

Pursuant to Article 44 paragraph 2 point 3 of the Central Bank of Montenegro Law (OGM 40/10, 46/10, 06/13) and Article 57 paragraph 2 of the Banking Law (OGM 17/08, 44/10), the Council of the Central Bank of Montenegro, at its session held on 29 November 2013, passed the following

DECISION
**amending the Decision on Minimum Standards for Credit Risk Management
in Banks**

Article 1

Article 6 paragraph 2 of the Decision on Minimum Standards for Credit Risk Management in Banks (OGM 22/12, 55/12) shall be amended to read:

“The bank shall monitor the entire structure and quality of the loan portfolio, credit risk arising from the total portfolio, as well as risks related to individual loans and transactions.”

Paragraph 8 shall be deleted.

Article 2

After Article 6 the following two new articles shall be added, worded as follows:

“Dealing with non-performing loans

Article 6a

When monitoring the structure and quality of loan portfolio and credit risk arising from the loan portfolio, a bank shall pay special attention to non-performing loans.

A non-performing loan, within the meaning of this Decision, shall be a loan classified into the classification categories “C”, “D” and “E” by the bank while applying the asset classification criteria laid down by this Decision.

A bank shall develop a comprehensive strategy for dealing with non-performing loans (hereinafter: NPL resolution strategy) for period of three years and determine annual operating objectives related to reducing the level of non-performing loans (hereinafter: operating objectives).

A bank shall submit to the Central Bank:

- 1) NPL resolution strategy that has been adopted, as well as its amendments and/or supplements within eight days from the date of its adoption;
- 2) Annual operating objectives by 31 January for the year for which operational objectives are determined.

Guidelines for developing of the NPL resolution strategy, determining of operating objectives and implementing financial restructuring are contained in Annex 2 which forms an integral part of this Decision.

Reporting on the accomplishment of operating objectives

Article 6b

A bank shall prepare and submit to the Central Bank quarterly reports on the accomplishment of operating objectives under Article 6a paragraph 3 herein.

The bank shall prepare the report under paragraph 1 above using the Form I-OC which is provided in Annex 3 and makes an integral part thereof, and submit it to the Central Bank in electronic form, within 20 days after the expiry of the quarter covered by the report.

Should the report under paragraph 2 above indicate that there are significant differences between activities implemented and determined operating objectives, the Central Bank shall require the bank to take additional organisational or other measures, as may be necessary, to improve the management of credit risk arising from the NPL portfolio.”

Article 3

In Articles 7, 42 and 44 the words “non-performing assets” shall be replaced by the words “non-performing loans”.

Article 4

Banks shall submit to the Central Bank the adopted NPL resolution strategies for period 2014–2017 and operating objectives for 2014 no later than 15 March 2014. Banks shall also submit by 30 April 2014 the report on the accomplishment of operating objectives for period January – March 2014.

Article 5

This decision shall enter into force on the eighth day following that of its publication in the Official Gazette of Montenegro.

THE COUNCIL OF THE CENTRAL BANK OF MONTENEGRO

Decision number 0101-4014/50-4
Podgorica, 29 November 2013

**CHAIRMAN
G O V E R N O R,**

Milojica Dakić m.p.

Banks' dealing with non-performing loans

1. Introduction

This Annex contains guidelines for the development of banks' dealing with non-performing loans (NPL resolution strategies), definition of operating objectives concerning the reduction of the level of non-performing loans and accomplishment of the financial restructuring.

2. Strategy and operating objectives

2.1. NPL resolution strategy. The Decision on Minimum Standards for Credit Risk Management in Bank prescribes the obligation to the banks to adopt NPL resolution strategy.

When developing the NPL resolution strategy, banks should take into account:

- 1) the "recovery" option of non-performing loans (hereinafter: the "recovery" option), which can be applied to non-performing loans assessed by the bank as restorable to the performing assets' status (classification categories "A" and "B") by means of a sustainable financial restructuring;
- 2) the "enforced resolution" option of non-performing loans (hereinafter: the "enforced resolution" option), which can be applied to non-performing loans assessed by the bank as non-restorable to the performing assets' status and which have therefore been designated for ultimate collection;
- 3) level of available reserves that can support possible impairments of amounts receivable in the process of resolving the issue of non-performing loans;
- 4) estimated release of provisions upon a successful completion of the restructuring process and restoration of a non-performing loan to the performing assets' status;
- 5) planning time frames for implementation of the "recovery" or "enforced resolution" options respectively;
- 6) potential risks or obstacles to the timely implementation of activities for resolving the issue of non-performing loans;
- 7) the need to define the key impact indicators of measures taken, which should be respected in the process of implementing the NPL resolution strategy.

