



H N B

G U V E R N E R

Pursuant to Article 101, paragraph (2), item (2) of the Credit Institutions Act (Official Gazette 159/2013, 19/2015 and 102/2015) and Article 43 paragraph (2), item (9) of the Act on the Croatian National Bank (Official Gazette 75/2008 and 54/2013), the Governor of the Croatian National Bank hereby issues the

**Decision
on the classification of exposures into risk categories and the method of
determining credit losses**

I GENERAL PROVISIONS

**Subject matter
Article 1**

- (1) This Decision prescribes:
- 1) the criteria for the classification of exposures into risk categories;
 - 2) the method of determining the expected credit losses arising from credit risk;
 - 3) the method for making balance sheet items' impairment and provisions for off-balance sheet items; and
 - 4) the definitions of eligible instruments of collateral for exposures for the purposes of determining the expected future cash flows.
- (2) The provisions of this Decision shall apply to:
- 1) financial instruments classified, in accordance with the International Financial Reporting Standard 9 Financial instruments (hereinafter: IFRS 9), into the following portfolios:
 - 1 financial assets at amortised cost;
 - 2 financial assets at fair value through other comprehensive income, except equity instruments; and
 - 2) financial instruments that are:
 - 1 lease receivables;
 - 2 liabilities under loans; and
 - 3 liabilities under financial guarantee contracts; and
 - 3) other exposures covered by IFRS 9.

**Legal persons subject to the Decision
Article 2**

The provisions of this Decision shall apply to:

- 1) credit institutions with head offices in the Republic of Croatia, authorised by the Croatian National Bank; and
- 2) branches of third-country credit institutions authorised by the Croatian National Bank to establish a third-country branch of a credit institution.

Definitions

Article 3

- (1) The individual terms used in this Decision shall have the following meaning:
- 1) **Financial instrument, financial asset and financial liabilities** shall be interpreted in terms of item (11) of the International Accounting Standard (hereinafter IAS) 32 *Financial Instruments: Presentation*;
 - 2) **Exposure** means all balance and off-balance sheet items relating to a specific financial instrument that are the subject of this Decision;
 - 3) **The category of retail exposures** shall be interpreted in terms with Article 147 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (hereinafter Regulation (EU) No 575/2013);
 - 4) **Expected credit losses** shall be interpreted in terms of IFRS 9 Appendix A;
 - 5) **Impairment** means an impairment for the expected credit losses on financial assets that are the subject of this Decision;
 - 6) **Provisions** mean provisions for the expected credit losses on off-balance sheet items that are the subject of this Decision;
 - 7) **Off-balance sheet items** means liabilities, the settling of which will require or might require an outflow of credit institution's cash, on the basis of which, due to uncollectibility of the future outflow of credit institution's funds, the credit institution is exposed to credit risk (issued guarantees, opened uncovered letters of credit, letters of guarantee and other commitments, commitments under credit contracts, etc., excluding the notional amount of derivative instruments);
 - 8) **Conversion factor** means the ratio of the currently undrawn amount of an off-balance sheet item that could be drawn and that could therefore be outstanding at default to the currently undrawn amount of the off-balance sheet item;
 - 9) **Restructured exposures** means exposures which underwent changes in the originally agreed lending terms due to a deterioration in any of the general classification criteria referred to in Article 4 of this Decision. An exposure shall be deemed to be restructured in the case of interest rate reduction, a write-down or write-off of interest receivables, a change in the amount of principal, a change in payment terms, a direct or indirect approval of a new exposure replacing the existing exposure and/or a change in other originally agreed lending terms;
 - 10) **Eligible instruments of collateral** means instruments of collateral for exposures taken into account by a credit institution in the estimation of future cash flows which meet the requirements laid down in Articles 17 to 19 of this Decision. Eligible instruments of collateral for exposures are divided into first-class instruments, appropriate instruments of collateral in the form of real estate or movable property and other appropriate instruments of collateral;
 - 11) **Impairment factor** means a factor used for value adjustment of estimated future cash flows arising from an eligible instrument of collateral in relation to the market price of the instrument of collateral and the appropriate internally estimated collection period;
 - 12) **Effective interest rate** shall be interpreted in terms of IFRS 9 Appendix A Financial Instruments;
 - 13) **Central government, central bank and a group of connected persons** shall be interpreted in terms of Regulation (EU) No 575/2013.

