

Pursuant to the Articles 89 and 90 of the Banking Law ("Official Gazette of the Republika Srpska", number: 04/17 and 19/18), Articles 5(1)(b), 20(2)(b) and 37 of the Law on the Banking Agency of the Republika Srpska ("Official Gazette of the Republika Srpska", number: 59/13 and 04/17), Articles 6(1)(b) and 19(1)(b) of the Statute of the Banking Agency of the Republika Srpska ("Official Gazette of the Republika Srpska", number: 63/17), the Management Board of the Banking Agency of the Republika Srpska adopted at its 11<sup>th</sup> session held on May 28<sup>th</sup>, 2019

**DECISION  
ON CREDIT RISK MANAGEMENT AND  
DETERMINATION OF EXPECTED CREDIT LOSSES**

**1. General Provisions**

**Subject Matter of the Decision  
Article 1**

- (1) This Decision stipulates:
  - 1) credit risk management rules,
  - 2) manner of classification of exposures into credit risk stages and determination of expected credit losses,
  - 3) eligible collateral for the purposes of determination of expected credit losses,
  - 4) eligible collateral for the purposes of setting exposure limits with reference to eligible capital,
  - 5) treatment of foreclosed assets collected in the recovery process,
  - 6) manner of reporting to the Banking Agency of the Republika Srpska (hereinafter: Agency).
- (2) This Decision stipulates the minimum requirements, while banks may apply stricter requirements.
- (3) This Decision's provisions shall apply to banks headquartered in the Republika Srpska and licensed by the Agency.
- (4) Banks shall apply this Decision's provisions on individual and consolidated basis.
- (5) Instruction on Financial Assets Classification and Valuation (hereinafter: Instruction) defines in greater detail specific provisions of this Decision with a view to ensuring a unified accounting and regulatory treatment of financial assets.
- (6) Provisions of the Banking Law or other bylaw shall apply to the matters relating to credit risk management in banks that were not defined by this Decision, but are defined by the Banking Law or other bylaws.

**Definitions  
Article 2**

- (1) Terms used in this Decision shall have the following meanings:
  - 1) **Exposure** means gross carrying value of an on-balance sheet and off-balance sheet asset item.

- 2) **Non-performing exposure** means:
  1. exposures in default, i.e. exposure classified into credit risk stage 3 from Article 20 of this Decision, and
  2. exposure valued at fair value through profit or loss account that meets the requirement for classification into credit risk stage 3.
- 3) **Non-performing loan** means:
  1. loan in default, i.e. loan classified into credit risk stage 3 from Article 20 of this Decision, and
  2. loan valued at fair value through profit or loss account that meets the requirement for classification into credit risk stage 3.
- 4) **Expected credit loss (ECL)** means impairment of on-balance sheet exposure and loss allowance for expected credit losses for off-balance sheet exposures that are accounted for by the bank through profit or loss account, which shall be determined in accordance with the provisions of this Decision and the Instruction.
- 5) **External credit assessment institution (ECAI)** has the same meaning as in the Decision on Bank Capital Calculation.
- 6) **Accounting write-off** means transfer of on-balance sheet exposure to off-balance sheet records, with the bank retaining the right to take further measures to collect the claims from the debtor.
- 7) **Permanent write-off** means a write-off of on-balance sheet exposure that leads to derecognition of the entire exposure or a portion thereof in the bank's accounts (on-balance sheet and off-balance sheet records).
- 8) **Modification of exposure** means a process whereby the terms of the original contract of such exposure are changed, where modification can be:
  - 1) triggered by the debtor's current needs (e.g. effective interest rate reduction due to changes in the market, collateral change, etc.), and not by the debtor's financial distress,
  - 2) triggered by the debtor's current financial distress or distress that will arise soon, i.e. deterioration of their creditworthiness, timeliness in meeting of their obligations to the bank or other creditors (the term: forbore exposure shall be used hereinafter for this type of modification).
- 9) **Eligible collateral** means a collateral that can be taken into account by the bank when assessing future cash flows for the purposes of determining expected credit losses, which must meet all requirements relating to collateral set out in this decision.
- 10) **Haircut** means a factor used by the bank to adjust the value of estimated future cash flows from an eligible collateral with reference to the collateral's market value, taking into account relevant internally estimated recovery deadline, and for calculation of the exposure amount secured by the eligible collateral for the purposes of applying Article 25(1) and (2) of this Decision.

- 11) **Independent appraiser** means a person employed in the bank or engaged by the bank, who has required professional qualifications, technical competence, experience and relevant authorization (license, decision and similar) required for determination of the value of immovable or movable property, and has a good knowledge of immovable and movable property market.

Independent appraiser or a member of their immediate family must not:

- 1) be involved in the exposure approval process or in intermediation, sale or leasing of the immovable or movable property,
- 2) have legal or business relationship with the debtor, save for the valuation operation,
- 3) be a related party to the buyer or seller of the movable or immovable property,
- 4) have their own interests with regard to the outcomes of the final report determining the market value of the immovable or movable property, save for the remuneration for the valuation performance.

The level of remuneration that shall be received by the independent appraiser must not depend on the valuation outcomes, while the independent appraiser shall prepare a clear, transparent, and objective report on the valuation of the immovable or movable property, in accordance with the professional rules and standards.

- 12) **Interest rate-induced credit risk** means a risk of loss that the bank taking the credit risk from the exposures relating to variable interest rate is additionally exposed to.

- 13) **Material amount** for the purposes of determining the number of overdue days has the same meaning as in the Decision on Bank Capital Calculation.

- 14) **Determination of the number of overdue days** has the same meaning as in the Decision on Bank Capital Calculation.

- (2) The terms not defined by this Article and used in this Decision have the meaning in accordance with the laws and other bylaws.

## **2. Credit Risk Management Rules**

### **Credit Risk Management Rules**

#### **Article 3**

- (1) In addition to the stipulated general and special risk management standards relating to the establishment and application of the internal governance system in banks, banks shall meet the requirements relating to special credit risk management rules stipulated by Articles 4-16 of this Decision.
- (2) Banks shall ensure that the annual internal audit activity plan includes a review of the compliance with the credit risk management rules from Paragraph (1) of this Article.

## **Bank's Internal Regulations**

### **Article 4**

- (1) Banks shall approve and implement adequate credit risk management strategies, policies and procedures, setting out clearly and in detail competences and responsibilities of the competent bodies and employees in the bank.
- (2) Banks shall manage credit risk at the level of individual exposures and at the level of the bank's entire portfolio, i.e. establish and implement an adequate and efficient system of ongoing monitoring of credit risk bearing individual exposures and entire portfolio, and ensure that the level, composition and quality of its portfolio are compliant with the adopted credit risk management strategies and policies.
- (3) Banks shall approve internal methodologies defining the manner of classification and valuation of exposures, their classification into credit risk levels and determination of expected credit losses, which shall be compliant with the requirements stipulated by this Decision and the Instruction.
- (4) Methodologies from Paragraph (3) of this Article shall be adopted by the bank's supervisory board, while the bank's management shall ensure consistent application of adopted methodologies, adequate monitoring and efficient system of internal controls of their application, establish an adequate reporting system, and propose revisions thereto where necessary.
- (5) The bank's internal audit function shall evaluate on a regular basis adequacy of all elements of the bank's established methodologies and procedures for classification and valuation of exposures, including evaluation of adequacy of the internal controls system within these procedures, and shall provide recommendations for remedying weaknesses and deficiencies identified.

