

In accordance with the Article 9 of Law on Banking Agency of Federation of Bosnia and Herzegovina (Official Gazzete of Federation of BiH, number 9/96, 27/98, 20/00, 45/00, 58/02, 13/03, 19/03, 47/06, 59/06 and 48/08) and Article 18 of the Federal Banking Agency statute („Official Gazzete of Federation of BiH ", number 42/04), Management Board of Banking Agency of Federation of Bosnia and Herzegovina, on its session held on 05.12.2011., confirmed the Consolidated version of the Decision on the minimum standards for managing the bank's credit risk and asset classification, as follows

DECISION
ON MINIMUM STANDARDS FOR
MANAGING THE BANK'S CREDIT RISK AND ASSET CLASSIFICATION
(Consolidated version)

Article 1

- 1) This Decision regulates minimum standards and criteria that a bank is obliged to provide and implement in order to grade, overtake, monitor, control and manage credit risk and its assets classification.
- 2) In accordance with their authorities and responsibilities from the Law on Banks (henceforth: the Law), bank's charter and appropriate regulations given by the Banking Agency of the Federation of BiH (henceforth: FBA), bank's Supervisory Board and Audit Board are obliged to provide for monitoring, review and classification of balance sheet assets items and certain off-balance sheet items (henceforth: assets), that is to perform the above in relation to bank's potential exposures to the collection risk, or the risk of potential losses on the granted loans, other placements risk, investments and potential off-balance sheet liabilities (henceforth: credit risk) and also, they are obliged to report to the FBA in compliance with this Decision.

Article 2

- 1) In compliance with Article 1, Paragraph 2 of this Decision, bank's assets to be classified are:
 1. Bank's balance sheet: loans, deposits at banks, interests and fees, securities held to maturity, securities available for sale, bank's participation in the capital of other legal entities, gained financial and material assets in the receivables collection process, except the balance sheet assets from the paragraph 2 of this Article and
 2. Bank's off balance sheet: issued guarantees, advances, debtor bonds and other types of warranties, uncovered letters of credit, irrevocable approved but not used loans and all other forms of potential liabilities of the bank.
- 2) The items of the bank's balance sheet assets, which are not classified are:
 1. Cash in the tellers and treasury, cash funds on the reserve accounts at the Central bank of BiH, gold and other precious materials;
 2. Demand and time deposits up to one month on the accounts of the banks which according to the last rating by Standard&Poor's or Fitch-IBCA were rated BBB or if performed by Moody's at least Baa3;
 3. Tangible and intangible assets;
 4. Gained financial and material assets in the receivable collection process during one year since the acquisition;

5. Treasury shares;
6. Receivables from overpaid tax liabilities;
7. Securities intended for trade;
8. Receivables from the Government of BiH, Government of FBiH and Government of RS, securities issued by the Government of BiH, Government of the Federation of BiH and the Government of Republic Srpska and the receivables secured by their irrevocable guarantees payable at first call.

Article 3

The Supervisory Board of the Bank is responsible for completeness, continuity, and success in performing loan risk management function in the bank. In order to fulfill their responsibilities Supervisory Board is obliged, as a minimum, to:

1. demand from bank's management members, with highest authorities and responsibilities related to the issues of the credit risk and asset classification, in compliance with the bank's by-laws, preparation of proposals for adopting, developing and maintaining the entire Program for managing credit risk (henceforth: the Program) including appropriate risk management policies (henceforth: the policies) of the bank;
2. adopt the Program and reconsider it, at least each six months that is performs its timely adjustment to the changes in the economy and market conditions (environment changes);
3. provide full operation of the bank according to the Program and maintenance of reasonable assets structure and quality, or credit portfolio related to acceptable credit risk and implementation of adequate control and audit in that area;
4. provide regular, good quality reports prepared by the management, internal control system, that is, internal and external audit, in order to monitor and control whether the policies of the bank, laws and regulations from the area of credit risk and asset classification are implemented by the Senior management of the bank;
5. provide election and appointment of qualified management members and senior loan officers of the bank, and ensure their future successful training;
6. ensure conditions for organization and operation of specialized department for loans restructuring and rearrangement and liquidation of problem customers (debtors) in order to minimize loan losses.
7. to provide implementation, maintenance and development of efficient internal controls system, and to adopt adequate internal and external revision program, to ensure environment for their implementation. Supervisory Board is also required to found independent internal audit in the bank, including adequate number of operators who would independently and regularly control risk items in the bank;
8. regularly review loans approved to entities, as they are regulated in the FBA Decision on bank's operations with related entities ("Official Gazettes of the Federation of BiH", 3/03) or guaranteed by them; and
9. regulate contents and deadlines (timing dynamics) of irregular and regular periodical reports on management of credit risk which the bank's management is obliged to submit to the Supervisory Board.

