

DECISION

**ON MINIMUM STANDARDS FOR CREDIT RISK MANAGEMENT IN BANKS
(OGM 22/12 of 23 April 2012, 55/12 of 2 November 2012, 57/13 of 16 December 2013, 44/17 of 6
July 2017, 82/17 of 8 December 2017, 86/18 of 28 December 2018, 41/19 of 26 July 2019)**

I. GENERAL PROVISION

Subject matter of the Decision

Article 1

This Decision shall regulate the minimum standards for identifying, measuring, monitoring and controlling credit risk (hereinafter: credit risk management) in banks, including also valuation and classification of banks' balance sheet assets and off-balance sheet items.

II. RISK MANAGEMENT

2.1. Risk identification, measurement, monitoring and control

Risk management framework

Article 2

A bank shall efficiently manage credit risk and maintain the level and the quality of its loan portfolio within frameworks set out in risk management strategy and credit policy.

Loan approval

Article 3

Before granting a loan and other bank placements, a bank shall evaluate debtor's credit capacity, taking into consideration the criteria laid down in its internal act as well as minimum requirements of this Decision.

Prior to loan approval, a bank shall assess the value and legal validity of collateral.

If the collateral value largely depends on credit capacity of collateral provider other than the loan beneficiary, the bank shall also assess credit capacity of such a person.

The bank shall require the client, prior to the occurrence of individually significant receivable within the meaning of Article 19 paragraph 2 of this Decision, to submit information on the existence or non-existence of ownership, managerial or economic interconnection with other clients, and inform the bank during the exposure on all new connections or changes in the existing connections with other clients.

Economic interconnection referred to in paragraph 4 of this Article shall be the connection between two or more persons within the meaning of Article 3 paragraph 8 indent 6 of the Banking Law (OGM 17/08, 44/10).

Loan file

Article 4

A bank shall ensure that every credit exposure is properly and correctly documented and that regular and complete loan file is created and kept for every loan, providing chronological evidence of the approval and the quality of loan granted, until its final repayment or regulation of debt in some other manner.

Loan file must contain, in addition to the loan application and loan agreement, as a minimum, other documents, data and information to provide the evidence of:

- 1) identity of loan beneficiary and its connected clients, as well as its guarantor;
- 2) legal capacity of loan beneficiary to take loans and/or borrow financial resources;
- 3) financial situation of loan beneficiary for the last three years, its ability to repay the loan, as well as the loan repayment dynamics and sources;
- 4) type and quality of collateral;
- 5) purpose of the loan granted and earmarked use of the funds, and
- 6) debt restructuring approved (request submitted by the loan beneficiary for debt restructuring and analysis of causes that led to debt restructuring and reasons for accepting debt restructuring).

Credit risk measurement

Article 5

A bank shall establish an adequate system and analytical methodologies, which enable the bank to measure credit risk by including all types of transactions and to pay sufficient attention to risks that cannot be quantified, and the relation between credit risk and other risks.

The bank shall measure exposures to credit risk taking into account the minimum requirements set forth in the provisions of this decision regulating valuation and classification of assets.

In the process of valuing individual exposures and the exposure to credit risk based on total portfolio, the bank shall also assess exposure to credit risk arising from an abrupt increase in balance sheet assets, as well as potential adverse business environment, including also changes in economic environment.

Loan monitoring process

Article 6

A bank shall establish a system of monitoring of the structure and the quality of different parts of the loan portfolio in accordance with the nature, size and complexity of its total portfolio.

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.

The process of monitoring individual loans shall include the assessment of credit capacity of debtor as well as clients connected with the debtor, the quality of collateral and debtor's regularity in repaying its obligations during the life of legal relationship representing bank exposure.

The process of monitoring of individual loans must be established so as to enable taking of adequate measures in timely fashion for the purpose of reducing credit risk in case of deterioration of credit capacity of a debtor or collateral provider.

The bank shall ensure the monitoring of fulfilment of obligations under loan agreement, and in case of granted purpose-specific loans, it shall also ensure the monitoring of earmarked use of funds disbursed.