## **Organizational Requirements**

### **Article 5**

- (1) Banks shall ensure a clear operational and organizational separation of transaction contracting function from support and risk management function, including governance and managerial levels.
- (2) Banks shall establish a clear and consistent organizational structure that shall ensure definition of:
  - 1) criteria and procedures for approval of new exposures or modification of existing exposures,
  - 2) exposure approval rules at the level of individual debtors and at the level of related party group,
  - 3) competences of the supervisory board and the management, as well as the committees appointed by them, and authorizations of specific managerial levels for approving risk exposures.
- (3) Banks shall ensure a prior opinion of the person charged with credit risk assessment in the bank for approval of all material exposures from the aspect of credit risk exposure determined based on net assets level in accordance with the Instruction.

- (4) Banks shall define exposure approval rules and responsibilities in exceptional cases when the person charged with transaction contracting and the person charged with credit risk assessment in the bank cannot agree on an exposure approval.
- (5) Exceptionally, if a bank is approving exposures that do not require an opinion of the person charged with credit risk assessment in the bank from Paragraph (3) of this Article, exposure approval decisions may be made within the transaction contracting function. In such case, the bank shall stipulate criteria for identifying exposures not requiring an opinion of the person charged with credit risk assessment in the bank, rules for approving such exposures, allowing for them to be grouped according to similar characteristics, and rules for their monitoring on a group basis, which must be performed within the risk management function.
- (6) Banks cannot within the transaction contracting function determine and account for expected credit losses.

### **Loan Process**

#### **Article 6**

Banks shall adopt adequate policies and procedures and establish an adequate loan process that shall include, as a minimum:

- 1) exposure approval,
- 2) exposure riskiness monitoring,
- 3) credit risk exposure analysis,
- 4) early warning system for increased credit risk,
- 5) non-performing exposure treatment,
- 6) forborne exposure treatment,
- 7) classification of exposures into credit risk stages,
- 8) loan file keeping and its contents.

### **Exposure Approval**

#### **Article 7**

- (1) Banks shall, prior to a credit exposure approval and any increase in credit exposure, assess comprehensively and adequately the debtor's creditworthiness, taking into account internally stipulated criteria and this Decision's requirements. Banks shall at least annually review stipulated criteria and adjust them, if necessary, to improve debtor creditworthiness assessment procedures.
- (2) Banks shall, prior to a credit exposure approval, assess the quality, marketability, availability and value, and legal validity of a collateral. If the collateral's value depends to a great extent on the third party collateral provider's creditworthiness, the bank shall also assess their credit worthiness.
- (3) Banks shall establish a reliable process for assessing the debtor's ability to meet their obligations under the terms agreed and review such process in regular intervals.
- (4) Banks shall, when analyzing the recoverability of an exposure, firstly take into account the debtor's creditworthiness, while considering the collateral received for such exposure only as a secondary source of repayment.
- (5) Banks shall approve a policy defining the types of collateral accepted by them as a security for an exposure and a collateral valuation methodology.

(6) Banks shall, in accordance with Paragraph (1) of this Article, stipulate in detail by internal regulations criteria to be taken into account by them when assessing the creditworthiness of a debtor, manner of the performance of an assessment and finding of facts relevant to the assessment, while including at least the following criteria:

1) for legal entities:

1. identifying the objective, i.e. use of an exposure,
2. the debtor's cash flows realized in the previous period and estimated future cash flows with reference to their obligations,
3. competence of the management and executives, quality of the plans and programs for whose realization the bank shall provide financial support,
4. the debtor's character, integrity and reputation, i.e. correctness of their intentions and conduct in business activities and toward the bank, with important factors comprising available information on the timeliness in meeting their obligations to the bank, other banks, other obligations to other creditors, on financial offenses, etc.
5. the debtor's liquidity and profitability,
6. the level of capital and reserves held by the debtor and their share in the balance sheet, and the debtor's asset quality
7. the debtor's means,
8. the debtor's indebtedness level, including the level and maturity of the debtor's obligations, and an analysis of the guarantees issued,
9. the terms on which the debtor operates and the debtor's outlook, and their market position, as well as the position of the entire industry that the debtor is in,
10. the debtor's exposure to currency-induced credit risk under the bank's claims with a currency clause, claims in foreign currency, including the debtor's off-balance sheet obligations with a currency clause and off-balance sheet obligations in foreign currency and with interest rate-induced credit risk under claims agreed at a variable interest rate. The bank should thereby assess credit risk also from the aspect of a potential change in the debtor's financial position due to a change in the exchange rate of BAM to the currency of the exposure or in the interest rate, i.e. assess the debtor's ability to meet the obligations to the bank under the terms agreed in the event of a potential change in such exchange rate or interest rate. The bank shall pay special attention to the exposures with a currency clause in foreign currency in cases when the debtor has no sources of income in the same currency as the exposure. The bank shall not be required to assess currency-induced credit risk for the exposures with a currency clause in EUR in the light of there being a currency board in Bosnia and Herzegovina.

2) for natural persons:

1. identifying the objective, i.e. use of a credit exposure,
2. the debtor's cash flows realized in the previous period and estimated future cash flows with reference to their obligations,
3. the debtor's means,
4. the debtor's indebtedness level, and an analysis of the guarantees issued,
5. the debtor's character, integrity and reputation, i.e. correctness of their intentions and conduct toward the bank, where the bank should take all

reasonable measures to, in addition to the data on repayment of loan obligations, also collect relevant data on the timeliness in repayment of other obligations and assess the impact on the debtor's future cash flows in case of there being significant outstanding obligations,

6. the debtor's exposure to currency-induced credit risk under the bank's claims with a currency clause, claims in foreign currency, including the debtor's off-balance sheet obligations with a currency clause and off-balance sheet obligations in foreign currency and with interest rate-induced credit risk under claims agreed at a variable interest rate. The bank should thereby assess credit risk also from the aspect of a potential change in the debtor's financial position due to a change in the exchange rate of BAM to the currency of the exposure or in the interest rate, i.e. assess the debtor's ability to meet the obligations to the bank under the terms agreed in the event of a potential change in such exchange rate or interest rate. The bank shall pay special attention to the exposures with a currency clause in foreign currency in cases when the debtor has no sources of income in the same currency as the exposure. The bank shall not be required to assess currency-induced credit risk for the exposures with a currency clause in EUR in the light of there being a currency board in Bosnia and Herzegovina.
- (7) Additionally, the creditworthiness assessment of a debtor established in the two years immediately preceding the day when the assessment is performed (newly established corporates), as well as a debtor established with a special purpose, i.e. for the implementation of a predefined project (project financing), shall be performed by the bank based on an assessment of such debtor's ability to realize adequate cash flows ensuring timely meeting of obligations according to the timeline agreed for the repayment of claims. When performing such an assessment, the bank shall take into account at least:
  - 1) estimate of the future cash flows of such an investment (business plan, financial projections, investment payback period evaluation, project risk sensitivity analysis, etc.) in case of newly established corporates,
  - 2) estimate of the project's future cash flows (business plan, financial projections, investment payback period evaluation, project risk sensitivity analysis, etc.), as well as continuous monitoring of such project's implementation in case of project financing,
  - 3) available financial statements.
- (8) The requirement to perform a creditworthiness assessment shall apply to all participants in the contractual relationship, i.e. the bank shall also perform a creditworthiness assessment of the co-signer, guarantor or guarantee provider as well as the related party group (where applicable), and the collateral provider only in cases from Paragraph (2) of this Article.
- (9) Banks shall make credit exposure approval decisions based on appropriate and clearly defined criteria, and define exposure approval and modification decision-making procedures.