Article 4

Management of the bank is responsible, as a minimum, to:

1. create, develop and submit in a timely manner proposals to the Supervisory Board for adopting the bank's program and policies and prepare the procedure for their implementation;

2. implement the program and the policies of the bank, establish the line of communication which provides a timely information flow of lower levels of management and executors of the bank policies and procedures for managing the credit risk, controls and provides for their preparation;
3. provide development and establishment appropriate reporting systems in regards to the assets and credit risk, which allows effective analysis, healthy and prudent management and control of existing and potential investment of the bank credit risk;
4. monitors and controls the structure and quality of assets and ensures that it is professionally, carefully and conservatively assessed by an expert. There should be reserves for non-collectable items (partly or entirely) or those loans should be written-off;
5. provides for internal control and internal auditors of the bank to complete their authorities and perform their responsibilities;
6. quarterly or in a shorter time interval, report in detail to the Supervisory Board and the FBA about significant credit operations, structure and the asset quality or credit portfolio, as well as about the success of the implementation of the Program of the bank.

Article 5

- 1) An adequate and successful management of the credit risk, in general, includes planning and maintaining of an acceptable relationship between the undertaken risk and the realistic level of collectability, and controlling and minimizing any risk in regards to the quality, concentration and ensuring the payment or instruments for ensuring payment (henceforth: collateral), maturity, currency, etc.
- 2) The bank is obliged to ensure an adequate Program, with minimum formalized standards in a written form. Having in mind that certain elements of those standards can differ from bank to bank, depending on the nature and complexity of their precise credit functions and establishing a portfolio, minimum has to contain:
 1. Defined policies for identifying the credit risk and managing that risk;
 2. Determined procedures for evaluation the credit applications, applications, that is, proposals for second placement, that is, investment and application regarding exposure of the bank to potential off-balance sheet liability (henceforth: loan application); and
 3. Determined procedures for loan approvals, second placements, investments and potential off-balance sheet liabilities (henceforth: loan), required documentation, monitoring, that is, follow up examination, as well as reporting and collection.

Article 6

- 1) The Program has to be established on a defined credit risk philosophy and established control parameters, identification of existing and potential risk in regards to bank's assets and development and establishment of clear and precisely defined written policies.
- 2) The bank has to develop a credit policy, in a written form, which, depending on the complexity and volume of bank's activities, will represents the basis for approving credit, other placements, investments and taking over off-balance sheet potential liabilities (henceforth: loan policies), and as a minimum, includes:
 1. the approach that is the philosophy related to the credit risk which defines (manages) the entire scope of risk that the bank is ready to overtake;
 2. general types of credit that bank is ready to engage in or not;
 3. clearly determined authorization for credit approval and the level of decision making bodies for reserves and write-offs; and

4. adequate (reasonable) and prudent portfolio concentration limits, at least, in compliance with the regulations of the FBA, and at least for: the individual clients, group of related clients, single industry branch, geographic regions, foreign countries and group of countries, types of bonds, term and form of instrument, etc.

Article 7

- 1) In order to minimize the credit risk failures the bank must implement an entire qualitative assessment system for credit requests and before approval of the credit funds to the beneficiary, they must develop good quality and reliable conclusions about each individual request. These evaluations and conclusions have to, at a minimum, include expert evaluation of the client, type of credit and credit risk related to the credit. At the same time, the bank is obliged to ensure that all approved loans have complete and correct documentation, at least in accordance with the FBA's Decision about the minimum standards for documenting loan activities in the banks and this Decision.
- 2) The procedures for assessment and documentation of each credit request have to be accompanied by clearly defined procedures for regular monitoring, control and collection of the approved loan.
- 3) Implementing their responsibilities, the management has to provide for development and application of adequate credit assessment criteria, including information on true needs of the client, necessary minimum financial analysis, indicators and standards.

Article 8

The management must, as a minimum, provide for the following in the process of credit request and its approval analysis:

1. loan goals (purpose of the loan), the client's repayment sources, where important factors are the assessment of earlier, current and future liquidity and solvency state of the client, and especially for the period of the loan maturity date. Also, an assessment of currency flow, income and expenses of the applicant, for the same period and expected ability for repayment of the loan;
2. character, honesty and reputation of the loan applicant, or loan applicant's intention and manners in the business activities and towards the bank. Important factors are available information on earlier repayment of loans and other liabilities to the bank or other institutions, eventual past dues or financial violations, respecting other contracted obligations, etc.
3. capital of the client, where important information are its level of total funds' sources, quality or true value and structure of assets, amount of other client's liabilities and its maturity dates, etc.
4. collateral adequacy, where an important factor is the true value and stability rate, complete contracted legal and financial control over collateral by the bank;
5. state, trend and perspectives of industry branch client operates, relative client's state in the branch and market, and client's chances for survival on the market; and
6. assessment of operational and managerial abilities of the client, and/or its managers and governing bodies.

Article 9

- 1) The bank must organize the commercial credit activities (credit approval to legal entities) in order to provide: adequate levels in specialized operations, strict independence of risk analysis from other segments and permanent training program in order to improve loan officers' expertise.

