

Pursuant to the Article 21, paragraph 1 of the Law on the National Bank of Serbia ("RS Official Gazette", Nos.72/2003 and 55/2004), and with reference to Article 28, paragraph 6, and Article 31, paragraph 3 of the Law on Banks ("RS Official Gazette", No.107/2005), the Governor of the National Bank of Serbia hereby issues

## **D E C I S I O N**

### **ON THE CLASSIFICATION OF BANK BALANCE SHEET ASSETS AND OFF-BALANCE SHEET ITEMS**

#### **Basic provisions**

1. For the purposes of adequate and efficient management of credit risk to which a bank is exposed in its operations, this decision sets out the conditions under which the bank shall classify its balance sheet assets and off-balance sheet items (hereinafter: criteria), as well as the manner of calculating and recording reserves for estimated losses that may arise on balance sheet assets and off-balance sheet items.

The receivables to be classified in the manner defined herein shall comprise balance sheet assets referred to in Section 4, paragraph 1 hereof and off-balance sheet items referred to in Section 5, paragraph 1 thereof.

Under the terms hereof, reserves for estimated losses that may arise on balance sheet assets and off-balance sheet items of a bank shall mean special reserves for estimated losses and reserves for general banking risks.

2. As part of its overall risk management system, the bank shall through its internal enactments define rules and procedures for the identification, measuring, monitoring and management of credit risk, including in particular:

- purview of bank bodies and organizational units, and the authority of bank staff members in decision-making on loan approval and creation of other receivables and on altering the terms of such loans and receivables, as well as decision-making limits, and eligibility requirements for participation in bodies under whose purview the above activities are;

- decision-making procedure from indent 1 hereof, and most notably who proposes a decision, the necessary quorum and the majority of votes needed for the decision to be made;

- decision-making procedure regarding the approval of the bank's large exposure to a single person or a group of related persons, and exposure to a person related to the bank;

- procedures for monitoring the quality of balance sheet assets and off-balance sheet items at the level of the bank and by individual borrower, primarily by providing current data on the borrower's financial position and market value of collateral, as well as other data relevant for assessing the bank's credit portfolio risk exposure;
- procedures for monitoring and limiting concentration of receivables in respect of each borrower, group of related borrowers, branch of industry, country, and/or geographical area and type of credit services;
- procedures for ongoing record keeping, monitoring and additional supervision of all payments in arrears from defaulting borrowers.

3. Under the terms hereof, default status of the borrower occurs if either of the following two conditions prevails:

1) the bank deems it unlikely that the borrower will settle its obligations in full, without recourse by the bank to actions such as collection through seizure of collateral, as indicated by:

- suspended calculation of interest in compliance with internal enactments,
- partial or full write-off of receivables,
- restructuring of receivables as a result of deterioration of the borrower's financial position including the shortening or prolongation of principal, interest or fee repayment periods,
- liquidation or bankruptcy of the borrower.

2) the borrower is in default on a materially significant amount for more than 90 days.

Under the terms hereof, a materially significant amount is an amount:

- higher than 1% of the bank's individual receivable from a borrower who is a natural person, entrepreneur or farmer, but not lower than 1,000 dinars, and/or
- higher than 2.5% of the bank's individual receivable from a borrower who is a legal entity, but not lower than 10,000 dinars.

In case of entrepreneurs, farmers and natural persons, the default status shall be assigned to individual items on the receivables side or to all receivables from one borrower.

For legal entities, the default status shall be assigned to individual borrowers, and/or to all receivables due from one and the same borrower.

## **Balance sheet assets and off-balance sheet items to be classified**

4. Balance sheet assets to be classified within the meaning hereof shall include:

- short- and long-term loans due or not yet due for payment;
- deposits with banks;
- interest and fees;
- short- and long-term securities held to maturity, and securities available for sale but not included in the trading book;
- bank's participation in the capital of other legal entities;
- assets acquired through collection of receivables;
- receivables in respect of derivatives used as a hedge for items included in the banking book;
- other balance sheet assets, except balance sheet assets specified in paragraph 2 hereof.

