

Pursuant to Articles 25 and 39, paragraph 2, under i), of the Croatian National Bank Act (Official Gazette 36/2001) and Article 69, paragraph 3, and Article 70, paragraph 3, of the Banking Act (Official Gazette 84/2002) the Governor of the Croatian National Bank on 12 December 2005 enacted the following

**DECISION  
ON AMENDMENTS TO THE DECISION ON THE CLASSIFICATION OF  
PLACEMENTS AND CONTINGENT LIABILITIES OF BANKS**

Article 1

In the Decision on the Classification of Placements and Contingent Liabilities of Banks (Official Gazette 17/2003) Article 2 is amended to read:

"For the purpose of this Decision, total bank assets shall be divided into:

- 1) assets that are classified into risk categories - items on the basis of which a bank is exposed to credit risk, i.e. a risk of loss as a result of debtors' default on their obligations to a bank.
- 2) assets that are not classified into risk categories - items on the basis of which a bank is exposed to market risk and other types of risks other than credit risk (investment in securities and other financial instruments designated at fair value through profit or loss, investment in associates and related companies, i.e. subsidiaries, and tangible assets and other similar items not mentioned here).

Article 2

Article 4 is amended to read:

"(1) A bank shall issue by-laws regulating more precisely the method of systematic:

- 1) determination and monitoring of (when establishing and in the course of the business relation) creditworthiness of persons to whom a bank is exposed, as well as the quality of instruments of collateral for bank claims and contingent liabilities,
- 2) keeping of credit records and records of assumed contingent liabilities, including systematic recording and monitoring of court proceedings initiated by the bank for the purpose of settling its claims,
- 3) classification of placements and contingent liabilities into risk categories,
- 4) provisioning for losses, i.e. individual and collective impairment of placements;

(2) By-laws referred in paragraph 1 of this Article shall contain detailed criteria for determining and monitoring the creditworthiness of persons to whom the bank is exposed as well as credit risk management procedures, laid down separately for credit exposures arising from:

- 1) kuna placements;

2) placements indexed to foreign currency;

3) foreign currency placements.

Placements referred to in item 1, 2 and 3 of this paragraph encompass all financial instruments which give rise to a bank's exposure to credit risk (loans, financial instruments held to maturity, debt instruments classified into the available-for-sale portfolio).

(3) Credit risk arising from placements referred to in paragraph 2, items 2 and 3, of this Article and the techniques used for managing such credit risk, should be determined by a bank, taking into account primarily possible changes in the financial situation of the debtor arising as a result of potential changes in the exchange rate of the kuna against the currencies in which such placements are denominated, i.e. taking into account the ability of debtors to service their credit obligations to a bank, in accordance with the contract, in potentially changed circumstances. For the purpose of this paragraph, subject to monitoring are placements indexed to foreign currency and foreign currency placements, including contingent liabilities of a bank denominated in foreign currency (indexed to foreign currency and in foreign currency). Exceptionally, short-term loans (with maturity up to 12 months), where the principal of individual loans granted to natural persons does not exceed HRK 50 000, i.e. HRK 500 000 in case of loans to legal persons, are not subject to monitoring for the purpose of this paragraph.

(4) The implementation of the provisions referred to in paragraph 3 of this Article shall include monitoring, analysing and assessment of the following:

1) whether the foreign exchange position of an individual debtor or peer groups of debtors is matched, awarding particular attention to debtors with a short foreign exchange position,

2) whether cash flows of an individual debtor or peer group of debtors can be adjusted to the potential changes in the level of their overall obligations, especially obligations towards the bank, arising from changes in the exchange rate of the kuna against the currencies in which bank placements are denominated.

(5) For the purpose of paragraph 4 of this Act it shall be deemed that the foreign exchange position of a bank's debtors is not matched if their foreign exchange inflow covers less than 80 percent of their foreign exchange liabilities and liabilities indexed to foreign currency which they have towards the bank and other creditors. A bank shall develop an internal system of identifying debtors with matched and mismatched position and notify the Croatian National Bank thereof in the manner stipulated by the Croatian National Bank in the Instruction for the Preparation of Supervisory Reports.

### Article 3

In Article 5, paragraph 2 is added after paragraph 1 and reads:

"Pursuant to items 63 and 64 of IAS 39 a bank shall form provisions for identified losses arising from placements, i.e. impairment losses, as follows:

1) on individual basis for placements which are not classified under the "portfolio of small loans"

2) on collective basis:

- for placements classified under the "portfolio of small loans" unless assessed individually by the bank;
- for all placements to a single debtor against whom bankruptcy proceedings have been initiated, unless the bank is a creditor with separate satisfaction right and assesses such placements individually;
- for placements classified into risk group A."