2 CLASSIFICATION OF EXPOSURES

General exposure classification criteria

Article 4

(1) A credit institution shall, for the duration of the contractual relationship, assess the credit quality of exposures and classify such exposures into appropriate risk categories on the basis of the following criteria:

- 1) debtors' creditworthiness;
- 2) debtors' timeliness in meeting their obligations towards a credit institution and other creditors; and
- 3) quality of the instruments of collateral by individual exposures.

Debtors' creditworthiness

Article 5

(1) A credit institution shall assess debtors' creditworthiness at least on the basis of the following criteria:

- 1) debtor's status, personal and economic characteristics, expertise of the management board and senior management, the quality of plans and programmes financially supported by a credit institution (for legal persons);
- 2) debtor's level of capital and reserves and their share in debtor's balance sheet (for legal persons);
- 3) debtor's asset strength;
- 4) debtor's liquidity and profitability;
- 5) debtor's cash flows in the previous period and the estimated future cash flows, relative to their liabilities;
- 6) debtor's business conditions and future prospects, as well as the debtor's market position and the position of the entire industry in which a debtor is engaged (for legal persons); and
- 7) debtor's exposure to currency and interest rate risk arising from receivables with a currency clause, receivables in a foreign currency and receivables with a variable interest rate, including off-balance sheet liabilities with a currency clause and off-balance sheet liabilities in a foreign currency.

(2) A credit institution shall view the credit risk arising from exposures referred to in paragraph (1), item (7) of this Article and the techniques for the management of that risk in the light of a possible change in a debtor's financial position which could take place due to a change in the exchange rate of the domestic currency against foreign currencies and interest rate changes, i.e. in the light of a debtor's ability to meet their credit liabilities towards a credit institution, in accordance with the contract, even in potentially changed circumstances.

(3) For the purposes of paragraph (2) of this Article, a credit institution shall establish an internal system of monitoring, analysing and assessing whether the foreign exchange position of individual debtors or peer groups of debtors is matched and whether their cash flows can be adjusted to the potential changes in the level of their liabilities towards a credit institution and overall liabilities due to the effect of exchange rate changes. A credit institution shall award a particular attention to debtors with a mismatched foreign exchange position (those with a short open foreign exchange position, including off-balance sheet liabilities), which may, in the case of a change in the exchange rate of the domestic

currency against foreign currencies, lead to major disturbances in such debtors' settlement of their liabilities towards a credit institution. The foreign exchange position of a credit institution's debtor shall be deemed mismatched if the debtor's expected foreign exchange inflows cover less than 80% of the debtor's foreign exchange liabilities and liabilities with a currency clause towards the credit institution and other creditors. A credit institution shall develop an internal system of identifying debtors with matched and mismatched foreign exchange positions.

- (4) Exceptionally, paragraphs (2) and (3) of this Article shall not apply to exposures with a currency clause and foreign exchange placements which include off-balance sheet liabilities denominated in a foreign currency, provided that the overall exposure, under this paragraph, to a single natural person and to a single legal person does not exceed HRK 50 000 and HRK 500 000, respectively.

Default **Article 6**

- (1) For the purposes of this Decision, a debtor shall be deemed to be in default if the conditions prescribed by Article 178 of Regulation (EU) No 575/2013 have been met.
- (2) By way of derogation from paragraph (1) of this Article, in the case of retail exposure category, a credit institution may assess the occurrence of a default based on an individual product if this is in line with the internal risk management process.
- (3) In the case referred to in paragraph (2) of this Article, if a credit institution has balance sheet exposures to a debtor which are in default and the gross carrying value of the exposures in default accounts for over 20% of the gross carrying value of all balance sheet exposures to that debtor, all balance and off-balance sheet exposures by each product of that debtor shall be deemed in default.
- (4) For the purposes of paragraph (1) of this Article, a credit institution shall prescribe the indicators suggesting a debtor's inability to settle their liabilities in full. For the purposes of this paragraph, the indicators shall be in particular:
 - 1) observable significant financial difficulties of a debtor;
 - 2) a breach of contract, such as a default or delinquency in interest and/or principal payments or failure to perform other provisions of the contract; and
 - 3) the existence of a probability of initiation of bankruptcy proceedings or taking of another legal action (financial reorganisation) as a result of a debtor's poor financial position.
- (5) In the case referred to in paragraph (4) of this Article, when determining the indicator suggesting the probability of a debtor's inability to settle their liabilities in full, the credit institution shall take into account the relationships within groups of connected persons. A credit institution shall determine in its internal procedures the situations in which a default by a debtor from a group of connected persons leads to spreading of default to other entities within that group.
- (6) For the purposes of paragraph (1) of this Article, default shall be considered to have occurred in the case of restructured exposures which will probably result in a debtor's diminished financial liability caused by a material forgiveness or postponement of principal, interest, of where applicable, fees.

