

Decision
on the obligation to make provisions for litigations conducted against a
credit institution

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Zagreb, February 2010

Decision
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I GENERAL PROVISIONS

Article 1

This Decision governs:

- 1) the manner of and procedure for recording and monitoring litigations conducted against a credit institution;
- 2) criteria for the allocation of litigations conducted against a credit institution to risk groups; and
- 3) the manner of and procedure for discharging the provisioning obligation.

Article 2

(1) The provisions of this Decision shall apply to credit institutions with registered offices in the Republic of Croatia which are authorised by the Croatian National Bank, except electronic money institutions.

(2) The provisions of this Decision shall apply as appropriate to the branches of third-country credit institutions authorised by the Croatian National Bank to provide services.

Article 3

(1) In terms of this Decision, litigations conducted against a credit institution shall be proceedings initiated before a court or another competent body, in which the credit institution is the party sued and whose consequence, should the credit institution lose the litigation, can be an increase in the credit institution's liabilities and an outflow of funds for settling these liabilities (hereinafter: litigations).

(2) Litigations in which the debtor makes a counterclaim or a proposal to declare a distraint to be illegal, and which relate to reducing his/her liabilities to a credit institution, shall not be the subject matter of this Decision.

II OBLIGATION AND MANNER OF KEEPING RECORDS OF LITIGATIONS

Article 4

(1) A credit institution shall open a file of each initiated litigation and enter the following information in the records of litigations:

- 1) general data on the plaintiff, such as the name and surname/firm name, address, etc.;

- 2) value of the subject of dispute, or the amount of the minimum legally prescribed fine;
- 3) value of incidental claims, such as interest, proceedings costs, etc.;
- 4) type of proceedings;
- 5) legal basis of the claim;
- 6) body conducting the litigation and the file number;
- 7) risk group indication (A, B or C);
- 8) level of provisions expressed in percent and in absolute amount;
- 9) litigation status and a brief opinion on the estimated litigation outcome;
- 10) person responsible for conducting the litigation; and
- 11) date of opening the file.

(2) In violation proceedings, the credit institution shall enter the data referred to in paragraph (1) of this Article in the records of litigations as appropriate.

(3) By way of derogation from paragraph (1) of this Article, regarding litigations for which, pursuant to the provisions of this Decision, provisions are to be made in a lump-sum, the credit institution shall enter the following information in the records:

- 1) total value of the subject of dispute, or total amount of the minimum legally prescribed fine;
- 2) total value of incidental claims (interest or costs); and
- 3) total level of provisions expressed in per cent and in absolute amount.

(4) By way of derogation from paragraph (1) of this Article, a credit institution may combine several litigations into one file, indicating to which litigations the file relates, provided that these litigations rest on the same factual and legal bases.

(5) Should a credit institution entrust the conduct of litigation to a proxy who is not employed with the credit institution, it shall indicate in the records of litigations a person within the credit institution who is responsible for the supervision of the proxy's work.

(6) A credit institution shall keep the records of litigations referred to in paragraph (1) of this Article in a computerised form. The credit institution shall regularly update the data in the records referred to in paragraph (1) of this Article. The credit institution shall update and calculate on a quarterly basis the data in the records referred to in paragraph (1), item (3) of this Article, so that they reflect the best estimate as at the balance sheet date.

(7) Apart from the data in the records of litigations referred to in paragraph (1) of this Article, the file must contain the documentation relating to the litigation.

Article 5

(1) A credit institution shall, immediately after being advised that litigation has been initiated:

- 1) allocate the litigation to a risk group as determined in Article 6 of this Decision;
- 2) make provisions in accordance with Article 8 of this Decision; and
- 3) enter the data on the risk group, amount of provisions and other necessary data in the records of litigations.

(2) A person or an organisational unit of a credit institution responsible for the operations referred to in paragraph (1), items (1) and (2) of this Article shall state reasons in writing for the allocation to a risk group and the determined amount of provisions. The written statement of reasons forms a part of the documentation referred to in Article 4, paragraph (7) of this Decision.

(3) Paragraphs (1) and (2) of this Article shall not apply to litigations for which lump-sum provisions are made.