## **Exposure Riskiness Monitoring**

### **Article 8**

- (1) Individual exposure monitoring shall include an assessment of the creditworthiness of the debtor, debtor's related party group, and the quality, marketability, availability, value, and legal validity of the collateral over the duration of the contractual relationship underlying the exposure concerned.
- (2) The bank shall monitor the fulfillment of requirements from the contract by the debtor, and, in case of purpose-specific exposures, it shall also monitor the use of the disbursed funds in accordance with the approved/agreed purpose.
- (3) Banks shall establish individual exposure monitoring to allow appropriate measures to be taken to mitigate credit risk in case of deteriorated creditworthiness of the debtor or collateral provided if the collateral's value depends largely on the creditworthiness of the third-party collateral provider.
- (4) Banks shall adopt procedures setting out collection and monitoring of all relevant information that may indicate increased exposure riskiness and changed value of the collateral, as well as procedures for reporting on such information by all authorized employees who are involved in the credit risk management process, in order to perform timely and adequately exposure riskiness assessment.
- (5) The bank shall collect at least annually the debtor's official financial statements filed with the competent register, and perform an analysis of the financial position to detect deteriorations requiring measures to be taken by the bank. When carrying out this analysis, the bank should collect and analyze independent auditor's reports on the debtor's financial statements for the debtors who have their financial statements audited and for the debtors who are required to have their financial statements audited under the provisions of the Law on Accounting and Auditing of the Republika Srpska and the Law on Accounting and Auditing of the Federation of Bosnia and Herzegovina.

## **Credit Risk Exposure Analysis**

### **Article 9**

- (1) Banks shall establish a system for an ongoing analysis of the loan portfolio's composition, quality and trends, including an analysis of the risks arising from the concentrations present in the loan portfolio. The bank shall take these analyses into account when defining credit risk taking and credit risk management strategies and policies.
- (2) Loan portfolio monitoring and analysis must be established to allow appropriate measures to be taken in a timely fashion to mitigate credit risk

## **Early Warning System for Increased Credit Risk**

### **Article 10**

- (1) Banks shall establish an early warning system to allow timely identification of debtors with an increased credit risk and keep records of such exposures, i.e. they must be included in the list of debtors that need to be especially monitored by the bank (watch list).

- (2) Banks shall define appropriate qualitative and quantitative indicators for early detection of increased credit risk.
- (3) An early warning system shall be based on internal (e.g. internal credit rating) or external indicators (e.g. credit ratings by external credit assessment institutions, specific sector surveys, macroeconomic indicators for specific geographic areas, etc.), and should allow identification of the deteriorated credit quality of an exposure at the earliest time, both on individual and group basis, for the exposures with similar characteristics.
- (4) The bank shall also include in the list from Paragraph (1) of this Article the bank's new debtors for whom it was identified during the creditworthiness assessment that they had been classified into a higher credit risk level in other bank.

### **Treatment of Non-Performing Exposures**

#### **Article 11**

- (1) Banks shall establish an adequate non-performing exposure treatment framework, which shall include:
  - 1) the manner of non-performing exposure identification, measurement, monitoring and supervision, as well as measures for avoidance of origination of such exposures,
  - 2) approval of a strategy for non-performing exposure treatment in short term (up to one year), in medium term (from one to three years), and long term (period longer than three years), including targeted non-performing exposure levels,
  - 3) operational annual non-performing exposure treatment plans, including exposures in enforcement proceedings,
  - 4) implementation of the operational non-performing exposure treatment plan,
  - 5) full integration of the strategy for non-performing exposure treatment into the bank's management processes, including regular monitoring and independent supervision of these processes.
- (2) The bank shall analyze the impact of non-performing exposures on the own funds, profitability, liquidity, and the bank's other performance indicators.
- (3) When setting strategic goals from Paragraph (1)(2) of this Article, the bank shall take into account:
  - 1) non-performing exposure monitoring and forbearance strategy,
  - 2) non-performing exposures active reduction strategy,
  - 3) change of the exposure type or debt for equity swap,
  - 4) different legal avenues, such as bankruptcy or extrajudicial settlement.
- (4) Banks shall establish a permanent and efficient function responsible for nonperforming exposure monitoring and treatment, which shall be independent of, and separate from, the transaction contracting function.
- (5) In its internal non-performing exposure treatment regulations, the bank shall:

- 1) stipulate policies, methods and frequency of the valuation of collaterals in the form of immovable and movable property, supervision and control of such valuation, as well as criteria for independent collateral appraisers,
  - 2) stipulate decision-making criteria, process and levels for taking appropriate legal actions required for collateral activation and realization,
  - 3) stipulate decision-making criteria, process and levels for accounting write-off of exposures in default, where it shall:
    1. perform accounting write-off of an on-balance sheet exposure two years after the bank accounted for expected credit losses in the amount of 100% of gross carrying value of such exposure and declared it fully matured, except for the exposures under financial leasing,
    2. keep detailed records of the exposures for which it performed accounting write-off and all activities it has undertaken to recover the claims, which shall be available for the purposes of internal and external controls, i.e. supervision of the bank.
  - 4) stipulate decision-making criteria, process and levels for permanent write-off of exposures,
  - 5) take into account consumer protection regulations.
- (6) The bank whose share of non-performing loans in total loans has been greater than 5% for three months continuously shall provide to the Agency:
- 1) the non-performing exposure treatment strategy, as well as the amendments thereto, within seven days from the day of its adoption by the supervisory board,
  - 2) operational plans by February 28<sup>th</sup> in the year for which the operational plans are approved, save for the initial operational plan that shall be submitted by the bank one month after meeting the requirements from Paragraph (6) of this Article, which shall be prepared by it for the period from the moment of meeting the requirements until December 31<sup>st</sup> of that financial year,
  - 3) report on the implementation of operational plans from Subparagraph (2) of this Paragraph on a quarterly basis, within 30 days from the day of the expiry of the reporting quarter.
- (7) If the Agency has identified that there are significant differences between the implemented activities and activities defined by the operational plan, the Agency may order the bank to take additional organizational or other measures required for improving management of credit risk arising from non-performing exposure portfolio.

### **Forborne Exposure Treatment Article 12**

- (1) The bank shall adopt and implement forborne exposure treatment policies, which shall include at least the following:
- 1) process and procedure for approving forbearance measures, manner of decision making on forbearance measures, including persons and functions involved in such process, where it shall take into account measures whereby sustainable debt repayment would be enabled and enforcement cases would be avoided,

- 2) use of specific short-term and long-term forbearance measures depending on the reasons for which the exposures were classified into credit risk stage 2 or 3,
  - 3) description of available forbearance measures,
  - 4) information that shall be taken into account when deciding on the feasibility of forbearance measures, process and procedures for monitoring and supervision of forbearance measures.
- (2) Based on the performance outcomes of the forbearance measures implemented, the bank shall update on a regular basis the forbore exposure treatment policies.
  - (3) Before making a decision on forbearance, the bank shall assess the economic feasibility of the forbearance of exposures to an individual debtor or related party group. If the forbearance of credit exposures is economically feasible, the bank shall establish an adequate forbearance plan and monitor its implementation and effects.
  - (4) When determining the sustainability of forbearance of exposure of an individual debtor or related party group, the bank shall have:
    - 1) detailed analysis of the reasons that led to distress in the business operations of the debtor, if applicable, the related party group,
    - 2) the debtor's operational, financial and ownership restructuring plan, if applicable, and
    - 3) cash flow projection for the period defined by the restructuring plan.
  - (5) Based on information from Paragraph (4) of this Article, the bank shall prepare:
    - 1) an assessment of the feasibility of the debtor's operational, financial and ownership restructuring plan, if applicable,
    - 2) an analysis of potential exposure forbearance methods and arguments for the method chosen,
    - 3) a new repayment schedule, which will be the basis for monitoring of the exposure forbearance plan's implementation.
  - (6) Before approval of any forbearance measure, the bank shall perform a creditworthiness assessment of the debtor or, if applicable, the related party group.
  - (7) After approval of forbearance measure, the bank shall continuously monitor the implementation of the overall forbearance and cash flow plan of the debtor (and, if applicable, the related party group), if the bank's exposure is individually significant from the aspect of credit risk exposure under the Instruction depending on the size of the bank's net assets, namely at least on a three-month basis if the exposure has been classified into credit risk stage 3, and at least on a semi-annual basis if the exposure has been classified into credit risk stage 2.