The bank shall establish early detection system for credit risk increase that enables timely identification of debtors with an increased risk, and which also includes determining adequate qualitative and quantitative indicators for early detection of credit risk increase.

The bank shall have procedures regulating the collection and monitoring of all relevant information that could point to the increase in the riskiness of loans and collaterals, and procedures for reporting on such information to all persons included in credit risk management so as to perform re-evaluation of placement risk.

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.

The bank shall develop a comprehensive strategy for dealing with non-performing loans (hereinafter: the 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).

The bank shall submit to the Central Bank the following:

- 1) the NPL resolution strategy, as well as its amendments and/or supplements within eight days following the date of its adoption;
- 2) annual operating objectives by 31 January for the year for which operational objectives are identified.

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

Reporting on the implementation of operating objectives

Article 6b

A bank shall prepare and submit to the Central Bank quarterly reports on the implementation of operating objectives referred to in Article 6a paragraph 3 of this Decision.

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

Where the report referred to in paragraph 2 of this Article indicates that there are significant differences between the activities implemented and the operating objectives identified, 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.

Credit risk control

Article 7

A bank shall prescribe in its internal acts the volume and the manner of controlling credit risk, as well as the volume and frequency of internal reporting on credit risk to bank management, board of directors and board of directors' committees.

For the purpose of taking measures to reduce credit risk, the bank shall provide timely and effective analysis and monitoring of credit risk, and inform relevant persons or bank's bodies in timely fashion on the exceptions in policies, procedures and credit limits.

The bank shall establish the procedures for taking activities in timely fashion to improve the condition of the loan portfolio and in particular, loans classified in the non-performing loans category, including also procedures for rescheduling and/or restructuring of loans or taking other measures against loan beneficiary aimed at reducing losses of the bank to the minimum level possible, and the procedures for exercising and foreclosing the collateral.

Stress testing

Article 8

A bank shall perform stress testing in the assessment of risk of total loan portfolio.

The stress testing process shall include identification of potential events or future changes in economic conditions that could have adverse effect on bank's exposure to credit risk and assessment of bank's capacity to sustain such changes.

The bank shall define types, volume and frequency of stress testing (at least on a quarterly basis), as well as the procedures and actions to be taken in case of unfavourable stress test results.

Treatment of large exposures

Article 9

A bank shall establish reliable administrative and accounting procedures and adequate internal control mechanisms for the purpose of identifying and recording all large exposures and their subsequent changes and monitoring those exposures, taking into account the bank's policies related to exposures.

The bank shall analyse, to the extent possible, the concentration of exposures to collateral providers, unfunded credit protection providers and underlying assets with specific exposures (securitisation, open investment funds) and report to the Central Bank of Montenegro (hereinafter: the Central Bank) on all significant findings.

Determining large exposures

Article 10

A bank shall determine large exposures on solo and consolidated basis for all exposures in banking and trading book.

Large exposure shall also be determined in cases when it does not occur on the basis of the decision of a bank, but it occurs due to:

- 1) Reduction in bank's own funds;
- 2) Establishment of interconnection between clients to which bank's exposure already exists;
- 3) Change in market prices or other factors influencing the value of the existing exposures of the bank.

The manner of identifying connected clients for the purpose of determining large exposures is enclosed in Annex 1 which makes an integral part of this Decision.

Large exposures reporting

Article 11

A bank shall submit reports on large exposures to the Central Bank in accordance with the decision governing bank reporting to the Central Bank and the Banking Law.

In addition to the reporting referred to in paragraph 1 of this Article, the bank shall:

- 1) inform the Central Bank on the occurrence of large exposure to individual clients, within ten days following that of passing the decision arising from large exposure;
- 2) inform the Central Bank on the occurrence of large exposure due to reasons referred to in Article 10 paragraph 2 of this Decision, within ten days following that of identification of large exposure;
- 3) immediately inform the Central Bank, when the exposure limit has been exceeded, on the amount of and the reasons for exceeding the prescribed limits.

Sale and purchase of receivables

Article 12

A bank that intends to purchase or sell loan or other receivable which amount exceeds 50.000 euro, shall first obtain the opinion of the Central Bank on the justification of the planned sale and/or purchase of such a receivable.