- 2) The bank's management must ensure that the terms for all loans are adequately and correctly documented, and that the bank, for each loan, maintains orderly and complete credit files in a chronological order starting from the approval, quality of the credit repayment and finally the total repayment or other type of loan liquidation.
- 3) Loan files must, as a minimum, contain the following information:
 1. Identify the name of the client, debtor or other type of the beneficiary (henceforth: beneficiary) and all its related entities and guarantor;
 2. Provide evidence on the legal state of the beneficiary if it is licensed to borrow,
 3. Provide evidence that the beneficiary's financial state and ability to repay the funds, the dynamics and repayment sources;
 4. Description of repayment conditions, aim of the loan and usage of the funds;
 5. Description and assessment of collateral, monitor their market value, state and location (storage location);
 6. Description of the flow of loan quality;
 7. Identify credit authorization, approval, evidence and review; and
 8. Derived from the provisions of the item 4 of this Article and Decision on minimum standards for documenting the banks' loan activities.
- 4) The bank must regulate and implement the appropriate internal procedures for repayment of principal, interest and fees (henceforth: the payment procedure), which ensure that the repayment is timely and adjusted to contracted conditions and that there are appropriate records about it. The payment procedures have to ensure system for quick investigation of repayment delays and qualification with the true level of credit risk exposure related to the debtors who are late in fulfilling their liabilities.
- 5) Apart from an early identification of credit quality deterioration, the bank management must carefully manage the deteriorated or increased risk, propose and develop a strategy for their successful solution and organize a special expert team or a specialized unit for renegotiations, restructuring or liquidation of bad debts, with the goal of minimizing potential loan losses for the bank.

Article 10

- 1) The controlling procedures in the bank have to include, at least, following elements:
 1. monitoring system of the portfolio characteristics;
 2. assets classification; and
 3. loan monitoring and internal loan control (as segment of internal control system) and internal audit function (as special control provided by the bank) with appropriate minimum scope and frequency.
- 2) The bank must establish a system (process) providing credits' grouping and assets monitoring by individual beneficiaries, associated group of beneficiaries, by type of credit, by industry and geographic regions, so the risk can be regularly tested, measured and controlled, and that the credit risk can be timely monitored and limited.

Article 11

The bank must develop total monitoring procedure and control of the assets features, therefore credit portfolio features, and reporting procedures, at least in compliance with the Decision. Further, the bank has to specially define identification criteria, treatment and reporting system

for problem loans identified by frequent controls and resolved by corrective actions for situations such as: unfavorable/more strict classification, appropriate reserves allowance and write-offs if required, collateral application, items and documentation restructuring, appropriate legal procedures, etc.

Article 12

The bank must establish an internal classification system for assets classification, which precisely and clearly defines criteria for undertaking new and assessment of existing credit risk in the bank. The minimum criteria are determined by this Decision.

Article 13

- 1) The bank must complete regular assessment, precise evaluation and classification of each individual loan.
- 2) Exception from the provision in the item 1 of this Article are "small loans portfolio" receivables, or loans below KM 10.000 approved to individuals (citizens) with the same or similar terms (mortgage loans, consumer loans, receivables on credit cards, individual loans, etc.), under the condition that the bank, with prior written approval from FBA, has determined special internal procedure that give a general assessment of all such loans in Category A – Good Assets, excluding loans with concrete indications, documentation or information that have become or will become problem loans.
- 3) Management in the bank is obliged to ensure timely and efficient reporting system for problem loans in the "small loans portfolio". It has to be prepared in detail and processed by appropriate internal procedures allowing follow up of: past due time in accordance with this Decision and each individual restructuring or refinancing approved and made by the bank, or each possible liquidation of the loan.
- 4) For the classification of loans approved to bank's shareholders with significant ownership interest in the bank, management of the bank has to provide for implementation and objective and subjective criteria from this Decision, as well as for a precise quantification and documenting of arguments that support subjective evaluations.
- 5) The program of the bank has to include the regular formal credit portfolio control procedures and assets classification, and if needed, a renewal or change of the previous classification of individual items of the assets, independent from the timing of the regular classification. The nature, complexity and analysis level of repeated periodical assessment and classification will change depending on type and experience with individual credits in the portfolio and/or individual beneficiaries.
- 6) Assets classification has to be correct and precise. Classification list has to be accompanied by special list of individual non-performing assets as it is regulated by the Article 14, item 1, paragraph 5 of this Decision (henceforth: non-performing assets). The bank is obliged to continuously adjust and update a special list of the poor quality assets, and simultaneously adjust the review of the asset classification, each time such items are defined.
- 7) At a minimum, the bank is obliged to perform control, prepare assets classification and list of non-performing assets at least by each end of quarter.

Article 14

Related to unified application of this Decision, the bank is obliged to apply the following categories in accordance with the definitions that follow:

1) **Interest capitalization** is the process of accumulation of accrued unpaid interest and unpaid principal, refinancing process, restructuring or conversion process of unpaid interest to a new banking loan, as of interest maturity date or as of credit maturity date.

The bank can complete capitalization of loan (receivables) interest rate only if:

- a) Previously determines that the beneficiary is able to repay the debt in the regular operation process of business out of beneficiary's regular operative cash flow income;
- b) the interest capitalization is regulated by initial contract and based on the beneficiary's in advance planned possible economic unbalance in the cash flow;
- c) the bank's claims are secured by high quality collateral as defined in this Decision;
- d) the credit collection, including capitalized interest, is established on precisely regulated expected future business activities of the debtor;
- e) the beneficiary proves that they can provide required funds from other sources under similar conditions; and
- f) if there is a real doubt about the final collection of the entire principal and interest, confirmed by written assessment of the internal control and audit of the bank.

Capitalized interest rate in case of restructuring and extension of loan cannot be included in income until it is actually collected from debtor-client's own sources.