### **Exposure Classification into Credit Risk Stages Process**

#### **Article 13**

The bank shall establish an adequate process for exposure classification into credit risk stages and for determination of expected credit losses under the provision of this Decision and the Instruction.

## **Loan File Contents and Keeping**

### **Article 14**

- (1) The bank shall approve and implement exposure record-keeping procedure and designate functions responsible for completeness and integrity of individual loan files.
- (2) The manner of loan file keeping and its minimum contents were stipulated through a decision regulating documentation of the bank's credit activities.

## **Currency-Induced Credit Risk and Interest Rate-Induced Credit Risk**

### **Article 15**

- (1) The bank shall include in its credit risk management system also the management of:
  - 1) currency-induced credit risk, and
  - 2) interest rate-induced credit risk.
- (2) Within the process of approval of exposures in foreign currency or with a currency clause and/or credit exposures with a variable interest rate, the bank shall define criteria for debtor creditworthiness assessment. The criteria shall include at least an assessment of a significant increase in the debt repayment amount in case of significant negative fluctuations in the respective variable parameters.
- (3) The bank shall take into account the outcomes of assessment from Paragraph (2) of this Article when determining the debtor's creditworthiness.
- (4) The bank shall ensure that management system from Paragraph (1) of this Article allows at least:
  - 1) identification of debtors exposed to risks from Paragraph (1) of this Article,
  - 2) determination of expected credit losses for exposures subject to risks from Paragraph (1) of this Article in case of changes in currency exchange rate or interest rates,
  - 3) matching of credit exposures to respective hedging instruments used by the bank, if applicable.
- (5) The bank shall not be required to implement requirements from Paragraphs (2) and (4) of this Article for exposures with a currency clause in EUR in the light of there being a currency board in Bosnia and Herzegovina.
- (6) If the banks uses risk hedging instruments from Paragraph (4) of this Article, it shall define in its internal regulations manners of credit exposure hedging.
- (7) For risks from Paragraph (1) of this Article, the bank shall perform a stress test. It shall thereby take into account the link between currency exchange rate and/or interest rate evolution and increase in the repayment amount under credit exposures measured by total payments under credit exposure to revenues, i.e. debtor's income ratio.

## **Concentration Risk**

### **Article 16**

- (1) The bank shall include in its concentration risk management policy at least:
  - 1) concentration relating to a single party or related party group,
  - 2) concentration relating to a group of exposures that are related by the same or similar sources of risk origination, such as: same sector of economy,

geographic area, same types of business operations, same type of products, application of the same credit risk mitigation techniques (same credit hedging instrument or same credit hedging provider),

- 3) concentration relating to the entire loan portfolio.
- (2) The bank shall approve adequate concentration risk monitoring and mitigation methodologies, which shall include at least:
  - 1) active credit exposure portfolio diversification management,
  - 2) setting of concentration limits, which shall be reviewed and adjusted on a regular basis,
  - 3) credit risk transfer, i.e. mitigation.
- (3) Limit of exposure after impairment for expected credit losses accounted for that is not collateralized (deposit and/or eligible collateral from Article 28 of this Decision) to a single party or related party group shall be 5% of the bank's eligible capital. The amount of an exposure above 5% of eligible capital must be secured by an eligible collateral whose value is at least 50% greater than the amount of the exposure above 5% of eligible capital, where haircuts provided for in Table 4 from Article 29 of this Decision shall not be taken into account for collateral valuation.

### **3. Exposure Classification into Credit Risk Stages and Determination of Expected Credit Losses**

#### **Classification into Credit Risk Stages and Determination of Expected Credit Losses Article 17**

- (1) The bank shall classify each exposure valued at amortized cost and at fair value through other comprehensive income into one of the following categories:
  - 1) credit risk stage 1 – low level of credit risk (English: performing),
  - 2) credit risk stage 2 – increased level of credit risk (English: underperforming), and
  - 3) credit risk stage 3 – exposures that were impaired, i.e. exposures in default (English: non-performing).
- (2) POCI assets identified under Article 21 of this Decision shall be classified on initial recognition into credit risk stage 3, and they can be later classified into credit risk stage 2 under the provisions of Article 22(3)(2)(1) of this Decision,
- (3) Over the duration of the contractual relationship, the bank shall perform classification into adequate credit risk stages and assess and account for expected credit losses on a regular basis, and at least on a monthly basis (on the last day of a month), in accordance with the provisions of this Decision and the Instruction.
- (4) The bank may not classify a modified exposure on initial recognition into a credit risk stage that is lower than the one into which the original exposure had been classified before modification was made.

- (5) Claims on a corporate to which the bank approved an exposure whereby a claim on other related party with the same bank is settled indirectly or directly, in part or in full, may not be classified on initial recognition into a better credit risk stage than the credit risk stage into which the exposure that is being settled was classified.
- (6) None of the criteria from this Decision and the Instruction may prevent the Agency's authorized persons from performing and ordering the bank to perform a classification into a higher credit risk stage if they consider this justified and, accordingly, order the bank to calculate and account for an adequate stage of expected credit losses.

### **Credit Risk Stage 1**

#### **Article 18**

- (1) The bank shall classify the following exposures into credit risk stage 1:
  - 1) exposures with a low credit risk from Paragraph (2) of this Article,
  - 2) exposures whose credit risk was not significantly increased after initial recognition, and under which the debtor is not overdue on a repayment in a material amount for more than 30 days,
  - 3) exposure modifications from this credit risk stage that were not triggered by the debtor's financial distress, but by their current needs (e.g. effective interest rate reduction due to changes in the market, collateral change, etc.), and under which the debtor is not overdue on a repayment in a material amount for more than 30 days.
- (2) Low risk exposures shall be considered to be:
  - 1) exposures to the Central Bank of Bosnia and Herzegovina,
  - 2) exposures to the Council of Ministers of Bosnia and Herzegovina, Government of the Republika Srpska, Government of the Federation of Bosnia and Herzegovina and Government of the Brcko District of Bosnia and Herzegovina, and
  - 3) exposures to central governments and central banks outside of Bosnia and Herzegovina for which there is a credit assessment by a recognized external credit assessment institution which shall, under Article 69 of the Decision on Bank Capital Calculation, be classified into credit quality step 1 or 2.
- (3) If there is no material amount that is overdue for more than 60 days, the bank shall not be required to consider indicators for determination of a significant increase of credit risk from Article 19(4) of this Decision for exposures from Paragraph (2) of this Article.

### **Credit Risk Stage 2**

#### **Article 19**

- (1) The bank shall classify exposures whose risk increased significantly after initial recognition into credit risk stage 2.
- (2) Repayment of obligations to the bank in a material amount that is overdue for more than 30 days, save for cases where the bank can prove that being overdue is not a result

of a significant increase of credit risk (being overdue due to a technical error), is a mandatory criterion for exposure classification into credit risk stage 2, save for cases from Article 18(3) of this Decision.

(3) Being overdue caused by a technical error from Paragraph (2) of this Article shall entail the following situations:

1) that the debtor made a payment through other bank (or in a post office) and has a proof of this, but the payment transaction was not realized on time,

2) that the debtor made a payment in the bank, which was not realized due to an error on the side of the employee who received the payment,

3) that the debtor made a payment in the bank, but it was not posted on time to the respective credit sub-account.