- (7) As regards restructured exposures, a credit institution shall keep special records on such exposures and set up a system for their subsequent monitoring.

2.1 RISK CATEGORIES

Classification of exposures into risk categories

Article 7

Depending on the assessment of the criteria referred to in Article 4 of this Decision, all exposures shall be classified into the following categories:

- 1) risk category A, consisting of risk sub-categories A-1 and A-2;
- 2) risk category B, consisting of risk sub-categories B-1, B-2 and B-3; and
- 3) risk category C.

Portfolio of small loans

Article 8

- (1) Exposure of a credit institution to a single person or a group of connected persons shall not be considered individually significant if it does not exceed the amounts referred to in paragraph (2) of this Article (portfolio of small loans).
- (2) A credit institution may conduct an assessment of impairment of exposures classified into risk categories B and C on a collective basis if the gross exposure of a credit institution to a debtor or a group of connected persons does not exceed the following amounts:
 - 1) HRK 500 000 if the total assets of a credit institution amount to less than HRK 7bn;
 - 2) HRK 1 000 000 if the total assets of a credit institution amount to over HRK 7bn and less than HRK 20 bn; or
 - 3) HRK 3 000 000 if the total assets of a credit institution amount to over HRK 20bn.
- (3) The assets referred to in paragraph (2) of this Article shall be the assets amount reported in the audited financial statements of a credit institution for the previous year.
- (4) By way of derogation from paragraph (2) of this Article, a credit institution may determine by its internal by-law, a smaller amount of overall exposure to a single debtor and the persons connected with that debtor as a threshold above which no assessment of impairment of exposure on a collective basis can be made.
- (5) A credit institution shall apply the criteria determined in paragraphs (2) or (4) of this Article consistently to all its debtors.

2.1.1 RISK CATEGORY A

Criteria for the classification into risk category A and impairment of exposures in risk category A

Article 9

- (1) Only exposures to debtors who are not in default under this Decision may be classified into risk category A.
- (2) A credit institution shall classify exposures into a risk sub-category:
 - 1) A-1 if after initial recognition the credit risk for individual exposures of a debtor has not risen considerably;
 - 2) A-2 if after initial recognition the credit risk for individual exposures of a debtor has risen considerably.
- (3) A credit institution shall, in line with the provisions of IFRS 9, make an appropriate impairment of exposures and provisions for exposures in an amount which equals:
 - 1) the expected credit losses over a twelve-month period for the risk sub-category A-1;
 - 2) the expected credit losses over full lifetime for the risk sub-category A-2.

General requirements for the methods of assessment of the expected credit losses

Article 10

- (1) A credit institution shall prescribe by its internal by-laws the indicators for determining a debtor's increased credit risk to be used for transition of exposure from risk sub-category A-1 to risk sub-category A-2.
- (2) For the purposes of paragraph (1) of this Article, a credit institution shall use as an obligatory indicator debtors' timeliness in meeting their due liabilities. A credit institution shall classify debtors with overdue exposures to a credit institution covered by this Decision over 30 days, but less than 90 days, into risk sub-category A-2. This provision shall not apply to exposures to the central government and other exposures for which a credit institution may prove that a 30 day default is not a relevant indicator.
- (3) For the purposes of adequacy of the assessment of the expected credit losses, a credit institution shall prescribe in detail:
 - 1) appropriate processes and control mechanisms for the development and use of the methods for the assessment of the expected credit losses with a view to ensuring their integrity and timely inclusion of relevant data;
 - 2) an independent regular process for method efficacy monitoring; and
 - 3) regular audit of the procedure for determining the expected credit losses by the internal audit or other comparable independent unit responsible for audit.
- (4) A credit institution shall set up the procedures necessary to address appropriately the deficiencies determined in processes and control mechanisms referred to in paragraph (3) of this Article.