2) **The collection process** is collection of claims:

- a) in a regular manner and timely;
- b) when possible, by second (repeated) attempt resulting in successful and secure collection of receivables and normalization of the loan by collection of matured principal and interest (for this, the bank has to have documents and safe evidence), but without lawsuit; and
- c) by legal procedure, including lawsuit against the beneficiary including bankruptcy procedure against debtor.

3) **Treatment of the accrued interest on poor performing assets.** If during the classification an item of assets get transferred to poor performing assets, for the accrued and unpaid interest, the bank will implement a correction of value of the unpaid receivable in compliance with the MRS/MSFE.

Such interest receivable remains reported as a balance sheet position until it is collected or legal action are not taken to terminate the liability of the debtor, in compliance with the law and regulations, as well as with from them derived bank's internal policies and procedures.

4) **Interest income from poor performing assets.** Interest income calculated on the poor performing assets is recognized in compliance with the MRS/MSFI.

5) **Non-performing assets** are assets, which by rule, do not provide revenues. Bank has to consider assets as non-performing assets if:

- a) the principal and/or interest are due, and have not been collected for over 90 days after the original maturity date, when in compliance with the provisions of the Articles 15 and 16 of this Decision they are classified in categories C, D and E, or

b) beneficiary's interest debt, due for over 90 days after the original maturity date, is capitalized.

6) Assets are **Past due** if:

- a) the principal and/or interest are past due, but have not been collected on the maturity date or later; or
- b) past due interest liabilities are capitalized as it is regulated by the item 1, paragraph 1 of this Article.

7) **Re-negotiated loan** is refinanced, restructured or in any other manner a changed loan, therefore, loan conditions are changed because of beneficiary was not able to repay the loan as it is regulated by the initial contract. So, beneficiary is given different rates, terms of repayment or any other changes made after the conclusion of the initial contract in order to perform better the debt repayment. In this case, the bank is obliged to ensure, before the new contract, that the beneficiary has repaid all past due interest and fees exclusively out of its performing assets, otherwise, the FBA will consider re-negotiated loan as a problem restructuring debt and to implement Article 17 and 23 of this Decision.

8) **Loan loss reserves** (henceforth: LR) are allowance reserves which the bank, during the assessment of the quality, that is, classification of assets in the balance sheet, must allocate as liability on the expense side of the loan loss reserves and, in accordance with decision made by Supervisory Board, that is, at least with the provisions of this Decision, taking into account the established corrections of value of the balance sheet assets and the reserves for losses in the balance sheet items.

In accordance with this Decision, LR allocated for assets classified as category A - good assets are "reserves for general loss" (henceforth: RGL); and LR allocated for assets classified as B - Special mention assets, category C - Substandard, D - Doubtful and E - Loss are Special reserves for loan losses (henceforth: SRL).

9) **First-class assets** are assets for which repayment the bank has a security in a form of a high quality marketable collateral (collateral with active and stable market rating) with value, determined by reliable and stable prices, higher than the liability. The collateral in question is sufficient to completely protect the bank from a possible loss of principal, interest, fees and operation expenses, or for which, in the case of a possible necessary bank liquidation program, liquidation of the debtor, the bank has a clear legal and physical ownership. (Henceforth: first-class collateral).

Related to this decision, the first-class collateral is:

- a) cash deposits as collateral, if following terms are fulfilled:
 - cash deposit is deposited at the bank, at some other bank in the Federation Bosnia and Herzegovina (henceforth: FBiH) or in the countries from the zone A;
 - if there is a contract on collateral deposit providing that the bank is the only entity authorized to use them in, providing that those assets are irrevocable, that the only condition ceasing the bank's authorization to collect the collateral is repayment of customers debt to the bank and that the collateral was deposited unconditionally as collateral;

- the collateral can be used by the bank without possibility for the (debtor-beneficiary) or anyone else to annul bank's legal rights regulated in the collateral contract.
- b) securities issued by Bosnia and Herzegovina (hereinafter: BiH), the Federation of BiH, Republic Srpska, Central Governments of the countries from zone A or institutions financed by them (through the budget), international development banks, the Central Bank of Bosnia and Herzegovina and central banks of the countries from zone A, first class banks and companies from the countries from zone A and the Federation of BiH and Republic Srpska, for which the banks has documented evidence that it performed all necessary financial, that is, other analysis and determined that the issuer of securities is financially sound, well capitalized (if applicable) and capable to fulfill the liabilities on securities, ensuring that:
- the deposit is deposited at the bank;
 - there is no doubt that the debtor/beneficiary is the owner;
 - there is contract on pledge of collateral, proving that the bank is the only entity having claims on the collateral, that the pledge is irrevocable, that the only condition for collateral collection is outstanding debt and that the collateral was deposited unconditionally as collateral;
 - the collateral can be used by the bank without possibility for the (debtor-beneficiary) or anyone else to annul bank's legal rights regulated in the collateral contract;
 - that the collateral value is, at least, 20% higher than bank's receivables secured by that collateral.
- c) irrevocable guarantees given by the state of BiH, Federation of BiH, Republic Srpska, central governments from countries zone A or institutions financed by them, international development banks, the Central Bank of Bosnia and Herzegovina and central banks from countries zone A, first class banks and companies from countries zone A and the Federation of BiH, that are covered by the documents showing all financial and other analysis proving that the guarantor is in good financial position, good capitalized (if applicable) and capable to repay the collateral, including condition that guarantees were verified by the guarantor, non-conditional and collectable in case of beneficiary does not repay its liability.
- d) Precious metals, if:
- it is deposited at the bank;
 - there is a contract proving that the bank is the only entity having claims on the collateral, that the collateral is irrevocable, that the only condition for collateral collection is outstanding debt and that the collateral was deposited unconditionally as collateral;
 - there is no doubt that debtor-beneficiary is lawful owner of the metals;
 - the collateral can be used by the conditions as they were provided in the contract;
 - the collateral has to have good quality, stable prices and to be marketable;
 - that the collateral is evaluated by the court appraiser and that the value is at least 20% higher than bank's receivables secured by that collateral;