(4) The bank shall define by internal regulations other indicators for identification of significant increase of credit risk (SICR) from Paragraph (1) of this Article, thereby taking into account at least the following indicators:

1) increase of PD parameter under the bank's internal methodology,

2) deterioration in the debtor's internal or external rating in the manner defined by the bank's internal methodology,

3) deterioration in the financial indicators of the debtor or related party group to which the debtor belongs (liquidity ratio, significant loss, financial liabilities/EBITDA, etc.), with the bank stipulating through its internal regulations the intervals of deterioration of such indicators,

4) move to the list of exposures that should be especially monitored by the bank (watch list), save for the clients who are an integral part of the watch list under Article 10(4) of this Decision,

5) the debtor's account was blocked.

(5) The bank should not limit itself to indicators from Paragraph (4) of this Article and indicators defined through its internal regulations and view them as a check list, but it shall also take into account other available information during credit risk assessment, in order to identify significant increase of credit risk situations as prudently as possible.

(6) In case of forborne exposures, the bank may classify into credit risk stage 2 only forborne exposures that at the time of approval were not classified into credit risk stage 3, which do not meet the requirement from Article 20(3)(4) of this Decision, as well as other requirements for classification into credit risk stage 3.

### **Credit Risk Stage 3 Exposures in Default Article 20**

(1) The bank shall classify exposures into credit risk stage 3, i.e. into default, when one or both of the following requirements have been met:

1) the debtor is overdue on a repayment of past due obligations to the bank for more than 90 days in a material amount,

2) the bank considers it certain that the debtor will not fully meet their obligations to the bank without recourse to realization of collateral (English: Unlikelihood to Pay – UTP).

(2) Forborne exposures that at the time of modification were classified into credit risk stage 3 shall be maintained as being in default until such time when the requirements under the provisions of Article 22 of this Decision have been met.

(3) For the purposes of Paragraph (1)(2) of this Article, it shall be considered certain that the debtor will not fully meet their obligations to the bank in the following situations:

- 1) if there is an objective proof that the exposure's value was impaired,
- 2) if the debtor is facing significant financial distress,
- 3) if the bank sold the same debtor's other exposure at a significant economic loss,
- 4) if the bank has agreed to modify the exposure due to the debtor's current financial distress or distress that will arise soon, which will likely result in a reduced financial liability of the debtor due to a significant write-off or deferred payment of the principle, interest or, where necessary, the fees,
- 5) if bankruptcy proceedings or winding down of the debtor have been initiated,
- 6) if the debtor has not met their obligation to the bank no later than within 60 days from the day when the previously issued guarantee was called on.

(4) The bank should not limit itself to cases specified in Paragraph (3) of this Article, but should also define precisely through its internal regulations other cases for which it is found that they indicate that it is certain that the debtor would not fully meet their obligations to the bank.

(5) For the purposes of applying criteria from Paragraph (3)(2) of this Article, the bank shall stipulate through its internal regulations indicators indicating significant financial distress, such as:

- 1) the debtor's revenue sources have significantly decreased, which may affect their ability to meet their obligations to the bank,
- 2) the collateral realization process has been initiated,
- 3) the bank has filed a lawsuit against the debtor before a competent court,
- 4) the debtor lost their operating license (e.g. bank, insurance company, microcredit organisation, leasing company etc.),
- 5) in case of exposure to newly established corporates, as well as exposure under project financing, if estimated future cash flows during any period of the settlement of obligations to the bank are inadequate, as well as if there is a significant departure from the initial business plan, i.e. planned project implementation, during the repayment of claims,
- 6) significant decrease in the debtor's capital,
- 7) significant deterioration in other financial indicators (liquidity ratio, significant loss, financial liabilities/EBITDA, etc.), with the bank stipulating through its internal regulations the intervals of deterioration of such indicators,
- 8) the debtor is a co-signer or guarantor under a loan in default, and the instalment is so high that it may significantly affect their ability to pay,
- 9) cases of fraud occurred,
- 10) the debtor is over indebted,

- 11) in case of natural persons: if a corporate or individual entrepreneurship is owned by the debtor in default, and the debtor guarantees with personal assets for the liabilities of such corporate or individual entrepreneurship,
- 12) the debtor's account has been blocked continuously over the period longer than 60 days,
- 13) credit risk stage in other bank, etc.

(6) When considering criteria from Paragraph (3)(3) of this Article, the bank shall consider whether it sold that same party's other exposures at a significant economic loss, while having to primarily analyze the reasons because of which the sale was made, and cases that are not credit risk related (e.g. sale because of a need for liquid assets, change in the bank's business strategy or a need to comply with regulatory provisions on exposure limits) should not be considered to be a default, even though the exposures were sold at a significant economic loss.

However, in cases in which the sale took place due to deterioration in the credit quality of an exposure, with the economic loss being significant, the bank should consider that other exposures of the bank to the same debtor are in default. The economic loss shall thereby be considered to be significant if the price at which the exposure is sold is lower by more than 5% of the exposure's net value (including the interest and fees).

(7) When considering criteria from Paragraph (3)(4) of this Article, the bank shall consider whether the modification of an exposure that had not been classified at the time of the modification into credit risk stage 3 has resulted in a reduced financial liability of the debtor due to a significant write-off or deferred payment of the principle, interest or fees, and if it finds that such reduction is greater than 1%, it shall be considered to be in default.

Reduction in financial liability (Do) shall thereby be calculated in accordance with the following formula:

$$Do = \frac{NPVo - NPVt}{NPVo}$$

where:

NPVo – is net present value of cash flows expected under the contract before its modification discounted by applying original effective interest rate,

NPVt – is net present value of cash flows expected under the new modified contract discounted by applying original effective interest rate.

However, the bank should consider whether there are other indications that it is certain that the debtor will not fully meet their obligations to the bank even in the case that the reduction in the financial liability is less than 1%. The indicators that may thereby indicate that it is certain that the debtor will not meet their obligations to the bank fully shall include the following:

- 1) large one-off repayment at the end of the period provided for by the repayment schedule,
- 2) repayment schedule providing for significantly lower payment amounts in the beginning,

- 3) longer grace period considering the loan's purpose,
- 4) exposures to the debtor were forborne several times by comparison with the initial exposure.

### **POCI Assets**

#### **Article 21**

(1) POCI asset is an exposure for which it is identified at the time of initial recognition that its value was impaired for credit losses due to a significant credit risk.

(2) The bank shall define through its internal regulations criteria for identifying POCI assets from Paragraph (1) of this Article, where the bank shall consider at least the following criteria:

- 1) whether it is an exposure that is classified into credit risk stage 3 under Article 20 of this Decision, which is being significantly modified under the Instruction,
- 2) whether it is a financial asset purchased at an economic loss (discount) greater than 5% of net carrying value, save for cases where the seller is selling financial assets in cases that are not credit risk related, and
- 3) whether it is a purchased financial asset or refinanced exposure (in part or in full) that had been classified into credit risk stage 3 in other bank.

(3) If any of criteria from Paragraph (2) of this Article is met, it shall be considered to be a POCI asset.

(4) Exceptionally, in case of mergers and acquisitions of banks, criteria from Paragraph (2) of this Article shall not apply for the purposes of identifying POCI assets.

(5) Exceptionally, in case of a purchase of a loan portfolio, criteria from Paragraph (2)(2) of this Article shall not apply for the purposes of identifying POCI assets, but instead each individual sub-account shall be assessed and it shall be identified whether it is a POCI asset under Paragraph (2)(3) of this Article.

(6) When identifying the status of a POCI asset, the bank shall view it at the level of the individual exposure, and not at the level of the client.

