



HNB

GUVERNER

Reg. No.: 57/020/20-1/BV

Zagreb, 29 January 2021

TO ALL CREDIT INSTITUTIONS

Attention of: Management Board

Subject: Amendment to supervisory expectations regarding the classification of exposures of credit institutions to clients in the area for which the Government of the Republic of Croatia has adopted a Decision declaring a state of disaster caused by the earthquake

Dear Sir/Madam,

On 4 January 2021, we received a proposal of the Croatian Banking Association that was amended on 27 January 2021 regarding the classification of exposures of credit institutions to clients, legal and natural persons who, as a result of the devastating consequences of the earthquake of 29 December 2020, cannot perform their business activity or whose place of residence has been destroyed in the area for which the Government of the Republic of Croatia has adopted the Decision declaring a state of disaster in the area struck by the earthquake (Official Gazette 1/2021).

With regard to the proposal by credit institutions that the aforementioned clients should be granted payment deferrals, other exposure restructuring measures or new exposures if the following conditions are met:

- exposures to such clients on 31 December 2020 were not classified into risk categories B and C, or that were not classified as non-performing;
- on the day of approval of the request, the clients were not in a default status, in particular clients not more than 90 days past due on any material obligation;
- the level of damage to property (residential or business):
 1. unusable (the “red” label for real estate usability) – the credit institution may offer its clients a moratorium in the duration of up to 12 months;
 2. temporarily unusable (the “yellow” label for real estate usability) – the credit institution may offer its clients a moratorium in the duration of up to 6 months;
 3. in case that at the time when the application for a moratorium is submitted competent authorities have not assigned the real estate usability labels, based on the client’s own assessment, credit institutions may offer the client a moratorium in the duration of up to 6 months with a possibility of extension by 6 more months in the case of a subsequent assessment of non-usability of the real estate (the “red” label for real estate usability);and in the case of classification of such exposures:
- the duration of the newly granted moratoria based on the impact of this earthquake on the credit risk assessment is not added up to the duration of the moratoria granted in the context of COVID-19 measures and regulated by the previous circulars of the Croatian National Bank;

- by way of derogation from the third indent, credit institutions may offer a moratorium in the duration of up to 6 months to their clients, natural and legal persons in the area struck by the earthquake, who do not have a real estate labelled as unusable or temporarily unusable, but whose income is reduced or who are unable to generate income, or whose business operations have been affected as a result of the consequences of the earthquake;
- credit institutions may agree all of the aforementioned measures with their clients not later than by 30 June 2021;

the position of the Croatian National Bank (hereinafter referred to as 'the CNB') is given below.

AMENDMENT TO SUPERVISORY EXPECTATIONS

Further to the Circular Reg. No.: 348/020/20-03/BV, defining supervisory expectations published by the CNB for the purpose of avoiding a negative financial impact on clients suffering the consequences of the devastating earthquake of 22 March 2020, we would hereby like to inform you of the amendment to supervisory expectations that take into account the difficult living and working conditions of credit institutions' clients and the settling of their obligations to credit institutions resulting from the devastating earthquake in the Republic of Croatia of 29 December 2020 with the epicentre in Sisak-Moslavina County.

The level of damage and the immediate consequences of the earthquake are so severe that they may result in the inability to regularly meet obligations, lack of liquidity and additional expenses for numerous natural persons and small and medium-sized enterprises; not even large enterprises are exempt from possible significant difficulties in their business operations. As a rule, the role of credit institutions in situations such as these is reflected in short-term urgent measures of granting moratoria/payment deferrals and similar forms of restructuring, as well as in granting new placements in order to mitigate short-term liquidity pressures on clients whose business is sustainable in the long term with an adequate level of historical data on the creditworthiness of particular exposure categories.

In that regard, the CNB has decided to expand the scope of its supervisory expectations by the following amendment. Taking into account that the aforementioned proposal by the Croatian Banking Association is based on the principles of non-legislative moratoria, as follows:

- the moratorium is based on a non-legislative payment relief initiative of a credit institution as part of a moratorium scheme at the level of the targeted localised group of clients, agreed or coordinated within the banking sector, such that participation in the moratorium scheme is open and similar payment relief measures are taken under this scheme by relevant credit institutions;
- the moratorium applies to a large group of obligors predefined on the basis of broad criteria, where any criteria for determining the scope of application of the moratorium should allow an obligor to take advantage of the moratorium without the assessment of its creditworthiness at the time when the moratorium is granted;
- the moratorium offers the same conditions for the changes of the payment schedules to all exposures subject to the moratorium, even if the application of the moratorium is not compulsory for obligors.

The CNB deems that such measures in themselves do not lead to a change in the classification of exposures under the definition of forbearance in accordance with Article 47b of Regulation (EU) No 575/2013 or have any effect on whether they are treated as distressed restructuring in accordance with Article 178, paragraph (3), item (d) of that Regulation. Consequently, the application of the general payment moratorium or any other measure within the described schedule in itself should not lead to reclassification of the exposure as forborne (either performing or non-performing) unless an exposure has already been classified as forborne at the moment of the introduction of the measures.

The CNB expects from credit institutions to apply to all exposures granted in accordance with this Circular the expectations presented in the Circular Reg. No.: 348/020/20-9/BV, in particular:

- regular assessment of the unlikelihood of borrowers to pay their obligations (UTP criteria) during the period of the measure approved in accordance with this Circular;
- timely identification and recording of each significant increase in credit risk of the borrower (SICR) during the period of the measure approved under this Circular;
- timely determining of impairments and provisions for exposures approved under this Circular based on realistic parameters and assumptions reflecting the existing situation; and
- governance arrangements enabling adequate supervision of all key elements of credit risk management in the existing situation and adjustment of strategic and operating plans to the existing situation.

When approving other restructuring measures, we would also like to draw attention to the amendments to the tax treatment of the write-off of receivables deemed as tax deductible expenditure of the credit institution in accordance with the criteria referred to in the Profit Tax Act and implementing regulations, which may be taken into account when adopting the decision on the restructuring of a client's receivables.

In order to stabilise the financial and social status of clients whose place of residence or business operations have been jeopardised by the devastating earthquake of 29 December 2020 in the Republic of Croatia, the CNB hereby instructs credit institutions to take the proposed measures referred to in this Circular in the period up to 30 June 2021, under the conditions provided in it, and, by way of exception in the manner described in this Circular, classify their existing and new exposures. Taking into account the series of adverse circumstances, according to which disasters occurred one after the other, the moratoria granted to clients from this earthquake-struck area are not subject to the application of the requirement referred to in the *EBA Guidelines amending Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis* (EBA/GL/2020/15) with regard to the limit of the cumulative duration of the period of moratorium of nine months.

The CNB will continue to adjust, where necessary, measures aimed at credit institutions to allow them to develop an adequate approach to re-defining their business relationships to clients in these exceptional circumstances.

The CNB expects from credit institutions that such borrowers and their exposures granted in accordance with this Circular be flagged in a credit institution's system so that they can be monitored and reported. Credit institutions should notify the CNB of the measures approved in accordance with this Circular as at

31 March 2021 and 30 June 2021. The form in Annex 1 to this Circular should be submitted by 30 April 2021 and 31 July 2021 respectively.

Kind regards,

Boris Vujčić
Governor