The following balance sheet assets shall not be subject to classification:

- vault cash, gyro-account balances, gold and other precious metals;
- securities refinaceable with the National Bank of Serbia;
- receivables from the National Bank of Serbia or the Republic of Serbia, and receivables secured by their unconditional guarantee payable on first demand;
- receivables from the governments and central banks of member countries of the Organization for Economic Cooperation and Development (hereinafter: the OECD) and receivables secured by their unconditional guarantee payable on first demand;
- demand deposits and term deposits up to seven days in accounts with banks awarded at least BBB in the latest Standard&Poor's or Fitch-IBCA rating or at least Baa3 in the latest Moody's rating;
- fixed assets and intangible investments;
- assets acquired through collection of receivables within one year from the date of acquisition thereof;
- unpaid subscribed capital;
- own shares;
- stocks;
- tax rebates receivable;
- balance sheet assets exposing the bank primarily to market risk and other types of risk other than credit risk (items included in the trading book under the terms of the decision on capital adequacy).

5. Off-balance sheet items to be classified within the meaning hereof shall include:

- financial and performance guarantees issued,

- avals and bill acceptances,
- other forms of guarantee,
- uncovered letters of credit,
- contingent liabilities,
- other off-balance sheet items in respect of which the bank may have to make payment.

The following off-balance sheet items shall not be subject to classification:

- bonds issued in compliance with the Law on Regulation of Public Debt of the Federal Republic of Yugoslavia Arising From Foreign Currency Savings of Citizens ("FRY Official Gazette", No.36/2002);
- off-balance sheet items exposing the bank to the National Bank of Serbia or the Republic of Serbia, as well as off-balance sheet items exposing the bank to other legal entities, secured by unconditional guarantees of the National Bank of Serbia or the Republic of Serbia that are payable on first demand;
- off-balance sheet items exposing the bank to the governments or central banks of OECD member countries, as well as off-balance sheet items exposing the bank to other legal entities, secured by unconditional guarantees of the National Bank of Serbia or the Republic of Serbia that are payable on first demand,
- off-balance sheet items exposing the bank primarily to market risk and other types of risk other than credit risk (items included in the trading book under the terms of the decision on capital adequacy);
- other off-balance sheet items in respect of which there can be no payment.

### **Criteria for the classification of balance sheet assets and off-balance sheet items**

6. Receivables from legal entities, autonomous territorial units, local governments, organizations for mandatory social insurance, entrepreneurs, farmers and natural persons, except for receivables from Section 4, paragraph 2 and Section 5, paragraph 2 hereof, shall be classified in accordance with Sections 7-16 thereof in categories A, B, C, D and E based on the assessment of the borrower's financial position and creditworthiness, timely settlement of obligations towards the bank and quality of the collateral.

7. *Receivables from legal entities* to be classified in:

1) category A:

- receivables from a borrower with whom no collection-related

problems are expected based on assessment of its financial position and creditworthiness, and who services its obligations on time, or by way of exception, with a delay of less than 30 days,

- receivables secured by prime collateral in the secured amount,
- receivables from international development financial institutions (IBRD, EBRD, EIB, IFC, etc.),
- receivables from banks awarded at least BBB in the latest Standard&Poor's or Fitch-IBCA rating or at least Baa3 in the latest Moody's rating;

2) category B:

- receivables from a borrower whose financial position is not entirely satisfactory due to certain problems in operation, which however, is not likely to deteriorate significantly in the future,
- 31 to 60 days past due receivables;

3) category C:

- receivables from a borrower whose financial position is not satisfactory, primarily with respect to adequacy of cash flow in terms of settling obligations and who suffers maturity mismatch between certain elements of assets and liabilities,
- 61 to 90 days past due receivables;

4) category D:

- receivables from a borrower whose financial position indicates significant problems in operation - primarily receivables from a borrower operating with losses or receivables from illiquid or insolvent borrowers,
- 91 to 180 days past due receivables;

5) category E:

- doubtful or disputable receivables,
- receivables from a borrower in liquidation or bankruptcy proceedings,
- receivables past due for more than 181 days,
- assets acquired through collection of receivables that had neither been alienated nor used in such bank's business operations within a year after they were acquired,
- receivables not eligible for classification in other categories.