10. **Quality collateral** are all other kinds of quality and marketable collateral (which have a recognized active market and stable prices), except those in the item 9, paragraph 2, a), b), c) and d) of this article, if they are:

- a) deposited at the bank;
- b) there is contract providing the bank as the only trustee claiming on the collateral, that the collateral is irrevocable, that beneficiaries outstanding debt is the only reason to claim the collateral and that the collateral was deposited unconditionally as collateral;
- c) that the collateral can be used, so no one can annul bank's legal right provided in the contract on the collateral.
- d) that the collateral value is at least 50% higher than bank's claims.

Article 15

- 1) The bank must periodically classify assets, by exposure of credit risk as they are mentioned in article 2 of this Decision, in the following categories:

Categories:

1. Category A - Performing assets;
 2. Category B - Special mention;
 3. Category C - Substandard
 4. Category D - Doubtful and
 5. Category E - Loss.
- 2) The bank's Supervisory Board must ensure and monitor that the bank, that is the management of the bank, is implementing a continuing procedure of periodical control of credit risk classification of assets, allocation of reserves regularly and that they are maintaining RGL in SRL, and at least as it is regulated in this Decision.

Article 16

- 1) The bank must classify assets according to guidelines from this article, whether they are matured or not. The issues to consider should be:
 1. objective criteria (maturity dates appreciation and maturity of already mature debts); and
 2. subjective criteria (in regards to finances, economic and moral qualities of the debtor).
- 2) The bank must classify by considering all factors related to the debtor's qualities and its ability to pay. Earlier experience of the bank about the debtor in performing the liabilities as scheduled is only one of the indicators for its current and future payment capability, so the bank is obliged to consider regulations from the Article 8 of this Decision and following criteria:

1. **Category A - Performing Assets:** Assets from this category are not subject to criticism and include:

- a) assets, completely insured by quality collateral as mentioned in the Article 14, item 9 of this Decision, with no regard to the remaining unpaid debts, parts of debt or other unfavorable credit factors of the beneficiary;
- b) assets without known problems and obstacles interfering with the repayment of the principal and interest on the maturity date and for which it is not expected to be paid by the bank, that is if:

- during their classification there are reasonable assumption that they will be paid in accordance with their contracted conditions and that the bank does not have to expect losses;
- if they are adequately structured according to the needs and abilities of the debtor for repayment;
- if they were previously repaid as initially determined and if the current repayment is performed in the same manner;
- if assets, and its collateral have appropriate documentation, if they are registered and legally applicable;
- if the debtor, officially or unofficially, did not cease regular implementation of their obligations towards the bank or a third party; and
- if the debtor's ability for repayment is relied on its good and stable financial state and prospects for vitality and sustainability of the business.

2) **Category B - Special mention:** The bank is obliged to classifies assets to this category if collection of the debt is not secured by the quality collateral as it is regulated in the Article 14, item 10 of this Decision, and in the same time there are some potential weaknesses which, if they are not monitored and occasionally corrected, can worsen or weaken financial ability and solvency of the bank in future. Those are:

- i) items which are not sufficiently controlled, monitored, processed and corrected by the credit officers in the bank, and/or, which do not have sufficient and good loan files proving justification and quality of the loan; and
- ii) items which are not adequately structured by maturity dates, files or other crediting terms.

Assets which are included in this category can appear performing, but it is possible to detect unfavorable trends or signs related to the debtor's obligations or market conditions, which can unfavorably affect the debtor in the future. Therefore, it is possible to view the debtor's cash flow, supported by evidence, as still satisfactory (sufficient) to service the liability, but there is the danger it could deteriorate in amount and quality and become insufficient for the debtor's coverage of own needs and self financing and reinvesting.

In this category the bank is obliged to classify all assets that the debtor is overdue or postponed repayment to the bank or other creditors, officially or unofficially, but the delay is not over 90 days after the original maturity date

3) **Category C - Substandard:** The bank is obliged to classify all assets, which are not supported by successful current business, and/or, adequate repayment ability of the debtor. The substandard assets include:

- a) claims by debtor whose cash flow is not sufficient to cover matured debts (liabilities);
- b) claims from debtors whose transfer from property (capital) to cash assets is longer than repayment dates; and
- c) claims from the debtor who is undercapitalized or insolvent.

This asset category includes receivables from the beneficiary who is not able to perform the repayment from its primary repayment funds, and if there is danger or if it already happened, that the bank had to use secondary sources to cover the debt. Secondary sources are:

- a) collateral activation to collect the debt;
- b) Refinancing, restructuring and transfer of the loan in any manner;
- c) securing additional capital by the beneficiary.

