarded as uncollectible.*

2 *MAS requires collateral values to be discounted to realisable value. DBS internally adopts the following guidelines:*
(a) *For properties, a discount is applied to the valuation to arrive at forced sale value.*
(b) *For shares/deposits, which are marked to market, no discount is applied.*
(c) *For debentures, discount factors generally range from 1/3 to 2/3 of book value of assets.*

judgement. As such, grading levels may be influenced by the culture of the bank's management who are making the qualitative judgement. In general, the practice of introducing qualitative judgement into the grading process has the effect of increasing both non-performing loan and provision levels in comparison with banks which do not practise this.

An example of a qualitative judgement is to classify a loan on which payments are on schedule as substandard by virtue of the fact that the customer has negative net worth together with cash losses at the date of his last financial statements.

An example of a quantitative guideline is one where a loan has not been serviced for three months or more being automatically classified as substandard (or worse).

6.2 Treatment of Restructured or Rescheduled Loans

At DBS, a case will be classified as substandard (or worse) if there is a need to reschedule or restructure loan repayments due to the borrowers' inability to generate sufficient cash income to service the loan in accordance with its original terms.

Upon restructuring, DBS will take an immediate write-off for any haircut (discount) given to the borrower on principal repayment. This is accordance with accepted banking practice. It is the bank's policy, that most restructurings are carried out at interest rates which are on commercially the same terms or better than the original borrowings. In cases where the new terms are below funding or at reduced rates, the bank will take the related losses over the remaining period of the loans. Whilst this is a common practice in Asia, it is not so in the U.S.

For declassification purposes, a loan can be upgraded to performing only after the borrower has met the revised repayment schedule for a year. Whilst this period is considered to be prudent by DBS management, it is a far longer period than is applied by a number of other banks in Asia (or the U.S.). In a number of jurisdictions loans can be declassified as at the date of restructuring. As a result, DBSH may report a somewhat higher level of non-performing loans than if it had followed other countries' practices.

6.3 Disclosure of MAS Notice 612 Classified Loans as Non-Performing Loans in the DBSH Financial Statements

The current public financial disclosure on non-performing loans for Singapore banks specifies the reporting of all classified loans as defined by MAS Notice 612. The inherent assumption is that all classified loans are considered "non-performing". This may not necessarily always be the case.

For example, DBS grades certain performing loans as "Substandard" (or worse) for situations which warrant closer monitoring by risk managers, for example, credit facilities with technical breach of a loan covenant, or where borrowers are in a negative net worth position. Whilst these loans are classified under MAS Notice 612, and, as such, are disclosed as non-performing in the financial statements, they may not necessarily be considered non-performing under other authoritative reporting criteria. As at 31 December 1999, for example, S$1.35 billion of DBS Group's S$8.1 billion of loans, which were disclosed as non-performing, were technically performing cases.

To address this disclosure issue, as from 31 December 1999, DBS has included the following analyses of its loan portfolio:

- An analysis of the loan portfolio setting forth classified and non-classified loans under MAS Notice 612 criteria set forth on page 102 of the Annual Report; and
- An analysis of the loan portfolio setting forth performing and non-performing loans using US Securities and Exchange Commission ("SEC") requirements[3] applicable to bank holding companies which is set forth in Table 3.

DBS believes that these additional disclosures will ensure not only comparability amongst the Singapore banks but also allow for greater understanding of DBS' non-performing loan position by its shareholders and other international constituents.

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3 Under the SEC requirements, "non-performing loans" are defined as those in the following categories:

(a) Non accrual loans;

(b) Accrual Loans which are contractually past due 90 days or more as to principal or interest repayment and;

(c) Troubled debt restructuring.

TABLE 3

In S$' million	31 December 1999	31 December 1998
Singapore		
Non accrual loans	**1,858.8**	1,788.8
Non-Restructured	**1,471.1**	1,515.7
Restructured	**387.7**	273.1
Regional Countries		
Non accrual loans	**4,172.9**	4,086.9
Non-Restructured	**3,665.7**	4,056.8
Restructured	**507.2**	30.1
Other Countries		
Non accrual loans	**769.7**	267.2
Non-Restructured	**695.4**	265.8
Restructured	**74.3**	1.4
	6,801.4	6,142.9
Loans not included above which are accruing, but classified troubled debt restructuring	**7.3**	-
Total	**6,808.7**	6,142.9

NB. There are no non-accruing loans which are contractually past due 90 days or more with regard to principal or interest payments. These loans are classified as NPLs under MAS guidelines for which the practice is not to recognise interest income until received.

6.4 Loan Grading in non-Singapore subsidiaries

DBS has adopted a policy that its non Singapore subsidiaries will report non-performing loan information in accordance with the prevailing regulations of the entity in which it is booked. However, the DBSH financial statements will disclose non-performing loans on a group basis in accordance with the guidelines set out in the paragraphs above.

As such, a newly restructured loan which is not considered non-performing under Bank of Thailand requirements for example, will be reported as performing in the DBS Thai Danu Bank financial statements. The same loan will be reported as non-performing in the DBSH financial statements until DBS' own policies allow for declassification. The effect of this policy is that non-performing loans, and related provisions, are higher in DBS' accounts than comparable Asian banks.

6.5 Loan Security

A bank may lend with or without security.

When it takes security, the bank does not usually do so with the expectation or intention of obtaining repayment of the loan by realising that security. It takes security as a means of reducing the risk that a loan will not be recovered in full, if the borrower defaults. Some of the types of assets typically used as security are (a) land and buildings; (b) trading assets of a business; (c) stocks and shares; (d) ships and other specialised assets; and (e) deposits and placements. In assessing the value of security, banks often apply percentage discounts to such assets. Discounts might vary from 20% (for example in the case of Singapore properties) to more than 50% (for fixed and floating charges over assets of a business). In essence, the discount applied varies with the type and quality of the security.

Land and buildings, commercial and residential, form a significant portion of loan security at DBS today. Historically, residential property security has carried a relatively low degree of risk for a bank, provided that the property is adequately covered by insurance and the bank has not lent too high a percentage of the property's value. DBS generally lends up to 80% of security valuation on mortgage facilities at inception.

Commercial property, on the other hand, may expose a bank to much greater risk due to short-term fluctuations in market demand. Overall, local, regional and international conditions, such as high unemployment, high interest rates and political uncertainty, can all have an adverse effect on realisable values of property held as collateral as can the timing and enforceability of security interests.

Bank deposits traditionally represent first class security, so long as a block on withdrawal remains effective. The value of stocks and shares can fluctuate significantly over the short-term, depending on market conditions and liquidity.

Under Singapore regulatory regime, the MAS requires collateral value to be discounted. DBS internally adopts the guidelines at Table 1.