2.1.2 RISK CATEGORIES B and C

Criteria for the classification of exposures into risk categories B and C

Article 11

- (1) A credit institution shall classify exposures to a debtor in default under this Decision into a risk sub-category B-1 or worse and make an appropriate impairment and provisions. The impairment in risk sub-category B-1 shall be minimum 2%.
- (2) By way of derogation from paragraph (1) of this Article, a credit institution may assess that impairment of an exposure to a debtor in default in risk sub-category B-1 amounts to less than 2%, in which case the credit institution shall take into account the risk or probability of credit loss in a manner which reflects the probability of credit loss and the probability of absence of credit loss, even if the probability of credit loss is very small.
- (3) Depending on the level of impairment and provisions, a credit institution shall classify exposures into an appropriate risk sub-category as follows:
 - 1) If the level of impairment and provisions does not exceed 30% of the amount of exposure, a credit institution shall classify the exposure into risk sub-category B-1;
 - 2) If the level of impairment and provisions is above 30% and below 70% of the amount of exposure, a credit institution shall classify the exposure into risk sub-category B-2;
 - 3) If the level of impairment and provisions is above 70% and below 100% of the amount of exposure, a credit institution shall classify the exposure into risk sub-category B-3; and
 - 4) if the level of impairment and provisions amounts to 100% of the exposure, and the conditions for the write-off of receivables under such exposures have not yet been met, a credit institution shall classify the exposure into risk category C.

Impairment of exposures in risk categories B and C

Article 12

- (1) Impairment by individual exposures classified into risk categories B and C shall be determined as the positive balance between gross carrying amount of an individual exposure and the present value of the estimated future cash flows of a debtor, discounted by effective interest rate.
- (2) In the case of default and when an estimate of future cash flows is based on the value of eligible instruments of collateral and a credit institution does not take appropriate legal action to collect its receivables by exercising instruments of collateral, the credit institution shall classify such exposures into risk sub-category B-1 or worse and make an appropriate impairment of minimum 15% of the exposure. If a credit institution does not take appropriate legal action to collect its receivables by exercising eligible instruments of collateral within one year from the date of a debtor's default, the credit institution shall make an impairment of minimum 25% of the exposure.
- (3) Regardless of the legal action taken by a credit institution to collect its receivables by exercising instruments of collateral, if collection has not taken place within two years, counting from the date of a debtor's default, a credit institution shall classify uncollected exposures until the date of their collection into risk sub-category B-1 or worse and, taking into account the chances for collection, shall make a one hundred-percent impairment of receivables based on interest receivables and an impairment of minimum 30% of receivables based on principal, and increase it by additional 5% of receivables based on principal every 180 days.

- (4) A credit institution shall make the impairment referred to in paragraphs (2) and (3) of this Article regardless of the present value of the estimated future cash flows based on the collection of instrument of collateral. If the loss on exposures secured by an eligible instrument of collateral and calculated in accordance with paragraph (1) of this Article is greater than that under paragraphs (2) and (3) of this Article, a credit institution shall make an appropriate impairment calculated in accordance with paragraph (1) of this Article.
- (5) A credit institution shall not be obligated to increase impairment of exposures referred to in paragraph (3) of this Article by 5% every 180 days above the amount of 80% of receivables based on principal exposure only if it can prove that exposure recoverability based on the estimate of future cash flows discounted to present value exceeds 20% of receivables based on principal exposure.
- (6) The collection of interest income for exposures referred to in paragraph (3) of this Article shall be deemed to be uncertain and thus the recognition of that income in income statement shall be deferred until its collection. A credit institution shall record the receivables based on interest income referred to in this paragraph in its business books in the off-balance sheet accounts.
- (7) By way of derogation from paragraphs (3), (5) and (6) of this Article, a credit institution may make an impairment for uncollected exposures referred to in these paragraphs of minimum 40% of the exposure if collection has not taken place within two years, counting from the date of the debtor's default, and increase it by additional 6% of exposure every 180 days. A credit institution choosing to apply this derogation shall apply it consistently to all exposures subject to these provisions.
- (8) By way of derogation from paragraph (1) of this Article, if it is certain that the period within which future cash flows based on an individual exposure will be shorter than one year, counting from the balance sheet date, a credit institution shall not be obligated to calculate the present value of the expected future cash flows. In that case, a credit institution shall determine the impairment of individual exposures as the difference between the gross carrying amount of the exposure and the estimated future cash flows from that exposure.
- (9) If exposure is not secured by an eligible instrument of collateral and future cash flows from an individual exposure cannot be estimated reliably, a credit institution shall make an appropriate impairment of the exposure and classify the exposure into an appropriate risk category as follows:
 - 1) in the case of debtors with overdue liabilities for more than 90 to 180 days, a credit institution shall make an impairment of minimum 2% of the exposure;
 - 2) in the case of debtors with overdue liabilities for more than 180 to 270 days, a credit institution shall make an impairment of over 30% of the exposure;
 - 3) in the case of debtors with overdue liabilities for more than 270 to 365 days, a credit institution shall make an impairment of over 70% of the exposure;
 - 4) in the case of debtors with overdue liabilities for more than 365 days, a credit institution shall make an impairment of 100% of the exposure.
- (10) When assessing impairment for exposures referred to in Article 8 of this Decision on a collective basis, a credit institution shall use the criteria referred to in paragraph (9) of this Article.