By way of exception to paragraph 1, provision 4, indent 1 hereof, the fact that a borrower operates with losses shall not automatically result in the classification of bank receivables from such borrower in category D in cases where:

- the borrower meets its payment obligations towards the bank on time or with a delay of not longer than 90 days, provided that such borrower was privatized by tender privatization during the three-year period preceding the date of classification, and provided that receivables from such borrower can not be classified in category A;

- the borrower meets its payment obligations on time or with a delay of not longer than 30 days, provided that receivables from such borrower can not be classified in category A.

By way of exception to paragraph 1 hereof, receivables from a borrower incorporated sometime during the two years preceding the date of classification, shall be classified based on the criteria of timeliness and assessment of the borrower's capacity to achieve adequate cash flows that would ensure unimpeded settlement of obligations specified in the loan repayment schedule, provided that receivables from such borrower may not be classified in category A. The above said assessment shall be performed pursuant to the methodology laid down by the bank's internal enactments based on the bank's analysis of the cost-effectiveness of investment for which funds have been approved, and assessment of future investment-related cash flows (business plan, financial projections, estimated investment repayment period, analysis of project sensitivity to risk, etc).

If the borrower's future investment-related cash flows are assessed as inadequate during any period of the servicing of obligations towards the bank, receivables from such borrower shall not be classified in any category above category C.

By way of exception to paragraph 1 hereof, receivables from a borrower founded for a special purpose, and/or for the implementation of a pre-determined project shall be classified based on the criteria of timeliness and assessment of the borrower's capacity to achieve adequate cash flows that will ensure unimpeded settlement of obligations specified in the loan repayment schedule. The above said assessment shall be performed pursuant to the methodology laid down by the bank's internal enactments based on the bank's analysis of the cost-effectiveness of the project and/or investment for which funds have been approved, and assessment of future investment-related cash flows (business plan, financial projections, estimated investment repayment period, analysis of project sensitivity to risk, etc), as well as based on ongoing monitoring of the project implementation. However, these receivables can not be classified

- in category A, and
- in any category above category C – if the borrower's future investment-related cash flows are assessed as inadequate during any period of the servicing of obligations to the bank and if any major departure from the

initially planned implementation of the project is ascertained during the repayment period.

Pursuant to this Section and from the aspect of meeting payment obligations, cash flow shall mean the difference between the borrower's net operating cash flow and short-term financial obligations, where the net operating cash flow shall mean the difference between net inflow and net outflow of cash from the borrower's business operations. If the borrower is not legally bound to produce cash flow statements – net operating cash flow shall be calculated, by using indirect method, on the basis of its core financial statements in the last two reporting periods.

Borrower's cash flow shall be deemed adequate from the aspect of meeting payment obligations if the borrower has reported positive difference as defined in paragraph 6 hereof.

Pursuant to this Section, maturity match between certain elements of assets and liabilities shall be deemed to exist if the borrower has reported positive difference between current assets on the one hand, and short-term liabilities increased by deferred tax liabilities, on the other.

When assessing the financial position of the borrower, the bank shall take into account the borrower's timeliness and/or past due status in settlement of obligations to the bank over the last twelve months and shall determine in its internal enactments the criteria and the manner of classifying receivables referred to in this Section based on that timeliness, stipulating however that the receivables from a borrower who settled its obligations to the bank over the last twelve months with a delay of more than 60 days may not be classified in category A.

8. *Receivables from autonomous territorial units, local governments and organizations of mandatory social insurance, as well as receivables from entrepreneurs and farmers* shall be classified in accordance with the criteria of timeliness and/or past due status in settling obligations towards the bank referred to in Section 7 hereof, means of collateral from Section 11 thereof and assessment of the borrower's ability to regularly meet its obligations to the bank, conducted on the basis of documentation referred to in Section 15 hereof.

The bank shall perform the assessment of the borrower's ability to regularly meet its obligations from paragraph 1 hereof also based on the borrower's timelines and/or past due status in settlement of obligations to the bank over the last twelve months, and shall determine in its internal

enactments the criteria and manner of classification of receivables from this Section based on that assessment, making sure:

1) that receivables from a borrower who settled its obligations to the bank over the last twelve months with a delay of more than 60 days may not be classified in category A;

2) that receivables on doubtful and disputable grounds are classified in category E.