III PROCEDURE AND CRITERIA FOR THE ALLOCATION OF LITIGATIONS TO RISK GROUPS AND DETERMINATION OF NECESSARY PROVISIONS

Article 6

(1) A credit institution shall allocate litigation to risk groups A, B or C, depending on the estimated litigation loss, expressed in percent and in absolute amount.

(2) By way of derogation from paragraph (1) of this Article, a credit institution shall not be obliged to individually allocate to a risk group, or estimate the litigation loss for litigation, for which lump-sum provisions are made as referred to in Article 8, paragraph (5) of this Decision.

(3) A credit institution shall allocate to risk group A litigation for which no risk of loss has been established, or for which a cash outflow of less than 10% of the total amount has been estimated.

(4) A credit institution shall allocate to risk group B litigation for which a risk of loss has been established, or for which a cash outflow between 10% and 70% of the total amount has been estimated.

(5) A credit institution shall allocate to risk group C litigation for which a high risk of loss has been established, or for which a cash outflow of more than 70% of the total amount has been estimated.

(6) The total amount is the value of the subject of dispute and of incidental claims against a credit institution in a litigation, to which the counterparty will be entitled if the credit institution loses the litigation in full.

(7) By way of derogation from paragraph (6) of this Article, the full amount in violation proceedings shall be the amount of the minimum legally prescribed fine for each violation.

Article 7

In estimating the risk of loss, a credit institution shall assess the following:

- 1) positions of the suing parties and the parties sued to the litigation;
- 2) well-foundedness of the claim;
- 3) provability of the well-foundedness of the claim;
- 4) possibility of complaint in the case of cessation of liabilities (due to a set-off or ageing);
- 5) possibility of complaint about the competence of the court or another body before which the litigation has been initiated;
- 6) possibility of complaint on the basis of internal bylaws or general terms of operation of the credit institution;
- 7) findings and expert opinions, as well as witness testimonies;
- 8) case law in identical cases; and
- 9) other criteria which, at a scrupulous estimate of the credit institution, can impact on cash outflows.

Article 8

(1) A credit institution shall make provisions for litigation allocated to risk group A, if the total amount of the litigation exceeds 0.1% of the credit institution's assets according to its audited financial statements for the previous year. The provisions shall be made in the amount of the estimated cash outflow pursuant to Article 6, paragraph (3) of this Decision, but not less than 1% of the total amount of the litigation.

(2) Exceptionally, a credit institution need not make provisions for litigation referred to in paragraph (1) of this Article when it is obvious that this is a case of sham litigation.

(3) A credit institution shall, within 30 days of becoming aware that litigation referred to in paragraph (2) is initiated, notify the Croatian National bank thereof and supply a relevant explanation.

(4) A credit institution shall make provisions for litigations allocated to risk groups B and C in the amount of the estimated cash outflow pursuant to Article 6, paragraphs (4) and (5) of this Decision.

(5) A credit institution may make lump-sum provisions for litigations whose individual total amounts do not exceed:

- 1) HRK 70,000 – in the case of a credit institution whose assets exceed HRK 15 billion, according to its audited financial statements for the previous year;

- 2) HRK 50,000 – in the case of a credit institution whose assets are higher than HRK 3 billion, but lower than HRK 15 billion, according to its audited financial statements for the previous year;
- 3) HRK 30,000 – in the case of a credit institution whose assets are lower than HRK 3 billion, according to its audited financial statements for the previous year.

(6) Should a credit institution proceed in accordance with paragraph (5) of this Article, the lump-sum provisions shall be debited to the costs of the calculation period, to a minimum of 30% of the total amount of all litigations for which lump-sum provisions are made.

Article 9

Provisions for litigations shall be booked in a credit institution's business books as the cost of provisions for the period in which the provisions are recognized, as well as in its balance sheet liabilities as provisions for litigations initiated against the credit institution.

Article 10

A credit institution may prescribe the criteria for assessing a significant time effect of the value of money, as well as the criteria for the choice of a discount rate or discount rates to be used in determining the current values of future cash flows, taking into account all factors that have influenced or will influence the time effect of the value of money.

Article 11

(1) A credit institution shall, at least quarterly, adjust the amount of provisions in the way that it reflects the best estimate as at the balance sheet date.