#### Article 4

In Article 6, paragraph 1, items 4 and 5 are amended to read:

"4) claims arising from factoring and forfaiting, provided they are classified as held-to-maturity financial assets, available-for-sale financial assets or loans in accordance with IAS 39.

5) investments in debt securities, if, in accordance with IAS 39, these investments are classified as held-to-maturity financial assets or available-for-sale financial assets".

#### Article 5

In Article 7, paragraph 2, item seven is added, which reads:

"7) debtor's exposure to currency risk."

#### Article 6

In Article 8, paragraphs 2 and 3 are amended to read:

"(2) Banks are obliged to specifically prescribe, in the by-laws referred to in Article 4 of this Decision, the procedures for granting placements and monitoring the recovery of placements from the "portfolio of small loans" and define in detail the criteria for the classification of these placements into risk categories. In the said by-laws, a bank may set as threshold a lower gross amount of total placements to a single debtor than the amounts stipulated in paragraph 1 of Article 8 of this Decision.

(3) If placements from the "portfolio of small loans" are classified into risk categories only on the basis of debtor's timeliness in meeting their obligations to a bank, for the purpose of this Decision, the conditions for the classification of these placements into the following risk categories shall be deemed to have been met:

- 1) risk category B - where there are overdue claims on the basis of these placements that have not been recovered within 90 days, counting from the maturity date,
- 2) risk category C - where there are overdue claims on the basis of these placements that have not been recovered within 180 days, counting from the maturity date."

Paragraph 4 is inserted after paragraph 3 and reads:

"(4) By way of derogation from the provisions of paragraph 3 of this Article, small amounts of overdue debt as compared with the remaining debt of the debtor must not be classified into risk category B or C. For the purpose of this paragraph a small amount of debt shall be overdue debt of up to HRK 500 for loans to legal persons or HRK 100 for loans to natural persons, provided that the said amount does not account for more than 1% of total debt."

#### Article 7

In Article 9, paragraph 1, the second sentence is deleted.

Paragraph 4 is amended to read:

"If a debtor becomes delinquent in settling his obligations to a bank and the bank fails to take appropriate legal actions in order to collect its claims by activating the available instruments of collateral, a bank shall classify the placements that were formerly, on the basis of instruments of collateral, graded A into risk category B, and make value adjustments or form provisions as appropriate. For the purpose of this paragraph, it shall be deemed that a debtor becomes delinquent in settling his obligations to a bank if more than 90 days have elapsed from the date of maturity.

Regardless of the legal actions taken in order to collect bank claims by activating instruments of collateral, if placements are not recovered within two years, counting from the day the debtor became delinquent in settling his obligations to a bank, a bank is obliged to classify the uncollected placement into risk sub-category B-2 or B-3 referred to in Article 11, paragraph 3, of this Decision and, taking into account the probability of recovery, make appropriate value adjustment equalling to at least 30% of the carrying amount of the principal of the placement.

The provisions of this paragraph shall also refer to placements that are classified under the "portfolio of small loans", pursuant to the criteria referred to in Article 8 of this Decision."

In paragraph 6 after the words "not more than" the number "60" is replaced by number "90", and the number "60" after the word "within" is replaced by number "90".

#### Article 8

In Article 10, paragraph 1 is amended to read:

"(1) Interest income from placements classified into risk category A shall be recognized in the income statement in accordance with IAS 18, item 30/a."

#### Article 9

In Article 11, paragraph 2, at the end of the text, after the words "carrying value", the words "recorded in balance sheet and off-balance sheet accounts" are added.

In paragraph 3, after the word "criteria", the words "for establishing future cash inflows arising from partly recoverable placements."

After paragraph 3, new paragraphs 4 and 5 are added, which read:

"(4) For the purpose of calculating the percentage, referred to in paragraph 3 of this Article, which is used as a criterion for classification of placements in sub-categories B-1, B-2, B-3, recoverable amount of placement shall imply the present value of estimated expected future inflows from that placement (principal plus interest), whereas the carrying amount, i.e. the agreed amount of placement, shall imply the balance of claims based on principal and accrued interest, recorded in the balance sheet and off-balance sheet accounts.

(5) If a larger inflow is expected, based on liquidation of the bank's collateral, compared to the amount to which a bank is entitled under the contract, such difference shall not be included in the calculation of the present value of expected future cash inflows, i.e. in the calculation of recoverable amount of placements, referred to in Article 4 of this Article".