(7) The bank shall enable in its information system identification of the exposures assigned the status of a POCI asset, which shall be maintained until such time when the obligation under such exposure has been fully settled.

### **Classification of Exposures into Lower Credit Risk Stages**

#### **Article 22**

- (1) The bank may classify exposures classified into credit risk stage 2 into credit risk stage 1 only once the following requirements have been met:
  - 1) when all reasons that indicated a significant increase of credit risk from Article 19 of this Decision ceased to exist, and
  - 2) when the debtor continuously demonstrated timeliness in repayment during the defined recovery period, namely:

1. for forbore exposures that at the time of forbearance had been classified into credit risk 2 during six months from the date of forbearance,
  2. for forbore exposures that at the time of forbearance had been classified into credit risk 3 during 24 months from the date of classification into credit risk stage 2. On the contrary, the bank shall classify the forbore exposure again into credit risk stage 3.
  3. for non-forbore exposures during three months from the date when all reasons indicating significant increase of credit risk ceased.
- (2) The bank may not reclassify exposures from credit risk stage 3 directly into credit risk stage 1.
- (3) The bank may reclassify exposures classified into credit risk stage 3 into credit risk stage 2 only once the following requirements have been met:
- 1) when all requirements from Article 20 of this Decision cease to be applicable, and
  - 2) when the debtor continuously demonstrated timeliness in repayment during the defined recovery period, namely:
    - 1) for forbore exposures and POCI assets during 12 months from the date of forbearance, i.e. on initial recognition of POCI assets,
    - 2) for non-forbore exposures during six months from the date when requirements from Article 20 of this Decision ceased to be met.
- (4) For the purposes of applying Paragraph (3)(2)(1) of this Article, it shall be considered that the requirement for reclassification from credit risk stage 3 into credit risk stage 2 has been met if the following additional requirements have also been met:
- 1) the debtor repaid the principal during the recovery period (through regular payments) in the amount that is equal to the greater of the following two amounts: amount of outstanding obligations previously past due (if any) or written-off amount,
  - 2) there is timeliness in repayment of obligations to the bank under the bank's other exposures to the debtor,
  - 3) the bank has no other additional indications that the debtor will not fully meet their obligations to the bank.
- (5) The bank shall define clear criteria and policies on when an exposure may be reclassified from credit risk stage 3 into credit risk stage 2, including situations when the improvement in the debtor's financial situation may be considered sufficient to allow full and timely repayment of credit obligations. The bank should monitor the efficiency of adopted policies, and in particular analyze debtor status changes, impact of adopted policies on the recovery rates of exposures in default and impact of adopted policies on the emergence of multiple defaults. The bank is thereby expected to have a small number of cases defaulting again after reclassification. If that is not the case, the bank should review its exposure reclassification policies and set longer recovery deadlines than the minimum stipulated deadlines in Paragraph (3) of this Article.
- (6) For the purposes of applying Paragraphs (1), (3) and (4) of this Article, it shall be considered that there is timeliness in repayment if the debtor is not overdue on

repayment for 30 and more days in a material amount during the defined recovery period.

- (7) In case that grace period/moratorium is set for forbore exposures, such period shall not be included in the recovery period under observation, i.e. recovery period shall start from the end of grace period/moratorium.

### **3.1 Minimum Expected Credit Loss Rates**

#### **Minimum Expected Credit Loss Rates for Credit Risk Stage 1**

##### **Article 23**

(1)The bank shall determine and account for expected credit losses for exposures classified into credit risk stage 1 at least in the amounts as follows:

- 1) for low risk exposures from Article 18(2) of this Decision – 0.1% of the exposure,
- 2) for exposures to central governments and central banks outside of Bosnia and Herzegovina for which there is a credit assessment by a recognized external credit assessment institution which shall, under Article 69 of the Decision on Bank Capital Calculation, be classified into credit quality steps 3 and 4 – 0.1% of the exposure,
- 3) for exposures to banks and other financial sector entities for which there is a credit assessment by a recognized external credit assessment institution which shall, under Article 69 of the Decision on Bank Capital Calculation, be classified into credit quality steps 1, 2 or 3 – 0.1% of the exposure,
- 4) for other exposures – 0.5% of exposure.

(2)Exceptionally from Paragraph (1)(4) of this Article, if the bank does not have an adequate time series, quantity and/or quality of relevant historical data, and is unable to establish the value of PD parameter using its model in an adequate and documented manner, the bank may not determine expected credit loss for other exposures classified into credit risk stage 1 in the amount lower than 1% of the exposure.

(3)Exceptionally from Paragraph (1)(4) of this Article, expected credit loss for exposures in the form of cash in hand and the bank's treasury shall be 0% if the requirements relating to protection of property stipulated by the bylaw regulating internal controls system in banks have been met.

(4)If the bank determines under its internal methodology the amount of expected credit losses that is greater than the ones arising from the provisions of this Article, it shall apply the greater amount determined in such manner.

#### **Minimum Expected Credit Loss Rates for Credit Risk Stage 2**

##### **Article 24**

(1)The bank shall determine and account for expected credit losses for exposures classified into credit risk stage 2 in the greater amount of the following two:

- 1) 5% of the exposure,

2) amount determined under the bank’s internal methodology.

(2) Exceptionally from Paragraph (1)(1) of this Article, if the bank does not have an adequate time series, quantity and/or quality of relevant historical data, and is unable to establish the value of PD parameter using its model in an adequate and documented manner, the bank may not determine expected credit loss for exposures classified into credit risk stage 2 in the amount lower than 8% of the exposure.

**Minimum Expected Credit  
Loss Rates for Credit Risk Stage 3  
Article 25**

(1) The bank shall determine and account for expected credit losses for exposures classified into credit risk stage 3 at least in the amounts defined in Table 1 or Table 2 from this Article.

Table 1 Minimum expected credit loss rates for exposures secured by eligible collateral:

Number	Overdue days	Minimum expected credit loss
1	up to 180 days	15%
2	from 181 to 270 days	25%
3	from 271 to 365 days	40%
4	from 366 to 730 days	60%
5	from 731 to 1460 days	80%
6	over 1460 days	100%

Table 2 Minimum expected credit loss rates for exposures not secured by eligible collateral:

Number	Overdue days	Minimum expected credit loss
1	up to 180 days	15%
2	from 181 to 270 days	45%
3	from 271 to 365 days	75%
4	from 366 to 456 days	85%
5	over 456 days	100%

(2) For the purposes of applying Paragraph (1) of this Article, the bank shall determine minimum expected credit losses in accordance with the chart below:

Exposure not secured by eligible collateral		Expected losses under Table 2 of this Article
Exposure secured in part by eligible collateral	Secured portion	
	Unsecured portion	Expected losses under Table 1 of this Article
Exposure fully secured by eligible collateral		Expected losses under Table 1 of this Article

- (3) Exceptionally from Paragraph (1) of this Article, if the bank has taken relevant legal actions and can document the certainty of realization of the collateral in the following three years, it shall not be required to increase the level of expected credit losses above 80% of the exposure. The estimate of future cash flows from eligible collateral reduced to present value must thereby be greater than 20% of such claim. In case that the bank fails to recover the claim in the aforementioned three-year period, it shall account for expected credit losses in the amount of 100% of the exposure.
- (4) In case of forbore exposures from Article 22(3)(2)(1) of this Decision, the bank will maintain throughout the 12-month recovery period expected credit losses at the level of coverage that had been formed on the date of the approval of the forbearance, which may not be lower than 15% of the exposure.
- (5) The bank shall, for the third and each following forbearance of an exposure that had been forbore earlier and classified at the time of the forbearance into credit risk stage 3 or POCI assets, determine and account for expected credit losses in the amount of 100% of the exposure, save for cases where requirements from Paragraph (3) of this Article have been met.
- (6) Exceptionally from Paragraph (1) of this Article, the bank shall, for the exposures relating to cases where the debtor has not met their obligation to the bank no later than within 60 days from the day when a previously issued guarantee was called on, determine and account for expected credit loss in the amount of 100%, save for cases where requirements from Paragraph (3) of this Article have been met.
- (7) If the bank determines under its internal methodology the amount of expected credit losses that is greater than the ones arising from the provisions of this Article, it shall apply the greater amount determined in such manner.
- (8) For exposures defined by Article 2(1)(2) of this Decision, it shall be considered that there is uncertainty in the recovery of interest income, and recognition of such income in profit and loss account shall be deferred until such time when they have been recovered. The bank shall keep records of such interest claims until their recovery.