The bank that intends to sell and/or purchase loan receivable shall submit to the Central Bank the following:

- 1) proposal on repurchase agreement;
- 2) information on reasons for the purchase and/or sale of receivables;
- 3) data on the quality of the receivable and collateral and the assessment of debtor's credit capacity;
- 4) information on the manner of determining the selling and/or purchase price;
- 5) assessment of effects of sale and/or purchase on the financial position and bank's performance indicators.

In addition to documents referred to in paragraph 2 of this Article, the Central Bank may require a bank to submit additional data and information.

The Central Bank shall, within eight working days following that of the receipt of documents referred to in paragraph 2 of this Article and/or following that of the receipt of the additional data and information referred to in paragraph 3 of this Article, provide the bank with the opinion on justification of then sale and/or purchase of receivables.

2.2. Valuation and classification of asset items

Obligation for Valuing and Classifying

Article 13

Deleted. (Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks, OGM 82/17).

Risk-Bearing and Risk-Free Items

Article 14

Deleted. (Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks, OGM 82/17).

2.2.1. Valuation of asset items

Implementation of IAS/IFRS

Article 15

A bank shall value and disclose balance sheet asset items and off-balance sheet items in accordance with the International Accounting Standards and the International Financial Reporting Standards.

Methodology

Article 16

A bank shall determine the methodology for classification, measurement and impairment of financial assets in accordance with International Financial Reporting Standard 9 – “Financial Instruments”.

The implementation of the methodology referred to in paragraph 1 of this Article shall ensure the following:

- 1) all analysis, assumptions, assessments and other procedures in the process of assessment of the impairment amount of balance sheet asset items and probable losses related to off-balance sheet items should be detailed and documented;
- 2) the assessment of the impairment amount of balance sheet asset items and probable losses related to off-balance sheet items should be based on accurate and updated information and take into account all important internal and external factors that may influence the collectability of receivables.

The bank shall apply consistently methodology referred to in paragraph 1 of this Article, review it at least once a year, and if needed, adjust it to the results of the review, and adjust the assumptions on which the methodology is based.

Frequency of valuation

Article 17

A bank shall, at least quarterly, assess asset quality, determine if there is an objective evidence of impairment of balance sheet assets and/or probable losses related to off-balance sheet items, and calculate adequate amount of such impairment and/or probable losses.

The objective evidence on the impairment of balance sheet assets and/or probable losses related to off-balance sheet items shall be information on one or more events that adversely affect the ability of debtor to regularly meet its obligations to the bank.

Treatment of collateral

Article 18

A bank may also take into account cash flows based on collateral when calculating impairment of balance sheet assets and probable losses related to off-balance sheet items.

When assessing future cash flows based on collections from collateral taken in the form of real estate or movable property, a bank shall apply appropriate impairment (haircut) factors to the market value of individual types of collateral, expressed in percentages, and relevant internally assessed period for the collection of those types of collateral.

The impairment factors and collection periods under paragraph 2 of this Article shall take into account bank's practices and past experience in the collection of appropriate instruments of collateral, economic and legal environment in which a bank operates and relevant characteristics of instruments of collateral.

When determining the impairment factor level and the length of collection period referred to in paragraph 2 of this Article, a bank shall take into account the fact that various types of instruments of collateral reflect different levels of risk of their implementation.

The methodology under Article 16 paragraph 1 of this Decision shall also determine the manner of valuation of collateral for which the bank estimates cash flows and expected period for exercising such collateral.

Individual assessment

Article 19

A bank shall perform individual assessment of impairment of balance sheet assets and probable losses related to off-balance sheet items in respect of individually significant receivables.

Individually significant receivable, within the meaning of paragraph 1 of this Article, shall be total gross exposure of the bank to a single client or a group of connected clients exceeding 50.000 euro.

Notwithstanding paragraph 2 of this Article, a bank may, in its internal acts, determine lower amount of total exposure to a single client or a group of connected clients as a threshold beyond which the exposure is considered an individually significant receivable.

The individual assessment of balance sheet assets for impairment shall include determining the existence of objective evidence of impairment, estimation of the present value of future cash flows and calculation of the amount of impairment for every individual receivable included in this assessment.