Pursuant to this Section, entrepreneurs shall be natural persons registered in accordance with the law governing the registration of business entities, and farmers shall mean natural persons – holders or members of agricultural households within the meaning of the law on agriculture and rural development.

#### 9. Deleted.

10. *Receivables from natural persons (other than farmers and entrepreneurs)* shall be classified in accordance with the criteria of timeliness and/or past due status in settling obligations to the bank from Section 7 and means of collateral from Section 11 hereof, as well as based on assessment of the borrower's creditworthiness and/or ability to regularly meet its obligations to the bank, conducted on the basis of documentation referred to in Section 15 thereof.

Assessment of the borrower's creditworthiness referred to in paragraph 1 hereof shall be performed in particular based on:

– level of personal debt, determined as the ratio of the borrower's total monthly credit obligations and regular net monthly income less the cost of the minimum consumer basket for the first adult household member according to the latest data issued by the Serbian Statistical Office;

– currency structure of the borrower's total monthly credit obligations, particularly taking into account higher risk exposure for borrowers a considerable amount of whose obligations is in denominated in foreign currency or in dinars with a foreign currency clause;

– the borrower's timeliness and/or past due status in settling obligations to the bank over the last twelve months.

The bank shall regulate by its internal enactments the criteria and manner of classification of receivables referred to in this Section based on the borrower's creditworthiness, making sure:



1) that receivables from a borrower who settled its obligations to the bank over the last twelve months with a delay of more than 60 days may not be classified in category A;

2) that the following receivables are classified in category E:

- receivables on doubtful or disputable grounds,
- receivables from a borrower whose debt to income ratio, determined in accordance with paragraph 2, indent one of this Section, exceeds 100%, and/or 80% if a considerable amount of the borrower's total monthly credit obligations is contracted in foreign currency or in dinars with a foreign currency clause.

Total monthly credit obligations referred to in this Section shall be the sum total of obligations under loans and credit cards (monthly payments due), obligations in respect of activated loan sureties and obligations under financial lease contracts. The bank may, however, in accordance with its internal enactments, include in total monthly credit obligations some other obligations of the persons from this Section.

Under the terms hereof, total monthly credit obligations of a natural person contracted in a considerable amount in foreign currency or in dinars with a foreign currency clause means that at least 20% of those obligations is contracted in foreign currency or in dinars with a foreign currency clause.

11. Under the terms hereof, according to its quality, collateral for the bank's receivables may be either prime or adequate.

Prime collateral, referred to in paragraph 1 hereof, shall be collateral in respect of receivables settled by the borrower with a delay of not longer than 90 days. Such collateral shall include:

- cash deposit with the bank – provided such deposit was agreed to serve as collateral for certain receivables due to the bank, as well as that its maturity matches the maturity of relevant receivables and that only the bank can dispose of the deposited funds up to the amount of overdue receivables;
- unconditional guarantee of a legal entity founded by the Republic of Serbia and payable on first demand, if provided by the law that the Republic of Serbia guarantees for the obligations of such legal entity;
- insurance of receivables with a legal entity founded by the Republic of Serbia, up to the insured amount, if provided by the law that the Republic of Serbia guarantees for the obligations of such legal entity;
- unconditional guarantee, payable on first demand, issued by international development financial institutions (IBRD, EBRD, EIB, IF, etc.), as well as pledge of securities issued by such institutions;
- unconditional guarantee, payable on first demand issued by banks awarded at least BBB in the latest Standard & Poor's or Fitch-IBCA rating or at

least Baa3 in the latest Moody's rating, excluding, however, unconditional guarantees issued by a bank being the bank's largest shareholder, and/or member of the same banking group, unless the National Bank of Serbia has granted prior approval in writing as specified in Section 17, paragraph 1, indent 7 of the Decision on Risk Management by Banks ("RS Official Gazette", No. 129/2007);

– pledge on gold and other precious metals, short-term securities refinanceable with the National Bank of Serbia, bonds issued by the Republic of Serbia or securities issued by the governments or central banks of OECD member countries – up to the level of their market value.