2.2. Operating objectives. For the purpose of a more efficient resolving of the issue of non-performing loans, the bank should define internal operating objectives related to reducing the level of non-performing loans, on the basis of the adopted NPL resolution strategy. The bank shall set forth these objectives taking into account the level of non-performing loans specific to that bank, the current operational ability of persons dealing with issues of non-performing loans and the need to review the recovery arrangements based on principles of viability.

Operating objectives shall include objectives that the bank intends to accomplish in terms of time-limits for the implementation of certain activities in the process of resolving the issue of non-performing loans, as well as in terms of certain effects of activities undertaken, in particular:

- 1) time-limits within which the loans classified as non-performing loans, as well as the loans that gain that status during the year for which operating objectives are determined, will be classified into loan categories subject to the "recovery" and "enforced resolution" options;
- 2) time-limits within which possible restructuring measures (extension of the repayment period, reduction of principal or interest, provision of additional collateral, etc.) will be defined for the loans that are designated for the "recovery" option;
- 3) time-limits within which the bank will, after defining the possible restructuring measures, start negotiations with the debtor and finalise the restructuring procedure (by concluding a restructuring agreement, or abandoning restructuring);
- 4) success level of the restructuring, which implies a targeted percentage amount of successful loan restructuring arrangements, compared to the total concluded restructuring arrangements which are currently implemented, whereat successful restructuring arrangements are deemed to be:
 - restructuring arrangements based on the financial restructuring plan accepted by the bank and the loan beneficiary, including voluntary financial restructuring carried out in accordance with a special law, if the loan beneficiary has not defaulted as regards the newly identified liabilities, or it is past due up to 60 days,
 - restructuring arrangements based on the reorganisation plan, which was adopted in accordance with the law governing bankruptcy, if the loan beneficiary is meeting its liabilities in full, in accordance with the adopted reorganisation plan;
- 5) time-limits within which appropriate measures (initiation of court proceedings, sale of receivables, collateral foreclosure, etc.) will be taken with regard to the loans that are designated for the "enforced resolution" option;
- 6) level of non-performing loans whose "enforced resolution" procedure will be finalised during the current year;
- 7) bank's level of claims settlement that will be generated in the current year, using the "enforced resolution" option.

2.3. Segmentation of the portfolio of non-performing loans. Banks are recommended to segment their non-performing loans portfolio and to lay down specific arrangements for activity planning and monitoring of each of the relevant segments of the non-performing loan portfolio. Depending on the specifics of each bank, different criteria for segmentation may be used. For example, a bank may use the amount of receivables as a criterion for identifying the appropriate number of relevant segments.

3. Sustainable financial restructuring

3.1. Selection of the "recovery" option. Selecting the "recovery" option of non-performing loans is based on an assessment of the financial restructuring's sustainability.

Sustainable financial restructuring may be deemed the restructuring that will ensure that the debtor meets in a timely manner or with minor delays its original financial or liabilities revised in the restructuring process, using its operating income and liquid assets that will be obtained by selling the property and/or otherwise.

The restructuring should improve the bank's prospects for return of the principal and interest and it should be in line with sound banking and accounting practices. The bank needs to consider the financial restructuring possibility after an analysis of the loan

beneficiary's financial ability, of the possible support from the guarantor and after a realistic collateral value assessment.

Restructuring arrangements need to be done so as to ensure that the bank makes a maximum use of the opportunities available for the settlement of its receivables, while simultaneously making sure that the debtor's ability to service its debts regularly is sustainable.