It is considered that there is objective evidence on the impairment of balance sheet assets on individual basis, if:

- 1) debtor's financial condition indicates significant problems in its operations;
- 2) there is information on default, and on frequent delay in principal and/or interest repayment, or non-compliance with other contractual obligations;
- 3) due to debtor's financial difficulties, the bank changes significantly the terms of repayment in relation to those originally agreed, or
- 4) it becomes certain that bankruptcy proceedings, reorganisation or other similar procedures will be initiated against the debtor.

Determining impairment amount

Article 20

The amount of impairment of balance sheet assets shall be determined as a difference between carrying amount of a receivable and present value of expected future cash flows of such receivable.

Notwithstanding paragraph 1 of this Article, if deadline for specific receivable in which future cash flows are expected is shorter than one year, a bank shall not calculate present value of expected future cash flows but it may determine the amount of impairment of those assets items as a difference between carrying amount of receivable and expected future cash flows on such receivable.

Assessment of probable loss

Article 21

The assessment of probable loss related to off-balance sheet items on individual basis includes the assessment of recoverability of future cash outflows for each of the assumed off-balance sheet commitments and the calculation of the amount of probable loss for each individual off-balance sheet item included in this assessment.

Irrecoverable future cash outflows shall be the nominal amount of expected cash outflows related to off-balance sheet obligations less the amount reasonably estimated to be recovered by counterparty or through exercising the collateral.

Determining probable loss

Article 22

The amount of probable loss related to off-balance sheet items shall be equal to the present value of expected irrecoverable future cash outflows under those items.

By way of derogation from paragraph 1 of this Article, if it is estimated that cash outflows will occur within a year following the calculation date of probable loss related to off-balance sheet items, a bank may determine the amount of cash outflows to equal those outflows.

Collective assessment

Article 23

A bank shall perform collective assessment of balance sheet assets for impairment or probable losses related to off-balance sheet items for all receivables where the impairment or losses may not be directly linked to those receivables, but which may be estimated, based on experience, to exist in the loan portfolio.

The bank shall perform collective assessment for the following receivables:

- 1) those where individual assessment showed no objective evidence of impairment of balance sheet assets or probable losses on off-balance sheet items, and/or if no amount of impairment of balance sheet assets and probable losses related to off-balance sheet items has been determined at individual level;
- 2) those that do not represent individually significant receivables referred to Article 19 paragraph 2 of this Decision.

The bank may perform assessment of impairment of balance sheet assets and probable losses related to off-balance sheet items for receivables that do not represent individually significant receivables on individual basis.

In performing collective assessment, a bank shall group receivables based on similar characteristics of credit risk that reflect the debtor's ability to meet its obligations in accordance with the agreed terms by applying one or more criteria, such as: type of products, regularity in meeting the obligations, credit rating, geographical areas, economic sector, type of collateral, and the like.

Accounting treatment

Article 24

A bank shall debit the amount of impairment loss calculated for balance sheet assets as expense and credit it to the allowances for the impairment.

A bank shall debit the calculated amount of probable losses related to off-balance sheet items and credit it to the provisions for losses on off-balance sheet items.

2.2.2. Classification of asset items

Article 25

A bank shall classify, at least once a month, balance sheet asset and off-balance sheet items exposing the bank to credit risk and calculate loan loss provisions.

Balance sheet asset items and off-balance sheet items which expose the bank to credit risk shall be balance sheet asset items which expose the bank to a default risk and off-balance sheet items representing contingent liabilities of the bank, and in particularly:

- 1) loans and receivables from banks (including funds with banks, interests and fees);
- 2) loans and receivables from clients (including interests and fees, receivables based on lease, forfaiting and factoring);
- 3) financial assets carried at fair value through profit or loss (debt and equity securities not included in trading book, or included in trading book but the bank does not calculate for these items capital required for market risks in accordance with the decision governing capital adequacy of banks);
- 4) securities measured at amortised cost and securities at fair value through other comprehensive income;
- 5) equity investments in other legal persons, excluding equity investments representing deductible item from bank's own funds in accordance with decision governing capital adequacy of banks;
- 6) guarantees issued;
- 7) credit obligations given (approved, unused loans);
- 8) bill of exchange security and bill of exchange acceptances;
- 9) other sureties;
- 10) uncovered letters of credit.