To this category are classified assets that are not covered by current financial reports and information on the beneficiary, which do not have adequate and full documentation on loan, beneficiary-debtor and collateral accepted, and if financial information on the debtor-beneficiary are unsatisfactory.

Apart from this, the bank is obliged to classify all assets that the beneficiary delayed or postponed to repay to the bank or any other entity, officially or unofficially, over 90 and less than 180 days starting from the original maturity date.

4) Category D - Doubtful assets: The bank should classify all assets which have weakness of C category, including additional deficiency: that there is no collateral. These weaknesses make the full repayment of loan highly unlikely. The possibility of loss is very high, but due to certain special factors that could lead to quality improvement of such assets, the classification of these assets to the category E, can be delayed until its definitive status is more objectively determined.

Apart from this, The bank is obliged to classify all assets that the debtor is overdue or postpones the repayment to the bank or third entity, officially or unofficially, longer than 180 days and less than 270 days starting from the original maturity date. Unless the bank has already started the lawsuit to collect the collateral and has firm arguments or documents proving that regular, timely and full collateral collection is to be expected (henceforth: proved collateral collection in process).

5) Category E - Loss: The bank is obliged to classify all assets which are regarded non-collectable and it is not justified to allocate them in any other classification group. Classification for this category does not mean these assets cannot be improved or partially preserved, but the delay in full write-off is no longer justifiable. In general, these items are most likely worthless assets (non-collectable), even if partial recovery is possible in the future. The items of assets classified in this category, for which a correction of value has been performed in the total amount, the bank will report in the balance sheet until legal proceedings are taken to terminate the liability of the debtor, in compliance with the legal provisions which regulate the obligation relations and internal bank's policies and procedures.

In addition, the bank is obliged to include in this category all the delayed or postponed repayments to the bank or any other entity, officially or unofficially, over than 270 days starting from the original maturity date, dates, except in the cases where the bank has evidence that the collateral realization is in process.

Article 17

- 1) If the exposure of the bank to particular loan cannot be precisely determined, or if a different classification is possible, the bank is obliged to decide on the stricter category, unless the bank has document and good proof for the other option.
- 2) If the debtor has paid the matured, accrued interest on the loan before it was re-negotiated, the bank is obliged to classify the assets to the C category - substandard, unless the bank has good proof enabling the eventual classification of the assets to the category C - special mention, unless it secured conditions and firm evidence for its possible classification in the category B – Special mention.

Article 18

None of the above mentioned criteria prevents FBA controllers to perform control in the bank and order transfer of particular assets to worse category, if they consider it as justified. If the FBA examiners have agreed that the bank has made classification of certain assets to the appropriate category, but it did not determine appropriate potential loan loss percentage within the same category, the percentage that is going to be used is made of summing the percent determined by the bank and 50% of difference between the bank's and the FBA's percentage. If FBA controllers detect that the bank classifies assets with the most favorable potential loss percentages, the FBA controllers are obliged to make correction of the percentage based on their personal assessment in all the cases with which they disagree.

Article 19

- 1) If the bank is exposed to credit risk (risks) towards a group of related entities, defined in article 6. of the FBA Decision on Minimum Standards for Managing Risk Concentration Risk in Banks, the bank is obliged to classify all those receivables to the same category, related to the category of the worst classified claim of one debtor. The bank can have an exception to this rule only if loan files of any of the debtors include documents and reports proving the classification to different group and including qualified collateral and analysis ratifying it. This exception has to be included to the monthly report for the Supervisory Board.
- 2) Delinquency period, as regulated by the article 16 of this decision, cannot be referred as interrupted by the re-negotiation, unless debtor has not repaid the full amount of accrued interest and fees by its operational assets, nor if regulations from article 14, item 1 of this decision are fulfilled or the conditions of the exception from this paragraph. This exception has to be included to the monthly report for the Supervisory Board.
- 3) The Supervisory Board has to ensure that Management has established and implemented internal control and to enable internal auditor to monitor adjustment of the bank to its policies related to this Article.

Article 20

The bank's Supervisory Board must adopt general decision on definition, assessment and implementation of collateral for collection of the bank's receivable, which, as a minimum, has to include following:

- 1) identification for the bank of acceptable and unacceptable types of collateral;
- 2) defining entities who can make assessments for the bank, depending on type, relative importance and complexity of the collateral;

- 3) assessment methodology and procedure acceptable for the bank;
- 4) securing the procurement and repeated assessments of the collateral if needed;
- 5) defining reasonable criteria for adjusting and treatment of different values forms such as, accounting, market etc.; and
- 6) defining prudential borders for the assessment of true or market value of the collateral by securing maximum true assessments of achievable value, related to the situation and time.

Article 21

The bank must classify all off balance sheet items, exposed to the loan risk, or potential liabilities of the bank in the sense of this Decision, according to criteria defined in article 16 of this Decision.