- (11) If a credit institution determines, based on a debtor's deteriorated creditworthiness, a loss bigger than that arising under paragraph (9) of this Article, it shall make an impairment equalling the amount of the bigger loss.
- (12) By way of derogation from paragraph (10) of this Article, a credit institution having in place an internal methodology which reflects better the risk of exposure for which impairment assessment is made on a collective basis, may use own internal methodologies for impairment assessment.

2.2 EXPOSURE REASSESSMENT

Exposure reassessment Article 13

- (1) During the contractual period, a credit institution shall reassess regularly, as a minimum every three months, the risk of exposure and impairment and provisions.
- (2) An exposure previously classified into risk sub-category B-1 or worse and shown by reassessment to meet the criteria for classification into risk category A, may be classified into risk category A only following the period of minimum three months. A credit institution may classify such exposures into risk category A if it determines that the conditions for classifying an exposure into a default category are no longer present,
 - 1) taking into account debtor's behaviour during the period referred to in the first sentence of this paragraph; and
 - 2) debtor's financial condition during the period referred to in the first sentence of this paragraph;
 - 3) and after expiry of the period referred to in the first sentence of this paragraph, make an assessment of debtor's creditworthiness.
- (3) By way of derogation from paragraph (2) of this Article, restructured exposures shall be dealt with in accordance with Article 14 of this Decision.

Treatment of restructured exposures Article 14

- (1) A credit institution shall prescribe the criteria for the treatment of:
 - 1) exposure restructuring, taking into account the provisions of paragraphs (2) and (3) of this Article; and
 - 2) restructured exposures throughout the duration of a credit relationship, taking into account the provisions of paragraphs (4) to (6) of this Article.
- (2) A credit institution shall classify the restructured exposures referred to in Article 6, paragraph (6) of this Decision, classified into risk category A before restructuring, as a minimum into a risk sub-category B-1.
- (3) A credit institution shall assess whether, in the case of restructuring which is not likely to result in a reduced financial liability of a debtor, there are other indications relating to such exposures that the debtor will not be able to settle their liabilities. A credit institution having reasonable doubt that a

debtor will not be able to settle their liabilities on time and in full, in accordance with the restructuring arrangement, shall consider the debtor to be in default and particularly so if the credit institution has granted to the debtor under restructuring:

- 1) a large lump-sum payment at the end of the repayment plan;
 - 2) an irregular repayment plan with much smaller payments at the beginning of the repayment plan;
 - 3) a long grace period at the beginning of the repayment plan; or
 - 4) if exposures to debtors have been restructured several times.
- (4) A credit institution shall classify restructured exposures classified into one of the sub-categories of risk category B before restructuring, into a risk sub-category into which they were classified before restructuring or worse.
- (5) A credit institution may classify the restructured exposures referred to in paragraphs (2) and (3) of this Article into risk category A after a period of minimum 12 months, provided the credit institution has determined, based on an assessment of a debtor's creditworthiness, that the exposure meets the following conditions:
- 1) debtor's financial position is based on reliable cash flows;
 - 2) a regular repayment of restructured exposures has been established for at least 12 months and during that period the debtor has made significant payments;
 - 3) there are no due unsettled receivables relating to exposures under a repayment plan used in accordance with a restructuring arrangement;
 - 4) for the purposes of this Article, regular repayment or regular settlement of due liabilities under an exposure means that a debtor's default does not exceed 30 days.
- (6) The period of minimum 12 months referred to in the previous paragraph of this Article shall begin on the last of the following events:
- 1) at the time of introduction of exposure restructuring measures;
 - 2) at the end of the grace period under an arrangement on exposure restructuring.
- (7) The period referred to in the previous paragraph shall be followed by a new 24-month period during which no material amount exposure may at any point be in default more than 30 days. Should it happen, a credit institution shall reclassify the restructured exposure into risk sub-category B-1 or worse.