#### Article 10

In Article 12, paragraph 1, the words "item 110" are replaced by the words "items 59 and 61."

In paragraph 2, in the first sentence, after the words "amount of" the words "principal of" are inserted, and after the word "flows" in the same sentence, the words "based on principal and interest" are added.

In paragraph 2, the third sentence is deleted which reads:

"The following items shall be separately monitored:

- portion of the loss related to a difference between the carrying amount of placements and the expected future collections
- portion of the loss that results from discounting the expected future collections to their present value."

Paragraph 4 is amended to read:

"(4) Expected future cash flows arising from partly recoverable placements shall be discounted to their present value at the original/initial effective interest rate, i.e. the effective interest rate computed at the conclusion of the placement contract (IAS 39, item 63 and item AG84 of Appendix A). For the purpose of discounting the expected future cash flows arising from partly recoverable placements, a bank shall apply the annual percentage rate (APR), which is computed in accordance with the methodology set out in the Decision on the Uniform Disclosure of the Effective Interest Rate on Loans and Deposits (the rate which does not include the effect of security deposit flows in calculating the effective interest rate). If, in the case of financial difficulties of a debtor, the lending terms and conditions, concerning the level and time limits for repayment, are modified by a subsequent annex to the contract, the initial rate (APR), which was determined prior to the modification of the contract, shall also be used for discounting the expected future cash flows. For discounting the expected future cash flows arising from partly recoverable placements, where the initial contract contains the interest rate variability clause or

where the originally contracted interest rate was changed by a subsequent annex to the contract, a bank shall apply current/present effective interest rate (APR). The application of the current/present effective interest rate shall imply the application of the annual percentage rate (APR) computed at the time of determining the present value of the expected future cash flows arising from partly recoverable placements. This rate (APR) shall be computed by taking into account the entire period for which the contract was concluded (rather than only the remaining maturity) and the interest rate applicable as at the date of computation (APR is computed under the assumption that a placement was initially contracted with the currently applicable, modified interest rate). When the present value of expected future cash flows for partly recoverable placements is determined for the placements which were not subject to effective interest rate computation at the time of approval, a bank shall calculate the annual percentage rate (APR) for the purpose of discounting, on the basis of the initial contractual provisions, applying fixed or current/present interest rate in accordance with this paragraph."

#### Article 11

Article 13 is amended to read:

"(1) Claims based on accrued interest income from partly recoverable and irrecoverable placements (following the classification of placements into risk categories B or C) shall be carried in business books in the off-balance sheet accounts.

(2) Interest income, referred to in paragraph 1 of this Article, shall be carried at profit or loss, when and if it is collected."

#### Article 12

In Article 14, paragraph 3, after the word "within" number "60" is replaced by number "90".

#### Article 13

In Article 15, paragraph 1, after the word "within" number "60" is replaced by number "90".

#### Article 14

After Article 22, Article 22a is added, which reads:

#### "Article 22a

(1) A bank shall prescribe, by a special by-law, procedures relating to the monitoring of court cases instituted against the bank, risk assessment and provisions for liabilities that are not reported in the bank's business books, and which may arise on the basis of the lost court cases or arbitration. In terms of this paragraph, court cases instituted against the bank shall imply the cases in which the bank is a defendant or the accused and which may result, in case the bank loses the case, in an increase of the bank's liabilities and outflow of monetary resources for settling these liabilities.

The court cases that may be brought against the bank for the purpose of diminishing the plaintiff's liabilities towards the bank (e.g. to declare enforcement proceedings in favour of the bank invalid, etc.) shall not be encompassed by this paragraph since they should be recorded and monitored as a part of credit records (in terms of Article 4, paragraph 1 of the Decision).

(2) The bank's by-law, referred to in paragraph 1 of this Article, shall prescribe the procedures concerning the systematic monitoring of court cases brought against the bank. The following shall be prescribed or determined in the procedures, as a minimum:

- method of keeping records on court documents,
- procedures, criteria, time limits and responsible persons for risk assessment and determining the required provisions for covering liabilities arising from instituted court cases against the bank,
- method of management reporting concerning court cases (contents of reports, obligated persons and reporting frequency which should not exceed 6 months, counting from the previous report).

(3) The amount of provisions, referred to in paragraph 2 of this Article, shall be determined in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets, and shall be recorded in the bank's business books as a cost of provision for the period in which the provisions are recognised, as well as under balance sheet liabilities as provisions for court cases instituted against the bank."