**Minimum Expected Credit Loss Rates for Accounts Receivable, Factoring and Financial Leasing Receivables and Other Receivables**

**Article 26**

(1)The bank shall determine expected credit loss rates for accounts receivable, factoring and financial leasing receivables and other receivables at least in the amounts as specified in Table 3 from this Article:

Table 3 Minimum expected credit loss rates

Number	Overdue days	Minimum expected credit loss
1	no material amount overdue	0.5%
2	up to 30 days	2%
3	from 31 to 60 days	5%

4	from 61 to 90 days	10%
5	from 91 to 120 days	15%
6	from 121 to 180 days	50%
7	from 181 to 365 days	75%
8	over 365 days	100%

(2) When determining the number of overdue days for receivables from Paragraph (1) of this Article, the bank shall take into account overdue repayments of obligations to the bank in material amount.

(3) If the bank determines under its internal methodology the amount of expected credit losses that is greater than the ones arising from the provisions of this Article, it shall apply the greater amount determined in such manner.

**Determination of Expected Credit Losses  
When Moving to Higher Credit Risk Stages  
Article 27**

For exposures moving to a higher credit risk stage, the minimum expected credit loss rate shall be the greater of the following two:

- 1) expected credit loss determined earlier that was recorded for them while the exposures had been classified into a lower credit risk stage,
- 2) stipulated minimum expected credit losses for the higher credit risk stage into which the exposure was classified on the reporting date.

**4. Eligible Collateral and Collateral Management**

**Eligible Collateral  
Article 28**

Only the following shall be considered to be eligible collateral for the purposes of this Decision and determination of expected credit losses:

- 1) immovable property (including land) and movable property specified in Table 4 from Article 29 of this Decision, provided that it meets all requirements from Articles 29 and 30 of this Decision,
- 2) other eligible collaterals from Article 31 of this Decision.

**Immovable and Movable Property  
Article 29**

- (1) The types of eligible collateral in the form of immovable and movable property are specified in Table 4 from this Article.
- (2) Immovable property may be considered to be an eligible collateral only if the following requirements have been met:

- 1) the bank has the entire required documentation from which it is evident that the immovable property is an efficient and appropriate secondary source of recovery, i.e. if there is evidence that the property is marketable,
  - 2) first ranking mortgage was registered in the land registers and other registers in favor of the bank or there is first ranking pari passu status with other mortgage lenders. The collateral shall be considered eligible in case that the same bank was registered as the first and higher ranking mortgage lender. Also, the collateral shall be considered eligible in case that it is possible to document that the obligations of the first ranking mortgage lender were duly settled, but that the proceedings to formally and legally delete the mortgage encumbrance have not been completed.
  - 3) the bank has in place efficient processes to verify legal validity of the mortgage on the immovable property concerned,
  - 4) the bank has ensured market valuation of the immovable property under the provisions of Article 30 of this Decision.
- (3) Movable property may be considered to be an eligible collateral only if the following requirements have been met:
- 1) the bank has the entire required documentation from which it is evident that the movable property is an efficient and appropriate secondary source of recovery, i.e. if there is evidence that the property is marketable,
  - 2) pledge on the movable property was registered in the register of liens on movable property with the institution responsible for keeping of such register,
  - 3) the bank has in place efficient processes to verify legal validity of the pledge on the movable property concerned,
  - 4) the bank has an option to perform monitoring of the collateral at its request,
  - 5) the movable property's market price is available,
  - 6) the bank has ensured market valuation of the movable property under the provisions of Article 30 of this Decision.
- (4) When estimating future cash flows under the recovery from the immovable and movable property, the bank shall apply relevant haircuts and relevant internally estimated recovery period. The haircuts and recovery period should take into consideration the bank's practice and the experience so far with the recovery, conditions in the economic and legal environment in which the bank operates, and respective characteristics of the collateral, then the fact that different types of collateral reflect different type of risk should be taken into consideration (e.g. set different haircuts and recovery periods taking into account the collateral's location in the case of immovable property or specificity of the use of construction and production machines in the case of movable property, etc.).

The bank may not thereby use the haircuts that are lower than the minimum haircuts set out in Table 4 from this Article, which shall be applied to the collateral's latest updated appraisal value.

Table 4 Types of eligible collateral in the form of immovable and movable property and minimum haircuts for such collaterals

<b>Number</b>	<b>Eligible collateral type</b>	<b>Haircut (%)</b>
1	Residential real estate – flat	20
2	Residential real estate – house	30
3	Residential real estate – other real estate that is not used for residential purposes (vacation homes, suites, etc.)	40
4	Commercial real estate – commercial premises	40
5	Commercial real estate – warehouse and industrial facilities (factories, warehouses, agricultural facilities, etc.)	50
6	Commercial real estate – service facilities (hotel, etc.)	40
7	Building land	40
8	Agricultural land	50
9	Movable property – construction and production machines used for specific purpose	90
10	Movable property – construction and production machines that may have wider use	70
11	Movable property – passenger vehicles	60
12	Movable property – freight vehicles	70

- (5) The bank shall review at least annually the adequacy of its assumptions about the initially determined recovery period and make adjustments there to, if necessary.
- (6) If the bank has no insurance policy that is valid at all times of the duration of the contractual relationship for which a restriction on transferability was obtained in favor of the bank, the haircuts from Table 4 shall be increased by 10 percentage points.

### **Market Valuation of Immovable and Movable Property**

#### **Article 30**

- (1) The bank shall adopt policies and procedures for market valuation of immovable and movable property serving as collateral, it shall review them at least annually and make adjustments thereto, where necessary.
- (2) The bank shall define through its internal regulations the requirements and criteria that must be met by an independent appraiser allowing them to perform market valuation of immovable and movable property, and shall establish a list of the independent appraisers whose valuations it shall use. The bank shall update the list of independent appraisers on an ongoing basis after conducting quality assurance of the market valuations of immovable and movable property performed by such appraisers.
- (3) With a view to assessing the adequacy of the established policies and procedures for market valuation of immovable and movable property, the bank shall establish

adequate and efficient quality assurance procedures for the market valuations of immovable and movable property performed by independent appraisers.

- (4) During the duration of the contractual relationship, the bank shall monitor on an ongoing basis the market value of the immovable property serving as collateral for its exposures (through regular collateral monitoring under the bank's internal regulations), namely for commercial real estate at least annually, and for residential real estate once in three years.

The bank shall monitor the value of the immovable property even more often if the market conditions are subject to major changes. If the bank identifies based on its monitoring that the market value of the immovable property could significantly drop by comparison with the usual market prices, it shall request immediately from an independent appraiser to perform their repeated market valuation.

For the exposures amounting to more than 5% of the bank's eligible capita or BAM one million (whichever one is lower), the bank shall ensure performance by an independent appraiser of follow-up repeated market valuation of the immovable property at least every three years.