3 CLASSIFICATION OF OFF-BALANCE SHEET ITEMS

Classification of off-balance sheet items

Article 15

- (1) Off-balance sheet items exposing a credit institution to credit risk due to unrecoverability of cash flows which may arise or which arises as a result of settlement of assumed off-balance sheet liabilities shall be classified into appropriate risk categories.
- (2) To assess provisions for off-balance sheet items, a credit institution shall use conversion factor 1.
- (3) By way of derogation from paragraph (2) of this Article, a credit institution that can prove, using the internal methods for the assessment of conversion factors, that a lower conversion factor adequately reflects the risk of individual off-balance sheet items. may use internal conversion factors for the assessment of provisions for off-balance sheet items.

Provisions for expected credit losses on off-balance sheet items

Article 16

The amount of provisions for losses arising from off-balance sheet liabilities classified into risk categories A, B and C, shall be accounted for by debiting expenses of a credit institution for the period when these losses are identified and by crediting the corresponding provisions account in the balance sheet liabilities.

4 ELIGIBLE INSTRUMENTS OF COLLATERAL

First-class instruments of collateral

Article 17

- (1) Instruments of collateral that may be recognised in exposure classification as first-class instruments shall include:
 - 1) the items referred to in Article 197, paragraph (1), items (a), (b), (c), (d), (e) and (g) of Regulation (EU) No 575/2013;
 - 2) guarantees and commitments which are irrevocable and payable upon first demand, issued by central governments, central banks and export credit agencies, referred to in Article 197, paragraph (1), item (b) of Regulation (EU) No 575/2013; and
 - 3) guarantees and commitments which are irrevocable and payable upon first demand, issued by credit institutions having a credit assessment determined in accordance with Article 197, paragraph (1), item (c) of Regulation (EU) No 575/2013.
- (2) Where securities referred to in paragraph (1), item (1) of this Article have two credit assessments by external credit assessment institutions, a credit institution shall use the less favourable assessment. In cases where a security has more than two credit assessments by external credit assessment institutions, a credit institution shall determine the two most favourable assessments and shall apply the less favourable of the two.

- (3) In addition to debt securities referred to in Article 197, paragraph (1), item (b) of Regulation (EU) No 575/2013, the first-class instruments of collateral in a form of debt securities issued by central governments or central banks, shall also include items referred to in Article 197, paragraph (2) of Regulation (EU) No 575/2013, in accordance with the Decision implementing the part of Regulation (EU) No 575/2013 pertaining to the valuation of assets and off-balance sheet items and the calculation of own funds and capital requirements (Official Gazette 160/2013, 140/2015 and 113/2016).
- (4) In addition to debt securities referred to in Article 197, paragraph (1), item (c) of Regulation (EU) No 575/2013, the first-class instruments of collateral in a form of debt securities issued by institutions, shall also include items referred to in Article 197, paragraph (3) of Regulation (EU) No 575/2013.
- (5) For the purposes of this Decision, other instruments equal in quality to the individually listed instruments of collateral referred to in paragraphs (1), (3) and (4) of this Article, shall also be deemed first-class instruments of collateral for receivables.

Appropriate instruments of collateral in a form of real-estate and movable property

Article 18

- (1) A credit institution may take into account appropriate instruments of collateral in a form of real estate or movable property in the classification of exposures, if it has at its disposal all the required documentation from which it is evident that the respective real estate or movable property represents an efficient and proper secondary source of collection. An instrument of collateral in a form of real estate or movable property shall be deemed to have these characteristics if a credit institution has been provided with the evidence that there is a market allowing for an expeditious and economically efficient (at an adequate price) liquidation of the instrument of collateral.
- (2) When assessing future cash flows based on collections from real estate or movable property, a credit institution shall apply appropriate impairment factors to the market value and relevant internally assessed collection period. The impairment factors and collection period shall take into account credit institutions' practices and past experience in the collection of appropriate instruments of collateral, economic and legal environment in which a credit institution operates and relevant characteristics of instruments of collateral. When determining the impairment factor level and the length of collection period, a credit institution shall take into account the fact that various types of instruments of collateral reflect different levels of risk.
- (3) The impairment factors and collection period referred to in paragraph (2) of this Article may not be lower than the minimum benchmark values referred to in Appendix 1, which constitutes an integral part of this Decision.
- (4) Credit institutions shall, at least once a year, review the validity of assumptions about the initially set collection periods and adjust them, where necessary.
- (5) A credit institution may reduce the collection period each quarter in accordance with the time passed only after actions have been taken to call on an instrument of collateral, if it assesses that the collection



is carried out in accordance with the initially set period. This reduction can only be made in the cases where a credit institution can prove the certainty of cash flows by adequate documentation and where it is possible to reliably measure the final settlement period and the total amount of cash flows into the credit institution on that basis.