## Article 15

Article 24 and the title above are amended to read:

"IV COLLECTIVE PROVISIONS FOR IDENTIFIED LOSSES

## Article 24

(1) In addition to loss provisions, i.e. individually impaired placements classified into risk categories B and C, which are individually significant placements, and individually or collectively impaired placements which are not individually significant ("portfolio of small loans"), a bank shall make loss provisions, i.e. collectively assess for impairment placements that are classified into risk category A, in accordance with items 63 and 64 of IAS 39.

(2) Provisions shall be formed, i.e. placements, referred to in paragraph 1 of this Article, shall be impaired by debiting banks' expenses and by crediting the special provisioning account under liabilities. They shall be entered as a special deduction item reducing the bank's balance sheet assets in the financial reports.

(3) Provisioning for losses, referred to in paragraph 2 of this Article, i.e. collective impairment of placements shall be performed in accordance with the criteria determined by the by-law, referred to in Article 4 of the Decision.

(4) When setting the criteria for the assessment of the existing losses in the portfolio of placements classified into risk category A, the bank should take the following characteristics into account: distribution of these placements by industries, geographic areas and institutional sectors (especially specific features of credit risk in the corporate and retail segment), financial strength of debtors, currency structure of placements, as well as other characteristics according to which these placements may be classified into several sub-categories involving different degrees of credit risk or loss. For the purpose of this paragraph, loans indexed to foreign currency and foreign currency loans are usually considered associated with a higher degree of risk, compared to loans denominated in kuna, since the former also contain a component of currency induced credit risk.

(5) Provisioning for losses in the portfolio of placements graded A, i.e. their impairment, shall be performed up to the amount of the estimated losses for an individual sub-group of these placements, with the sum of loss provisions, i.e. impairment, amounting to 0.85% to 1.20% of the total balance of placements classified into risk category A.

(6) The bank shall monitor on an on-going basis and shall revise, as appropriately, the criteria for forming loss provisions, i.e. for impairment of placements classified into risk category A, in order to maintain these provisions, i.e. impairments, at the level of actual latent losses associated with these placements.

(7) Parallel to the provisioning for losses arising from placements graded A, a bank shall make collective provisions for losses arising from risky off-balance sheet items classified into risk category A. Provisions, referred to in this paragraph, shall be formed by debiting the bank's expenses and crediting a special liabilities account, while they shall be recorded as other liabilities in the financial reports. The amount of these provisions may be between 0.85% and 1.20% of the total amount of the bank's contingent liabilities classified into risk category A."

#### Article 16

In Article 28, paragraph 3, the word "and" is replaced by a coma, and after the word "commitments", the words "and other traditional off-balance sheet risky items" are added.

After paragraph 3, paragraph 4 is added, which reads:

"(4) A bank shall deliver in writing a calculation of the basis for forming reserves for general bank risks as at 31 December of the year for which the calculation is made, together with special financial reports, referred to in item 20 of the Decision on the audit of financial reports and business functions of the bank, within the time limit set out in Article 112, paragraph 3 of the Banking Act."

#### Article 17

In Article 34, item 1, the word "and" after the word "loans" is replaced by a coma, and the words "generated by a bank" are deleted, and after the word "cost", the words "as well as debt instruments from the portfolio of available-for-sale assets" are inserted.

In item 2, after the word "assets", the words "consisting of equity instruments" are added.

Item 3 is amended to read:

"(3) derivatives classified as held for trading financial assets, in accordance with IAS 39, as well as derivatives used as hedging instruments, shall be reported, for the purpose of measuring exposure, at the amount entered under "total exposure/original exposure" in the form KOIRS – Credit Risk of Other Off-Balance Sheet Risky Items, in accordance with the Instruction for the uniform implementation of the Decision on the capital adequacy of banks."

#### Article 18

(1) Financial reports as at 31 December 2005 and 31 March 2006 shall be prepared in accordance with the provisions of the Decision on the Classification of Placements and Contingent Liabilities of Banks (Official Gazette 17/03). The first financial reports under this Decision shall be prepared as at 30 June 2006.

(2) Banks shall make the adjustment of their by-law, referred to in Article 4 of the Decision, by 30 April 2006.

(3) Banks shall adopt the by-law, referred to in paragraph 22a of the Decision, by 31 August 2006 and shall begin to apply the same when preparing the financial reports as at 30 September 2006.

(4) This Decision shall enter into force on the eighth day following its publication in the Official Gazette.

Decision No. 474-020/12-05/ŽR  
Zagreb, 12 December 2005

Governor  
Croatian National Bank  
Dr Željko Rohatinski