Balance sheet asset items and off-balance sheet items which do not expose the bank to a credit risk shall be the following:

- 1) cash and deposit account with central banks (cash and cash equivalents, which include cash and other short-term highly liquid instruments with original maturity up to three months, and for which there is low risk of change in value);
- 2) derivative financial assets used as hedging instruments;
- 3) investment properties, properties, plant and equipment and intangible assets;
- 4) equity investments in other legal persons representing deductible item from banks' own funds in accordance with the decision governing capital adequacy of banks;
- 5) financial assets included in trading book, for which the bank calculates capital requirement for market risks in accordance with the decision governing capital adequacy of banks;
- 6) guarantees obtained;
- 7) credit obligations obtained;
- 8) written-off loans;
- 9) collateral obtained;
- 10) custody assets.

The bank shall determine if all balance sheet asset items and off-balance items other than items referred to in paragraphs 2 and 3 of this Article expose it to credit risk, and it shall classify those items into the corresponding classification category in accordance with the provisions of this Decision.

Classification criteria

Article 26

The criteria for asset classification shall be:

- 1) debtor's credit capacity;
- 2) debtor's regularity in meeting its obligations;
- 3) other relevant factors.

Assessment of debtor's credit capacity

Article 27

The assessment of debtor's credit capacity is based on the assessment of capacity and readiness of a debtor to completely and timely meet their obligations to the bank from primary sources of debt repayment.

Primary sources of debt repayment shall be considered, in particular, cash from debtor's operating and other activities.

In assessing debtor's credit capacity, the bank shall analyse, in particular, performance indicators that refer to:

- 1) maturity structure of specific elements of assets and liabilities showing liquidity level of debtor, matching of sources of financing and placements and net working assets, including also information on turnover on customers' accounts with the bank and in the system, and information on account freezes;
- 2) cash flows, in respect of the fulfilment of obligations, cash flows incurred in the previous period, and adequacy of projected cash flows;
- 3) level of indebtedness of loan beneficiary, loan maturity, influence of new loan on maturity structure, cash flows, interest expenses and indicators of capitalisation;
- 4) total operating income and extraordinary income and expenses of loan beneficiaries influencing the profitability and attainment of financial result.

Assessment of collateral quality

Article 28

Deleted (Decision Amending the Decision on Minimum Standards for Credit Risk Management in Banks OGM 42/19)

Prime collateral

Article 29

Deleted (Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks OGM 42/19)

Adequate collateral

Article 30

Deleted. (Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks, OGM 86/18).

Assessment of other relevant factors

Article 31

In the procedure of classification of assets items, the assessment of other relevant factors for classifying asset items shall include, in particular:

- 1) information on general economic cycle;
- 2) information on the condition and prospects of economic sector to which a debtor belongs;
- 3) information on loan concentration per economic sectors and certain group of loan beneficiaries;
- 4) debtor's market position;
- 5) debtor's ownership and status changes;
- 6) corporate governance and management's capacity to implement the programme subject to financial support from the bank;
- 7) loan structure;
- 8) compatibility of the loan purpose with debtor's activity, and
- 9) compliance of loan approval with the bank policies and procedures.

When classifying asset items, a bank shall take into account the relations within the group of connected parties and identify in its internal documents situations in which loans of other entities from the same group should be classified in the same category due to the classification of one debtor from the group of connected parties into the category of non-performing loans.

Classification categories

Article 32

Bank shall, depending on probability of incurring losses, classify asset items into one of the following classification categories:

- 1) category A – “pass”;
- 2) category B – “special mention” with subcategories B1 and B2;
- 3) category C – “substandard” with subcategories C1 and C2;
- 4) category D – “doubtful”;
- 5) category E – “loss”.

Classification category “A”

Article 33

Loans and other receivables (hereinafter the loan) shall be classified into the classification category “A” where highly documented evidence exist that it will be collected in full in accordance with the agreed terms and conditions.