Article 22

- 1) The bank Supervisory Board must provide that the Management of the bank establishes the required reserves, depending on the assessment of quality of balance sheet assets and off-balance sheet items and their classification in accordance with the provisions of this Decision.
- 2) At the same time, in the identification of the eventual amount of loan losses (henceforth: LL), or general loan risk (GLR) and potential loan losses (PLL) as it is determined by this Article, the Management in the bank is obliged to put maximum efforts to ensure timely assessment, determination of amount and classification of collectability or possibility to acquire a request for repayment on the bank's potential liabilities taken (liabilities on some items of the off balance) as it is regulated by this Decision.
- 3) The bank is obliged to make individual assessment and reserves allocation for balance sheet assets and off-balance sheet items for each beneficiary or group of related entities, as it is provided by this Decision.
- 4) The reserves the bank is obliged to allocate for GLR are required reserves for GLLR (General Loan Loss Reserves).
- 5) The reserves the bank is obliged to allocate for PLL are required reserves for SLLR (Special Loan Loss Reserves).
- 6) Required reserves, which the bank must present in the internal evidence and both above mentioned reserves (GLLR and SLLR), are identified and recorded individually for each beneficiary, by their individual assets and by each group of related entities-beneficiaries.
- 7) The bank must form and continually maintain the General reserves for loan losses and Special reserve for loan losses, by assets classification category, at least as follows:

Category A- Performing assets:	2% GLLR for GLR
Category B - Special mention:	5 – 15% SLLR for PLL;
Category C – Substandard:	16% - 40% SLLR for PLL;
Category D - Doubtful	41% - 60% SLLR for PLL;

- 8) Bank's obligation to establish and maintain GLLR for GLR of 2% for assets classified in Category A – Good Assets does not refer to the placements or parts of placements and potential liabilities of the bank, which are secured with the collateral in a form of a cash deposit at the same bank, under the condition that the contract regulates that until the repayment of the bank's receivable or termination of the potential liability of the bank, the cash deposit as collateral is tied to the loan or guarantee in question.

Article 23

- 1) The bank is obliged to regularly calculate the PLL for estimated losses that can be generated from the items of assets from the Article 2 of this Decision. The base for accrual of the PLL is the gross book keeping value of the receivable.
- 2) The correction of value of the balance sheet assets and provisioning for losses for off-balance sheet items, calculated with the use of the methodology for measurement of the decrease of the value of the loan and other financial property held to maturity, are reported against the losses.
- 3) If the amount of the PLL, calculated in compliance with this Decision, is higher than the total amount of the correction of the value of the balance sheet assets and provisioning for loan losses for the off-balance sheet and already established PLL, this determined difference the bank is obliged to treat as lacking PLL in compliance with this Decision and/or requests of the FBA (henceforth: regulatory request). The noted amount of the lacking reserves on the regulatory request presents a negative item against capital, and in compliance with the Article 10, paragraph 1, item 5 of the Decision on the minimum standards for managing the bank's capital.
- 4) If the amount of the correction of value and provisioning for losses for the off-balance sheet items is higher than the accrued amount of the PLL, the bank does not have an obligation to establish reserves for loan losses.
- 5) The authorized bodies of the bank are obliged to, when adopting the annual budget, issue a Decision on distribution of the profit to cover for the lacking reserves according to the regulatory request, or against the profit, undistributed profit from the previous years, retained profit and other reserves established from the profit. In the case that the listed positions are not enough to cover the lacking PLL from the regulatory request, the uncovered amount of the lacking PLL is reported as a negative item against the bank's capital, in compliance with the Article 10, paragraph 5 of the Decision on minimum standards for managing the bank's capital.
- 6) Until the bank does not ensure the providing of the lacking PLL according to the regulatory request, it cannot perform the distribution of other payments from the profit, nor any of the reimbursements or bonuses to the members of the bank's bodies.

Article 24

- 1) In regard to this Decision, the bank has restructured its receivables when it made one or more concessions or terms changes, but only in cases when the debtor has financial or economic problems, for those reasons the bank has (or could have) problems in the collection (henceforth: restructuring of problem receivables - RPR). The concessions and term changes in RPR are:
 1. receiving other beneficiary's assets or properties as full or partial collection of the debt;
 2. extending the repayment dates for principal and/or interest;
 3. decreasing the interest rate on the debt;

4. decreasing the debt, principal and/or interest
 5. and other similar concessions to the beneficiary.
- 2) **Accounting rules:** In cases mentioned in the item 1 of this Article, Management is obliged to apply prudent accounting rules and provide adequate information on RPR results, so to perform following:
1. define and asses values to be utilized for accounting records of material and financial assets gained in the RPR process and determine loss connected to each such transaction if there is one and
 2. ensure regular book keeping of all transaction elements performed during the assets transformation process.
- 3) **Gained material assets:** For assessment of obtained material assets, received as full or partial repayment of debts, the bank must apply the concept ‘satisfactory value’ or true value assessment (henceforth: TVA). If there is stable market, TVA of assets is equivalent to market values. Lack of market results in determining TVA by independent, regulated and professional assessment. The bank's Supervisory Board must ensure implementation of professional and strict standards for determination of the assets, to precisely specify it in the written procedures of the bank and to ensure that assessment experts are completely implementing them. Gained material assets for which unarguable and stable values cannot be proven, the bank can use only technical value of 1KM unit of domestic currency (abbreviated form: TV).
- 4) **Gained financial assets:** Gained financial assets, the assets the bank can accept as a repayment of the claims are ownership and debtor security papers, loan and other similar claims. In the assessment process, the bank must follow following principals:
1. gaining shares and participation in the capital (henceforth: shares) in the full repayment of the original debt, or as part of RPR process, the bank is obliged to record such shares at the lowest prudential value;
 2. the lowest prudential value cannot be lower than the amount of the receivable (principal and interest), and if the share was accepted only as a part of restructuring credit, the lowest prudential value should not be lower than the amount of the debt (principal and interest) decreased by the book value of the new, restructured credit and possible collected material assets.
 3. the lowest prudential value can be:
 - a) present share value which are actively sold in an organized stock market; or
 - b) most 75% of the nominal share value are not justifies to the condition as mentioned under a) of this item.
 4. if the bank presents material evidence that third party, which is not related to the beneficiary nor bank, has bought more than 25% of share in the beneficiary's capital, the FBA can give written approval for accounting recording of lowest prudential value of shares gained at the price paid by the third party in cash, and it is an exception from the principles regulated in the item 1, 2, and 3 of this item.
- 5) **Loan terms changes:** The bank must, in the RPR process based on the present value assessment of future currency flows and if new or restructured amount is lower that originating debt under RPR, to allocate SLLR and make write off identified PLL.