Adequate collateral, referred to in paragraph 1 hereof, shall include:

1) guarantee, if the guarantor is of good financial standing and willing to guarantee for the settlement of receivables, and if it has provided:

– irrevocable and unconditional corporate guarantee, payable on first demand, whereby it guarantees the settlement of receivables, and has been awarded at least BBB in the latest Standard&Poor's or Fitch-IBCA rating or at least Baa3 in the latest Moody's rating, or

– instrument providing an irrevocable and unconditional guarantee for the settlement of receivables and payable on first demand (bill of exchange guaranteed by the bank or bank guarantee showing that the guarantor will settle all claims on the borrower), and if the receivables qualify for classification in at least category B as specified in Section 7 hereof;

2) mortgage on real estate provided that:

– the bank's receivables from legal entities, entrepreneurs and farmers, are secured by a mortgage on real estate the value of which, according to the assessment by an authorized appraiser from paragraph 4 hereof, is not less than the total amount of the bank's receivables and other receivables secured by the first right of pledge over the same property, and that the delay in the settlement of receivables by the borrower is not longer than 360 days,

– the bank's receivables from natural persons are secured by a mortgage on residential facility (to be) inhabited or (to be ) given under lease by the owner, the value of which, according to the assessment by an authorized appraiser from paragraph 4 hereof, is not less than the total amount of the bank's receivables and other receivables secured by the first right of pledge over the same property, and that the delay in the settlement of receivables by the borrower is not longer than 360 days.

Authorized appraiser referred to in paragraph 3, provision 2 hereof, shall be understood to mean a court appointed expert working in appropriate field,

legal entity set up and licensed to perform appraisal activities in accordance with the law on requirements for the performance of appraisal activities or an authority which, pursuant to the law governing tax proceedings and tax administration, is competent for conducting tax proceedings.

Banks shall organize the appraisal of property from paragraph 3 hereof on a regular basis, on any change in the real estate value caused by significant changes in market property prices or changes in the physical condition of property. The appraisal shall be performed at least once in a three-year period from the preceding appraisal.

Bank receivables secured by adequate collateral may be classified in only one category above the category they would have been classified otherwise.

12. All receivables from one borrower, except receivables secured as specified in Section 11 hereof, shall be classified in one and the same category, i.e. the least favourable category in which any of its receivables is classified.

By way of exception to paragraph 1 hereof, classification of doubtful and disputable receivables shall not affect the classification of other receivables.

13. Delay in the collection of receivables shall be calculated as of the original maturity date, and for the materially significant amount of receivables as defined in Section 3, paragraph 2 hereof.

Delay in the collection of receivables against which the borrower was directly or indirectly provided with funds to settle the previously approved debt due to the bank shall be calculated as of the original maturity date of the receivables settled.

By way of exception to paragraphs 1 and 2 hereof, delay in the collection of receivables shall be calculated as of the subsequently agreed maturity date if the following conditions are met:

- that at the moment of applying for the extension of a repayment period the borrower is not past due on its obligations for more than 90 days;
- that the borrower's financial position and/or creditworthiness assessed based on financial indicators prescribed by this decision and the criteria determined by the bank's internal model for credit risk assessment, final financial statement and periodic financial statements of the borrower in the year following the assessment date, and/or if the borrower is a natural person, based on updated documentation from Section 15 of that decision – shows that the borrower will be able to regularly settle its obligations according to the subsequently agreed repayment terms;

- that at least monthly calculation and collection of interest are agreed on the extension of the repayment period;
- that after the extension of the repayment period, the borrower settles its obligations to the bank on time and/or with a delay not longer than 60 days.

The provisions of paragraphs 1 and 2 hereof shall not apply to the first-time restructured receivables, provided that in the period of no less than 3 months, and/or through at least 3 consecutive payments pursuant to the repayment schedule agreed upon within the effected restructuring, the borrower settled its obligations with a delay of not more than 30 days.