- (5) The bank shall define through its internal regulations the minimum contents of immovable property market valuation reports, documentation of data sources and assumptions used, and manner of immovable property market valuation, setting the criteria for application of different valuation methods (market, income and cost based), taking into consideration the type of real estate that is subject to valuation, where cost-based method would be acceptable in exceptional cases.
- (6) During the duration of the contractual relationship, the bank shall monitor on an ongoing basis the market value of the movable property serving as collateral for its exposures.
- (7) The bank shall ensure performance by an independent appraiser of market valuation of the movable property every third year if its value on exposure approval was greater than BAM 500,000.
- (8) The documentation relating to immovable and movable property serving as collateral that the bank is required to have in the loan file shall be stipulated through the decision regulating documentation of the bank's credit activities.
- (9) The Agency may stipulate through a special regulation more detailed requirements relating to market valuation of movable and immovable property.

### **Other Eligible**

### **Collaterals**

### **Article 31**

- (1) Other eligible collateral shall be considered to be:
  - debt securities issued by the Council of Ministers of Bosnia and Herzegovina, Government of the Republika Srpska, Government of the Federation of Bosnia and Herzegovina and Government of the Brcko District of Bosnia and Herzegovina,
  - 1) debt securities issued by the central governments and central banks with a credit assessment by a recognized external credit assessment institution which shall,

- under Article 69 of the Decision on Bank Capital Calculation, be classified into credit quality step 4 or better,
- 2) debt securities issued by the multilateral development banks from Article 53(2) of the Decision on Bank Capital Calculation,
  - 3) debt securities issued by the international organizations from Article 54 of the Decision on Bank Capital Calculation,
  - 4) debt securities issued by banks, investment companies, regional governments and local authorities, public sector entities and multilateral development banks (that are not covered by Subparagraph (3) of this Paragraph and other entities with a credit assessment by a recognized external credit assessment institution which shall, under Article 69 of the Decision on Bank Capital Calculation, be classified into credit quality grade 3 or better,
  - 5) debt securities issued by banks and regional governments and local authorities without an assessment by a recognized external credit assessment institution, if the issuers of such securities are listed on a recognized stock exchange from Annex III of the Decision on Bank Capital Calculation,
  - 6) pledge on monetary gold,
  - 7) share or convertible bonds included in the main stock exchange index,
  - 8) guarantees and counter-guarantees payable on first demand issued by entities referred to in Subparagraphs (1) – (6) of this Paragraph.
- (2) Collaterals from Paragraph (1) of this Article must meet the following additional requirements:
- 1) when estimating future cash flows under recovery from debt securities, the bank shall apply respective haircuts with reference to the market value taking into account the quantity and frequency of trading with such debt securities, experience so far with the recovery, conditions in the issuer's economic and legal environment, and respective features of such debt securities. The bank shall define in its internal policies and procedures respective haircuts and apply them consistently. The bank may not thereby set the haircut that is lower than 10% for debt securities from Paragraph (1)(1) – (4) of this Article that it uses as collateral, nor may it set the haircut that is lower than 20% for other securities.
  - 2) if there is inconsistency between the maturity of the exposure and the maturity of the other eligible collateral, the other eligible collateral shall be recognize on determination of expected credit losses only in the case if its maturity is equal or longer than the maturity of the exposure.
  - 3) guarantees and counter-guarantees should meet the conditions and requirements from Articles 84 – 86 of the Decision on Bank Capital Calculation.

## **5. Accounting Treatment of Assets Foreclosed in the Claims Recovery Process**

### **Article 32**

#### **Accounting Treatment**

- (1) Accounting treatment of tangible assets received by the bank as the repayment of its claims in full or in part (hereinafter: foreclosed assets) shall depend on the intent of the bank's competent bodies with regard to further handling of such assets.
- (2) The bank shall recognize foreclosed assets in its financial statements once the competent court has issued an Order Awarding Ownership or other equivalent

document and once it has become final and unappealable or on the date when it acquired ownership through an extrajudicial settlement.

- (3) In the case that the bank does not intend to use the foreclosed assets for its own purposes, it shall account for them on initial recognition at the lower of the following values:
  - 1) The amount of net carrying value of the bank's claims. In the case that the amount of expected credit losses accounted is equal to the amount of the claims, the bank shall record the foreclosed assets at the technical value in the amount of BAM 1.
  - 2) The appraisal fair value by an independent appraiser minus expected selling costs.

The selling costs shall be the costs that are directly associated with the sale, e.g. notary costs, tax, court fees, etc.
- (4) The bank must not in any case report income on any basis when acquiring tangible assets that it received as debt repayment in full or in part all until such time when they have been sold.
- (5) In the case that the bank does not intend to use the foreclosed assets for its own purposes, it shall approve, under its internal regulations, a decision and respective sale plan and implement an active policy to sell such assets.
- (6) The bank's management shall report, at the minimum on a quarterly basis, to the supervisory board on the volume and type of foreclosed assets, as well as on the sale activities undertaken, i.e. fulfillment of the sale plan from the previous Paragraph of this Article.
- (7) The bank shall perform a follow-up valuation of foreclosed assets by an independent appraiser under the bank's internal regulations, and shall keep respective off-balance sheet/auxiliary records of them, save for cases where their recorded value is BAM 1.
- (8) In the case that the bank fails to sell the foreclosed assets within three years from the date of their initial recognition in the bank's books, it shall reduce their value to BAM 1.
- (9) In the case that the bank fails to sell the foreclosed assets recorded in the bank's books before January 01<sup>st</sup>, 2019, it shall reduce their value to BAM 1 within two years from the day of the start of the application of this Decision. Paragraph (8) of this Article shall be applied to the assets foreclosed after January 01<sup>st</sup>, 2019.

## **6. Reporting to the Agency and Transitional and Final Provisions**

### **Reporting to the Agency**

#### **Article 33**

- (1) The Bank shall report to the Agency on the exposures classified into credit risk stages under this Decision's provisions.
- (2) The bank shall deliver reports from Paragraph (1) of this Article in the form, manner and within the deadlines stipulated by the Decision on the Reports Provided by Banks to the Banking Agency of the Republika Srpska.

## **Transitional and Final Provisions**

### **Article 34**

- (1) This Decision shall enter into force on the eighth day from the day of its publication in "Official Gazette of the Republika Srpska", and it shall be applied from January 01<sup>st</sup>, 2020.
- (2) Article 25(5) shall be applied to the exposures forborne after January 01<sup>st</sup>, 2018.
- (3) The bank shall calculate the effects of this Decision's application with the balance as of December 31<sup>st</sup>, 2019, i.e. the opening balance as of January 01<sup>st</sup>, 2020, record them in the capital accounts and report them in Common Equity Tier 1. The effects of the initial application shall represent the difference between expected credit losses determined under this Decision's provisions and those determined and accounted for by the bank under its internal methodology, in the case where expected credit losses determined in such manner are lower. The bank shall calculate the effects for each individual exposure.
- (4) On the day of the start of the application of this Decision, the following shall cease to apply:
  - 1) Decision on the Minimum Credit Risk Management and Bank Assets Classification Standards („Official Gazette of the Republika Srpska“, number 49/13, 01/15 and 117/17),
  - 2) Instruction on changed way on formation, recording and reporting od reserves for credit losses number 01-D-1/100 as of 11/01/2011 and Amendments to Instruction on changed way on formation, recording and reporting od reserves for credit losses number 01-D-3/14 as of 04/02/2014.
- (5) Director of the Agency adopts Instruction on Financial Assets Classification and Valuation which defines in greater detail specific provisions of this Decision.

Number: UO.-34-3/19

Date: May 28<sup>th</sup>, 2019

**CHAIRMAN  
OF THE MANAGEMENT BOARD**

**Bratoljub Radulovic**