- (6) A credit institution shall, when estimating cash flows and after determining the present value in accordance with the provisions of this Decision, take into account that portion of the value of the instrument of collateral in a form of real estate property, which remains after deducting all liabilities secured by the same real estate property, which are registered in the land registry with a higher priority rank or after deducting a proportional part of liabilities that have the same priority rank as the receivables of the respective credit institution.
- (7) The value of the instrument of collateral shall be the valuation of the real estate property market value executed by an independent valuer in accordance with the regulations governing valuation of real estate property.
- (8) A credit institution shall have the following documents related to the real estate property used as an instrument of collateral for receivables:
 - 1) public notary contract on the registration of mortgage or fiduciary transfer of ownership on the respective real estate property;
 - 2) court decision concerning the registration of mortgage or fiduciary transfer of ownership on the respective real estate property in the land registry;
 - 3) updated land registry certificate, with the registered mortgage or fiduciary transfer of ownership;
 - 4) insurance policy for the respective real estate property, with transferability restricted to a credit institution (except where the real estate property is an undeveloped land); and
 - 5) valuation executed by an independent valuer and, where applicable, a purchase and sale contract for the respective real estate property.
- (9) In the course of a contractual relationship, a credit institution shall continuously monitor the value of real estate accepted as an instrument of collateral for its exposures, at a minimum once every year for commercial real estate and once every three years for residential real estate. A credit institution shall carry out more frequent monitoring of the value of real estate property where the market is subject to significant changes in conditions. Statistical methods may be used to monitor the value of real estate property and to identify property that needs revaluation. If a credit institution has established, on the basis of monitoring, that the value of a real estate property might decline materially relative to general market prices, it shall request from an independent valuer to review the real estate property valuation.
- (10) For exposures exceeding 5% of own funds of a credit institution or exceeding HRK 20m (whichever is the lower), a credit institution shall ensure property valuation by an independent valuer at least every three years.
- (11) When calculating impairment of a balance sheet exposure and provisions for losses arising from off-balance sheet liabilities, a credit institution may use a movable property as an eligible instrument of collateral, if the following conditions are met:

- 1) there is a liquid market allowing for an expeditious and economically efficient (at an adequate price) disposal of the instrument of collateral;
 - 2) market prices for the respective movable property are available;
 - 3) operational conditions for executing sales are fulfilled;
 - 4) collateral arrangements enable realisation of value of the property within a reasonable timeframe;
 - 5) there is a first priority claim over all other creditors;
 - 6) a proper control is in place of the value of the instrument of collateral at a minimum once every year and on a more frequent basis where the market is subject to significant price changes;
 - 7) credit contract, i.e. contract on off-balance sheet liability, shall include detailed descriptions of the instrument of collateral;
 - 8) a credit institution has a list of eligible types of instruments of collateral in a form of movable property, and it has determined by its internal by-law the processes and procedures concerning the required coverage for an individual type of instrument of collateral, including the ratio of the value of receivables to instruments of collateral;
 - 9) a credit institution's credit policies address appropriate requirements relative to the amount of exposure to debtor, the ability to liquidate the instrument of collateral readily and the ability to establish objectively a price or market value of the instrument of collateral;
 - 10) both initial valuation and revaluation of the respective movable property take fully into account any deterioration of the movable property or the effects of the passage of time on the valuation;
 - 11) a credit institution has in place the procedures for a legal examination of validity of the lien on the respective movable property;
 - 12) the lien shall be registered in the registry of liens on movable property at the institution competent for keeping that registry; and
 - 13) the movable property is secured by an insurance policy with transferability restricted to the credit institution.
- (12) A credit institution shall ensure movable property valuation by an independent valuer at least every three years, for movable property the value of which, at the time of negotiating the instrument of collateral, exceeded HRK 3 million. A credit institution shall ensure that the independent property valuation for this movable property is not older than 3 years. For other instruments of collateral in a form of movable property, which serves as the basis for cash flow estimation and which is taken into account for the calculation of exposure impairment, a credit institution may take, as the value of movable property, the purchase and sales price reduced by the depreciation amount, the value of the movable property from the insurance policy, or the market value which is easily accessible, transparent and determined in accordance with professional standards.