Under the terms hereof, restructured receivables shall be understood to mean receivables regulated by a contract that redefines debtor-creditor relations of the bank and the borrower due to the borrower's financial difficulties. Restructured receivables replace the balance of all receivables from a borrower, and/or their major part, and the terms and conditions under which the receivables were originally approved are significantly changed (extension of the principal or interest repayment term, reduction of interest rate or the amount of receivables outstanding, *datio in solutum* and other changes in terms and conditions which alleviate the borrower's position) provided an adequate program of financial consolidation of the borrower is adopted, or in case of a natural person borrower – provided that the bank has assessed based on the borrower's creditworthiness that the borrower will be able to regularly meet its obligations to the bank in the coming period, that the bank has reduced the amount of receivables by the amount of collateral deposit, if such deposit was placed, and has contracted that the borrower would not go further into debt after the effected restructuring.

14. In its enactments, the bank shall define methodology for the identification and measuring of credit risk arising from the impact of changes in the exchange rate of the dinar on the borrower's financial position, as well as the manner of managing such risk.

Methodology from paragraph 1 hereof shall refer to the analysis of the borrower's exposure to the dinar exchange rate risk, assessment of the borrower's ability to meet its payment obligations towards the bank, and most notably analysis of the adequacy of the borrower's cash flows in relation to the changed volume of credit obligations and assessment of the borrower's classification – assuming that there will be some changes in the exchange rate of the dinar at annual level.

The bank shall apply the methodology referred to herein in the classification of receivables contracted in foreign currency or in dinars but with a

foreign currency clause, and additionally monitor any receivables from debtors for which the bank has assessed, based on the methodology, that a change in the dinar exchange rate could lead to deterioration in the borrowers' financial position and/or jeopardize their ability to meet their payment obligations.

15. In its enactments, the bank shall define procedures for establishing and continuous updating of a credit file for each borrower. The credit file is to contain complete and accurate data needed for the assessment of the likelihood of collection of receivables, in particular the following:

- documentation on the borrower's status (for a legal entity – excerpt from the Register of business entities, for a natural person – photocopy of ID card, and/or passport, for an entrepreneur – excerpt from the Register of business entities or decision on setting up a business, for a farmer – excerpt from the Register of agricultural land holdings);
- appraisal of financial standing and creditworthiness of such borrower, including analysis of such borrower's exposure to the dinar exchange rate risk;
- financial statements of the borrower for the two reporting periods preceding the date when the receivables arose, as well as for all reporting periods until full settlement of such receivables, including auditor's report for the borrowers if such report is required by law, with the exception of borrowers that are in the initial stages of their operations;
- evidence of the settlement of obligations towards the bank in the preceding twelve months, except for the bank's new borrowers;
- Credit Bureau Report (with which the National Bank of Serbia has concluded a Memorandum of Understanding) on the borrower's obligations and timeliness in settling such obligations;
- bank's decisions on granting loans and creation of other receivables, and possible amendments to the terms and conditions thereof;
- contract documents relating to the borrower;
- data on the classification of receivables from the borrower by degree of collectibility at the time such receivables were created and in subsequent periods;
- correspondence and other documents proving contact between the bank and the borrower in respect of receivables;
- documentation regarding security instruments for receivables;
- documentation relating to the collection of receivables and any measures taken by the bank for the purpose of their collection.

File on a borrower being an autonomous territorial unit, local government unit or organization of mandatory social insurance shall contain data referred to in paragraph 1 of this Section, decision on debt acceptance as defined in Articles 33 and 39 of the Law on Public Debt ("RS Official Gazette", No.61/05), as well as bank analysis of the cost-effectiveness of investment for

which the funds were approved (business plan, financial projections, assessment of investment repayment period and the analysis of project sensitivity to risk).

Borrower's financial statements referred to in paragraph 2 of this Section constitute an integral part of the manual on the manner of preparing, compiling and submitting final accounts of budget beneficiaries, organizations of mandatory social insurance, budget funds of the Republic of Serbia and local governments.

File on a borrower – entrepreneur and farmer shall contain data from paragraph 1 of this Section, except for data referred to in indent 3 of that Section, along with total tax bill issued by the tax authority, evidence of settlement of tax bills issued in the preceding twelve months and data on total turnover in the preceding twelve months, while files on private entrepreneurs who run their books using single-entry bookkeeping shall also contain the profit and loss account and files on private entrepreneurs using double-entry bookkeeping shall contain balance sheet, profit and loss account and statistical annex for the preceding twelve months.