Financial restructuring shall be based on:

- 1) a reasonable restructuring policy establishing adequate time-limits and loan repayment plans and allowing the bank to amend the plan if it turns out that the newly contracted repayment time-limits are not sustainable;
- 2) a well-designed restructuring plan for each individual loan, based on the analysis of financial information about the loan beneficiary and the possible guarantor and the collateral quality, taking into account:
 - current, comprehensive financial information about the loan beneficiary, its business activities and guarantors,
 - assessment of the collateral value,
 - analysis and setting appropriate financial restructuring measures (new repayment time-limits, reduction of principal or interest, changes in the collateral quality and value, etc.),
 - appropriate legal documents which enable possible changes to the loan repayment time-limits;
- 3) analysis of the sustainability of the loan beneficiary's total debts, which reflects a realistic projection of the expenses of the loan beneficiary and the guarantor (total debt represents the sum of the financial liabilities of the loan beneficiary and/or guarantor, including contingent liabilities);
- 4) possibilities to monitor the financial performance of the loan beneficiary and of the guarantor during the execution of the restructuring arrangement;
- 5) a realistic estimate that, in the event of a temporary delay of payments of interest or principal, the debtor would gain a greater ability to fully repay the amount of the debt after the expiry of the agreed period of delay;
- 6) internal credit rating system that accurately and consistently reflects the risk contained in the restructuring arrangement.

3.2. Measures for sustainable financial restructuring. Measures that need to ensure sustainable financial restructuring are various and the choice of specific measures depends on their applicability and impact on the success of the restructuring of a certain loan receivable. The financial restructuring arrangement may include one or several financial restructuring measures, such as:

- 1) extension of principal and/or interest repayment dates;
- 2) reduction of interest rate on the loan granted;
- 3) assumption of receivables that the loan beneficiary has to a third party, either against full or partial repayment of its loan;
- 4) reducing the amount of debt, principal or interest;
- 5) replacement of the existing loan(s) with (a) new loan(s) (loan renewal);
- 6) redemption of debtor's receivables;
- 7) obtaining additional collateral from the debtor or third parties;
- 8) debt to equity swap;
- 9) settlement.

3.3. Assessment of the creditworthiness of the loan beneficiary. When considering a specific restructuring arrangement, primary focus should be given to the analysis of the beneficiary's ability to repay the loan in a timely manner after its restructuring. The factors that affect this analysis are the readiness and ability of the loan beneficiary to repay the loan within reasonable time-limits and in accordance with the potential cash flows generated from its operating activities or collateral.

When analysing the repayment ability of the loan beneficiary which is an economic entity, the following shall specifically be taken into account:

- 1) characteristics, overall financial position and historical information about the loan beneficiary in respect of payment of liabilities;
- 2) the nature and the level of protection provided by the cash flows from operating activities or collateral compared to the total liabilities of the loan beneficiary;
- 3) market conditions that may affect the future repayment and potential cash flows from business operations.

Bank's assessment of the debt servicing sustainability should be based on an assessment of the loan beneficiary's ability to meet its liabilities after the restructuring, taking into account the historical and current data on its financial position, as well as reasonable income and expenses' projections.

When assessing the current and future income and expenses of the loan beneficiary, the following basic requirements should be met:

- 1) assessment of the current financial abilities of the loan beneficiary should be based on the amounts of income and expenses that can be checked;
- 2) the bank should be confident and be able to prove that an adequate level of conservatism was applied in evaluating the variable elements of income taken into account (e.g. variable elements of lease income and the like should not be taken into account, in order to acknowledge the possibility of their non-collection);
- 3) future increase in income should be taken into account only where there is valid reason to expect that this increase will actually happen. The bank should be confident and be able to prove that an adequate level of conservatism was applied when considering the level of future income growth. The assumed increases in income should be adjusted to the situation in a particular branch/sector to which the loan beneficiary belongs and the market in which it operates and, if necessary, these should be reduced to reflect the risk that income will not be fully collected;
- 4) when assessing the level of expenses of a loan beneficiary, the bank should take into account the likely future increase in expenses, by applying the appropriate level of conservatism;
- 5) if the assessment takes into account the reduction in future and specific expenses, the bank should be confident and be able to show that a conservative approach was applied when considering the levels of these reductions;
- 6) when the loan beneficiary is required, as part of the restructuring arrangement, to reduce the level of expenses so as to be able to repay debt, the bank needs to be confident and to be able to show that these reductions are possible and practicable during the implementation of the revised decision, and that these reductions will not create an unreasonable burden for the loan beneficiary;
- 7) when the loan beneficiary is required, as part of the restructuring arrangement, to accept an accelerated repayment of the loan, the bank needs to be confident that there is a good reason to expect that the loan beneficiary can fulfil such a commitment.