- 6) **Combination of material and financial assets:** In general, if bank achieves material or financial assets as partial repayment of original debt and later restructures remaining debt, the book value of the original debt has to be previously decreased by TVA or TV of material and/or assets gained.
- 7) **Financial assets with third party:** When the bank, as a full or partial collection of its receivables, gains a receivable which the bank's debtor has towards a third party, it must implement principles and regulations from this Article and, at the same time, make assessment of credit abilities of the third party exclusively on current financial and economic information, and in that manner hinder the overvaluing of the real value of the claims gained.
- 8) **Updating re-assessments:** The bank's Board must provide that senior management applies policies and procedures for at least quarterly re-assessment and adequate bookkeeping revising of all the gained material and financial assets. This obligation is primarily referring to material assets gained and not used by the bank in the regular operation process.
- 9) **Reserves for restructured financial assets:** New receivables which are a result of the restructuring process have to be examined in the same way and classified as any other regular capital items, and the bank needs to allocate new Special reserves. Those allocations cannot be terminated without a special prior written approval of the FBA or prior effective repayment of the debt.

Article 25

- 1) In compliance with this Decision, the bank is obliged to prepare quarterly reports for the FBA about the classification of their assets as well as a special list of the poor performing assets.
- 2) Quarterly reports, mentioned in the item 1 of this Article, the bank must submit to the FBA in the form prescribed by the FBA in a special Decision, latest 30 calendar days after the last day of the reporting quarter.
- 3) Last annual report, based on preliminary information, has to be submitted to the FBA latest one month after the last day of the reporting year.
- 4) The report, mentioned in the item 3 of this Article, has to be prepared on the basis of final information, and submitted to the FBA the latest by the 5th of March of the current year.
- 5) The reports must be signed by two bank's representatives authorized and responsible to represent the bank.
- 6) The prescribed report of the bank has to be adopted by its Supervisory Board and submitted to FBA in accordance with the Decision on Reporting Forms that Banks Submit to the Federation of BiH Banking Agency.

Article 26

The bank's Supervisory Board has to ensure that Management establishes and maintains an information system adequate to monitor and manage the credit risk and assets classification, in compliance with this Decision, and to regularly report about that to the Supervisory Board.

Article 27

- 1) The bank is obliged to comply with the provisions of this Decision latest by 31/12/2011.
- 2) In the implementation of this Decision the bank is implementing the Guidelines for establishing, recording and reporting the reserves for loan losses issued by the Agency.

Article 28

The consolidated text of the Decision on minimum standards for managing the bank's credit risk and asset classification contains: Decision on minimum standards for managing bank's credit risks and asset classification ("Official Gazette of the Federation of Bosnia and Herzegovina", number: 3/03), Decision on changes and additions to the Decision on minimum standards for managing bank's credit risk and asset classification ("Official Gazette of the Federation of Bosnia and Herzegovina", number: 54/04), Decision on changes and additions to the Decision on minimum standards for managing the bank's credit risk and asset classification ("Official Gazette of the Federation of Bosnia and Herzegovina", number: 68/05), Decision on changes and additions to the Decision on minimum standards for managing bank's credit risk and asset classification ("Official Gazette of the Federation of Bosnia and Herzegovina", number: 86/10), Decision on changes and additions to the Decision on minimum standards for managing the bank's credit risk and asset classification ("Official Gazette of the Federation of Bosnia and Herzegovina", number: 06/11), Decision on changes and additions to the Decision on minimum standards for managing bank's credit risk and asset classification ("Official Gazette of the Federation of Bosnia and Herzegovina", number: 07/11) and the Decision on changes and additions to the Decision on minimum standards for managing bank's loan risk and asset classification ("Official Gazette of the Federation of Bosnia and Herzegovina", number: __/11), which state the date on which those decision come into effect.

Article 29

The consolidated version of this Decision is issued in the "Official Gazette of the Federation of Bosnia and Herzegovina".

No. U.O.-35-6/11
Sarajevo, 05/12/2011

DEPUTY PRESIDENT
OF THE MANAGEMENT BOARD
Mrs. Ljerka Marić, M. Sc (Econ)