File on a borrower - natural person (other than farmer and entrepreneur) shall contain data from paragraph 1 of this Section, excluding data specified in indent 3 of that Section, as well as evidence of employment and earnings or pension of such borrower in the preceding three months, issued and certified by the employer (pay slip), along with the borrower's statement confirming that they may be used for verification of tax and contribution payments and, if the borrower is a tax obligor within the meaning of the law governing personal income tax, the file shall also contain data on the annual earnings of an employee and the prescribed taxes and contributions paid therefrom. The bank shall determine by its internal enactments the dynamics of updating the borrower's credit file from this paragraph after loan approval and/or during loan repayment in the manner which ensures adequate credit risk management.

16. Any receivables from borrowers on whom updated and complete data referred to in Section 15 hereof are not available to the bank shall be classified in category E, unless only the less significant data are partially incomplete or not up to date, in which case receivables from such borrowers shall be classified one category below the category in which they would have been classified otherwise.

**Methodology for calculating allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items**

17. In its enactments, the bank shall define an internal model for the assessment of credit risk, and adopt methodology for calculating allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items (hereinafter: methodology).

Internal model for the assessment of credit risk shall enable:

- unambiguous specification of different rating levels for receivables based on financial position, timeliness in the settlement of obligations, as well as other data significant for the assessment of risk assigned to the relevant investments (quality of collateral, etc.);
- rating of receivables based on accurate and current data;
- analysis of the bank's receivables, and in particular analysis by group of similar receivables;
- assessment of the likelihood of default status as defined in Section 3 hereof;
- specification of the appropriate amount of allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet assets to match the level of credit risk assumed by the bank.

Methodology for calculating allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items shall be applied to:

- identify receivables for which the calculation of allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items is to be performed at individual level (individual assessment) and define criteria for the classification of the rest of the portfolio in groups of receivables with similar characteristics (type of product, sector, geographical location, type of collateral, timeliness in settling obligations, etc.) for the purposes of assessment at group level (group assessment);
- define methods and techniques to be applied in individual and group assessment, including the manner of determining the expected time of collection and percentage of the value of collateral to be collected (taking into account the costs of seizure and collection), factors to be taken into consideration in determining the timeframe for the estimation of losses based on historical data, etc.;
- ensure that receivables being subject to individual assessment, but for which no allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items were determined, are included in groups of receivables with similar characteristics for the purposes of group assessment, and/or calculation of allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items at group level;
- ensure that all the analyses, assessments and other procedures in the process of determining allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items are clearly explained and documented in writing;

- ensure that allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items are based on accurate data and by taking into account all significant internal and external factors that may affect the collectibility of receivables.

If in calculating allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items the bank assesses credit risk based on its experience, it shall clearly define in its internal enactments:

- bodies and organizational units to be in charge of the experience-based assessment of credit risk;
- conditions under which experience-based assessment of credit risk may be made.

Experience-based assessment of credit risk shall be clearly documented and backed by a rational line of reasoning.

18. In accordance with the adopted methodology, the bank shall make calculation of allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items:

1) at individual level for receivables that do not belong to the small loan portfolio, if the bank assesses that there has been a significant increase in credit risk;

2) at group level for:

- receivables belonging to the small loan portfolio,
- receivables not belonging to the small loan portfolio if the bank assesses that there has been no increase in credit risk,
- receivables for which the amount of allowances for impairment of balance sheet assets or reserves for losses on off-balance sheet items calculated at individual level equal zero.

Within the meaning hereof, small loan portfolio shall consist of receivables due from borrowers whose total debt (prior to reduction by the amount of allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items) as at the date of calculation is less than:

- 6 million dinars – for banks whose balance sheet total is over 80 billion dinars according to financial statements for the preceding year;
- 4 million dinars – for banks whose balance sheet total is over 40 and less than 80 billion dinars according to financial statements for the preceding year;



- 2.5 million dinars – for banks whose balance sheet total is over 12 and less than 40 billion dinars according to financial statements for the preceding year;
- 1.5 million dinars – for banks whose balance sheet total is less than 12 billion dinars according to financial statements for the preceding year.