Other appropriate instruments of collateral
Article 19

- (1) In addition to instruments referred to in Article 18 of this Decision, debt securities issued by institutions which securities do not have a credit assessment by an external credit assessment institution may be recognised by a credit institution as appropriate instrument of collateral if they fulfil all the conditions referred to in Article 197, paragraph (4) of Regulation (EU) No No 575/2013.

- (2) A credit institution may recognise units or shares in collective investment undertakings as appropriate instruments of collateral if all the conditions referred to in Article 197, paragraph (5) of Regulation (EU) No 575/2013 are met.
- (3) For the purposes of this Decision, the provisions of Article 197, paragraph (5) subparagraphs (2) and (3) of Regulation (EU) No 575/2013 shall apply to units or shares in collective investment undertakings.
- (4) A credit institution may recognise equities or convertible bonds that are included in the main stock exchange index as appropriate instruments of collateral.
- (5) When assessing future cash flows arising from the collections related to the equities or convertible bonds referred to in paragraph (4) of this Article, a credit institution shall apply the appropriate impairment factors with respect to the market price, taking into account the volume and frequency of trading in the respective equities or convertible bonds, past experience in the collection of equities or convertible bonds, the economic and legal environments in which the credit institution operates and the appropriate characteristics of the equities or convertible bonds.
- (6) Other appropriate instruments of collateral, in addition to those referred in paragraphs (1) and (2) of this Article, shall encompass insurance policies for credit receivables and life insurance policies with a surrender value and other instruments of collateral equal in quality to the instruments of collateral referred to in paragraphs (1) and (2) of this Article, on the basis of the appropriate evidence.

5 REPORTING TO THE CROATIAN NATIONAL BANK

Contents of reports and reporting time limits

Article 20

- (1) A credit institution shall report to the Croatian National Bank on the status of exposures classified into risk categories in accordance with the provisions of this Decision.
- (2) The reports, referred to in paragraph (1) of this Article shall be submitted by a credit institution in a form, manner and within the time limits prescribed by the Decision on supervisory reports of credit institutions and the Instructions for statistical and prudential reporting.

6 TRANSITIONAL AND FINAL PROVISIONS

Article 21

- (1) As of the date of entry into force of this Decision, the Decision on the classification of placements and off-balance sheet liabilities of credit institutions (Official Gazette 41A/2014 and 28/2017) shall cease to have effect.
- (2) The total impairment by exposures classified into risk sub-categories A-1 and A-2 until 31 December 2018 may not be below 0.8% of the gross carrying value of exposures in those risk sub-categories, except in the case of financial assets at fair value through other comprehensive income.

Article 22

This Decision shall be published in the Official Gazette and shall enter into force on 1 January 2018.

No.: 309-020/11-17/BV
Zagreb, 10 November 2017

Boris Vujčić

Governor

APPENDIX 1

An overview of instruments of collateral with the related impairment factors and the expected collection periods (benchmark values for the purposes of estimates of the expected future cash flows by exposures classified into risk categories B and C)

No.	Sub-type of instrument of collateral	Impairment factor (%)	Collection period (years)
1	Residential buildings*	10	2
2	Buildings with apartments for sale and/or rent**	20	2.5
3	Commercial buildings (offices)	20	2
4	Commercial premises (shopping centres, warehouses, shops, automotive stores ...)	30	2.5
5	Industrial facilities (factories, industrial plants, buildings, farms...)	50	4.5
6	Agricultural real estate (mills, silos...)	40	2.5
7	Building land	20	1.5
8	Agricultural land	40	2
9	Tourist facilities	20	2
10	Right to build	30	2.5
11	Unfinished commercial areas – for business purposes	50	2
12	Unfinished commercial areas – for residential and mixed purposes	40	2
13	Unfinished tourist areas	20	2
	MOVABLE PROPERTY***		
14	General-purpose equipment and apparatus	60	3
15	Special-purpose equipment and apparatus	60	3
16	Passenger cars	60	1
17	Vehicles (commercial)	60	1.5
18	Ships	60	2
19	Aircrafts and helicopters	60	5
20	Stocks that are not under control of a credit institution	70	1



21	Stocks under control of a credit institution (locked up, the key is in the credit institution)	60	1
22	Precious metals and works of art – not deposited at the credit institution	60	1
23	Precious metals and works of art – deposited at the credit institution	40	1
24	Construction machinery	60	3
25	Manufacturing machinery	60	3
26	Agricultural machinery	60	3

Notes:

* individual apartments

** provided that the building is completed and has an occupancy permit

*** provided that they have a valid insurance policy

The registered encumbrances are deducted after determination of the present value.