(2) Apart from the obligation referred to in paragraph (1) of this Article, a credit institution shall also change the allocations to risk groups and the amount of necessary provisions if:

- 1) the decision pronounced is not legally effective;
- 2) a legally effective decision has been pronounced and a motion for revision or another legal remedy has been filed; or
- 3) the status has been changed during the proceedings with respect to the criteria set in Article 7 of this Decision, which can impact on the litigation outcome.

(3) A credit institution shall change the risk group and the amount of the necessary provisions only if the former risk group and/or amount of the necessary provisions are no more adequate owing to the circumstances referred to in paragraph (2) of this Article.

(4) In case of a partial or full loss of the litigation, a credit institution shall be obliged to make provisions:

- 1) of a minimum of 10% of the total amount, in the case the decision pronounced is not final;
- 2) of 100% of the total amount, in the case of a final decision challenged by an appeal or another exceptional remedy.

(5) A decision on the change of the risk group and of the amount of provisions shall contain the reason for and date of changing the risk group and the amount of the necessary provisions.

IV REPORTS TO THE MANAGEMENT BOARD

Article 12

(1) A person or an organisational unit of a credit institution responsible for keeping records of the credit institution's litigations shall submit, at least semi-annually, a litigation status report.

(2) A credit institution shall prepare the report referred to in paragraph (1) of this Article based on the data from the records referred to in Article 4 of this Decision, which must contain at least the data on the:

- 1) total number of litigations and the total amount thereof;
- 2) total number of litigations by risk group;
- 3) total amount of provisions made;
- 4) total number of litigations and the amount of provisions for litigations for which lump-sum provisions are made; and
- 5) the total number and amount of contingent liabilities in relation to which the counterparty has not as yet initiated litigation proceedings but the credit institution is aware that the counterparty will initiate litigation proceedings for the purpose of their fulfilment.

V INTERNAL AUDIT

Article 13

The subject matter of a regular internal audit shall be provisions for litigations. A credit institution's management board shall evaluate the provisions for litigations.

VI REPORTING TO THE CROATIAN NATIONAL BANK

Article 14

(1) A credit institution shall submit to the Croatian National Bank a report on litigations with a detailed description of the litigation status. The sum of the total amounts of litigations must be at least 50% of the value of all litigations. The credit institution shall

prepare the report as at 31 December and submit it to the Croatian National Bank no later than 31 January of the following year.

(2) The report referred to in paragraph (1) of this Article shall be submitted on a form attached to and forming an integral part of this Decision.

VII INTERNAL BYLAWS OF A CREDIT INSTITUTION

Article 15

(1) A credit institution shall adopt or amend its bylaw regulating litigations in accordance with the provisions of this Decision, as well as prescribe in detail:

- 1) the procedure for litigation monitoring; and
- 2) the deadlines and persons responsible for risk estimation and determination of the necessary provisions for litigations.

(2) A credit institution shall prescribe in detail in its internal bylaw referred to in paragraph (1) of this Article, the treatment of litigations the conducting of which is entrusted to a proxy who is not employed with the credit institution. In such a case, the proxy shall inform the credit institution of the litigation status and of all the data required by the credit institution in complying with this Decision.

VIII TRANSITIONAL AND FINAL PROVISIONS

Article 16

This Decision shall be published in the Official Gazette and shall enter into force on 31 March 2010.¹

¹ A credit institution shall, within 30 days of entry into force of this Decision, notify the Croatian National Bank of all litigations referred to in Article 8, paragraph (1) of this Decision for which it deems that are obviously cases of sham litigation and had been initiated prior to the entry into force of this Decision. The notification shall be accompanied by a relevant explanation.

No.	Title/name of plaintiff	Start date of litigation	1	2	3	4=1+2+3	Risk group	Percentage of provisions	Amount of provisions	Litigation status
			VSD	Interest amount	Litigation costs	Total amount				
1.										
2.										
3.										
4.										
5.										
TOTAL										
Other litigations not listed individually (report the total amount of other litigations in columns 1, 2 and 3)							Not to be completed	Not to be completed		Not to be completed
Litigations for which lump-sum provisions are made (total) <hr/> Report the total number of such litigations			Not to be completed	Not to be completed	Not to be completed		Not to be completed	Not to be completed		Not to be completed
TOTAL							Not to be completed	Not to be completed		Not to be completed