Receivables in the small loan portfolio shall be classified into subgroups of receivables with similar characteristics.

19. At least once a year, the bank shall test the quality of internal model for credit risk assessment in use, as well as:

- define basic elements of the method to be used in the appraisal of the model's quality;
- establish internal tolerance limits with respect to deviation of the model appraisal results from the actual values;
- document results of appraisal of the model's quality;
- make sure that the relevant body of the bank is informed of the results of the appraisal of the model's quality, as well as upgrade the model if internal tolerance limits referred to in indent 2 hereof are exceeded;
- ensure periodical review of appraisal results by internal audit.

### **Calculation and record keeping of special reserves for estimated losses and allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items**

20. The bank shall periodically calculate special reserves for estimated losses that may arise on balance sheet assets and off-balance sheet items and disclose such reserves in total amounts as specified in Sections 21 and 22 hereof subject to any changes in the quality and amount of its receivables, and at least on a quarterly basis.

21. Base for the calculation of special reserves for estimated losses shall be equal to the bookkeeping value of the receivables reduced by:

- the amount of unfunded commitments of lines of credit subject to unconditional cancellation by the bank without prior notice;
- 80% of the unfunded commitments of lines of credit with maturity of up to one year which are not subject to unconditional cancellation by the bank or cancellation without prior notice;
- 50% of the unfunded commitments of lines of credit with maturity of over one year which are not subject to unconditional cancellation by the bank or cancellation without prior notice;
- 50% of the value of performance guarantees.

22. Special reserves for estimated losses shall be calculated by taking into account the base for calculating special reserves determined in the manner specified in Section 21 hereof, namely as the sum of:

- 0% of receivables classified in category A,
- 5 – 10% receivables classified in category B,
- 20 – 35% receivables classified in category C,
- 40 – 75% receivables classified in category D,
- 100% receivables classified in category E.

In its enactments, the bank shall define in more detail criteria for the calculation of special reserves for estimated losses within the percentage bands from paragraph 1 hereof. The criteria may include past due status in the settlement of obligations, life insurance policy provided to the benefit of the bank, pledge on movable property, etc.

23. If the amount of special reserves for estimated losses calculated as stipulated hereunder exceeds the determined amount of allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items per borrower, in accordance with the bank assembly decision, the bank shall use its earnings to fund reserves for estimated losses in the amount of established positive differences.

If the bank's earnings are insufficient to cover the required level of reserves for estimated losses in a particular year – the difference shall be shown as the shortfall amount of such reserves as provided by Section 3, paragraph 2, provision 4) of the Decision on Capital Adequacy of Banks ("RS Official Gazette", No. 129/2007).

Allowances for impairment of balance sheet assets and reserves for losses on off-balance sheet items, calculated pursuant to the relevant methodology, shall be carried at the expense of expenditures.

If the amount of allowances for impairment from paragraph 3 hereof is higher than the calculated amount of special reserves for estimated losses per borrower, the bank shall not be required to use its earnings to fund reserves for estimated losses.

26. Until the prescribed level of reserves for estimated losses is reached, the bank may not pay out dividends on shares (from earnings in the current year, retained earnings from previous years and reserves), nor may the bank make any payments from earnings, such as payments to members of the board of directors and executive board, payments to the management on service contract, and/or on any other grounds.

27. The bank shall submit quarterly reports to the National Bank of Serbia on the amount and classification of its balance sheet assets and off-balance sheet items, as well as reports on the level of reserves for estimated losses.

Reports referred to in paragraph 1 hereof shall be prepared using the forms prescribed by special guidelines of the National Bank of Serbia and submitted within the deadlines and in the manner specified thereunder.

### **Transitional and closing provisions**

28. The bank shall submit enactments from Section 17 hereof to the National Bank of Serbia not later than 15 days from the effectiveness thereof, and amendments and supplements to such enactments within 15 days from their issue.

29. This decision shall supersede Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items ("RS Official Gazette", Nos.57/2006 and 116/2006).

30. This decision shall be published in the "RS Official Gazette" and shall take effect as of 1 July 2008.

D. No.106  
28 December 2007  
B e l g r a d e

G o v e r n o r  
National Bank of Serbia

Radovan Jelašić, sign.