The bank's ability to adequately assess cash flows, expenses and the loan beneficiary's debt servicing ability, depends on its possibility to access current, timely and accurate information on the loan beneficiary's business activities. The bank needs to collect information about the financial position of the loan beneficiary, its assets, equity, liabilities, operational and business prospects and income, so as to be able to make a valid assessment of its financial position and viability, to the extent that this information is necessary to consider and prepare financial restructuring options. The cooperation of the loan beneficiary in providing current, accurate, timely and complete data and information, in order to create conditions for an adequate assessment of the loan beneficiary's business activities, is one of the key factors for the bank's decision on whether it should begin restructuring or not.

3.4. Assessment of the collateral's value. When analysing credit risk, collateral will be treated as an important secondary source of loan repayment. The bank needs to monitor and update the current assessments of the collateral's value (to obtain a report from an independent appraiser), in order to ensure that the preconditions and conclusions related to the loan repayment are realistic. For purposes of financial restructuring, assessment of the collateral's value should be made again if the last assessment was made more than six months ago, counting from the commencement date of restructuring negotiations. The collateral should be assessed on the basis of current market prices and conditions, taking into account the type of the collateral and special factors which are decisive for the market value of that type of the collateral.

3.5. Support by the guarantor. The support provided by guarantors may be a significant factor for the bank's decision whether to begin the loan restructuring or not. The existence of a guarantee given by a financially responsible guarantor may improve prospects for debts repayment and could be the basis for a more favourable classification of a certain loan.

The guarantor may be considered financially responsible if:

- 1) it is financially able and ready to provide support for the settlement of receivables;
- 2) the guarantee is adequate, because it can provide support for debt repayment, in whole or in part, during the remaining life of the loan;
- 3) the guarantee meets the requirements in terms of its form and execution.

The bank should obtain sufficient information about the guarantor (e.g., general financial situation, revenues, liquidity, cash flows, contingent liabilities and other relevant factors), including its credit rating, if any, to demonstrate its financial ability to fulfil its commitment. This assessment also includes the consideration of the total number and amounts of guarantees given, in order to assess whether the guarantor has the financial ability to cover the existing contingent liabilities. Furthermore, the bank needs to consider whether the guarantor had demonstrated readiness in the past to fulfil all commitments and whether it has sufficient economic incentive to fulfil the commitment undertaken in case of loan repayment problems. A significant indicator of guarantor's readiness to fulfil commitments may be information on whether the guarantor had fulfilled voluntarily a commitment under an earlier guarantee, or whether the fulfilment of that commitment was the result of court proceedings or other proceedings conducted by the loan grantee in view of a forced execution of the commitments under the guarantee.

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Bank name / head office

ANNEX 3

Form I-OC

**REPORT
on the accomplishment of operating objectives for non-performing loans**

For the period January - _____ 20__

No.	Description	Balance as at the end of the previous year	Balance as at the end of the quarter	%
		1	2	3
1.	Non-performing loans (NPL)			
2.	NPL designated for the "recovery" option			compared to the total NPL (row 1, column 2)
3.	NPL designated for the "recovery" option, subject to recovery arrangements prepared by the bank			compared to the total NPL (row 2, column 2)
4.	NPL designated for the "recovery" option, subject to negotiations with the debtor conducted by the bank			compared to the NPL (3, column 2)
5.	NPL subject to a concluded restructuring arrangement			compared to the NPL (row 3, column 2)
6.	Successful restructuring arrangements*			compared to the NPL (row 4, column 2)
7.	NPL designated for the "enforced resolution" option			compared to the total NPL (row 1, column 2)
8.	NPL designated for the "enforced resolution" option, subject to an on-going appropriate receivables collection procedure			compared to the NPL (row 7, column 2)
9.	NPL designated for the "enforced resolution" option, subject to finalised resolution procedure			compared to the NPL (row 7, column 2)
10.	The amount of claims collected by using the "enforced resolution" option			

/Name and last name/signature/phone. no. of the authorised person/

NOTE:

*) Successful restructuring arrangements (row 6) are considered to be: restructuring arrangements based on the financial restructuring plan accepted by the bank and the loan beneficiary, including voluntary restructuring carried out in accordance with a special law, if the loan beneficiary has not defaulted with regards to its newly established liabilities, or where it is past due up to 60 days, as well as restructuring arrangements based on the reorganisation plan adopted in accordance with the law governing bankruptcy, if the loan beneficiary fully meets its liabilities in accordance with the adopted reorganisation plan.