The following shall be classified into the classification category “A”:

- 1) loan granted to central governments, central banks, public authorities, multilateral development banks and international organisations which receive a 0% risk weight pursuant to the decision regulating banks' capital adequacy;
- 2) loan which has the following characteristics:
 - loan is granted in accordance with the criteria laid down in bank's internal documents;
 - loan beneficiary is financially sound;
 - loan repayment is regular (as at maturity date or with small delay);
 - information and data on the fulfilment of obligations in prior period indicate that loan beneficiary met regularly its obligations; and

- loan is secured by collateral, which in combination with debtor's financial condition minimises risk of loan collection..

Classification category "B"

Article 34

A loan shall be classified into the classification category "B" (subcategories "B1" and "B2") if there is a small probability of incurring losses. However, such loan must be subject to special watch of a bank, as the potential risk, if not adequately monitored, might result in poor perspective for its repayment.

A loan classified into the classification category "B" (sub-category "B1" or "B2") shall have some of the following characteristics:

- 1) financial information on loan beneficiary are incomplete;
- 2) loan has not been granted in accordance with the internal policies of the bank;
- 3) the assessment of financial value of collateral is incomplete or inadequately documented;
- 4) connected loan beneficiaries are not included in the loan analysis;
- 5) debtor's financial situation is stable but it has some features that point to possible difficulties in future loan repayment;
- 6) debtor is over 30 days past due.

A loan that is over 30 days past due may not be classified into higher classification category and/or sub-category other than sub-category "B1", and a loan that is over 60 days past due may not be classified in higher classification category and/or sub-category other than sub-category "B2".

Classification category "C"

Article 35

A loan shall be classified into the classification category "C" if there is high probability of incurring losses due to clearly disclosed weaknesses jeopardising their repayment.

A loan classified into the classification category "C" (sub-category "C1" or "C2") shall have some of the following characteristics:

- 1) primary sources of repayment are insufficient to repay debt and bank must use secondary sources to collect debt, i.e. to foreclose the collateral, restructure debt, and the like;
- 2) current financial possibilities of the loan beneficiary or cash flows are insufficient for the repayment of maturing debt (customer is insufficiently liquid, significantly indebted or not well capitalised, it has critically low level of profitability or operates with loss);
- 3) negative trend in debtor's operations exists;
- 4) there is an indication in short-term loans that loan beneficiary will not be able to convert assets into cash which will result in an inability of the borrower to repay debt when it becomes due;
- 5) bank does not have required and updated financial information to determine financial ability of customer to repay the debt;
- 6) loan is over 90 days past due.

A loan that is over 90 days past due may not be classified in higher classification category and/or sub-category other than sub-category "C1" and a loan that is over 150 days past due may not be classified in higher classification category and/or sub-category other than sub-category "C2".

Classification category “D”

Article 36

A loan shall be classified into classification category “D” if there is a low probability of the collection of loan in full, taking into consideration debtor’s credit capacity, value and possibility of collateral enforcement.

A loan classified into classification category “D” shall have some of the following characteristics:

- 1) legal person who is loan beneficiary is illiquid with insufficient amount of capital, highly leveraged, non-profitable, has difficulties or shows permanent non-competitiveness without any perspective for further development, and the like;
- 2) bankruptcy proceedings have been initiated;
- 3) there is significant credit risk, thus it is quite uncertain if the loan will be collected in full, but there are facts that indicate that there is real expectation for at least partial collection in near future (loan is in the process of collection, loan beneficiary has initiated the procedure of providing additional collateral which will fully secure the loan in case of its enforcement, the bank initiated foreclosure of additional instruments of security, and the like);
- 4) loan is over 270 days past due.

A loan that is over 270 days past due may not be classified in higher classification category and/or subcategory other than sub-category of category “D”.

Classification category “E”

Article 37

A loan shall be classified into classification category “E” if it is fully uncollectible or if it will be collected in an insignificant amount.

A loan shall be classified into classification category “E” if:

- 1) regardless of default, it contains at least one characteristic of doubtful assets, it is not fully secured and no facts exist indicating that there is real expectation for at least partial collection in near future;
- 2) loan is over 365 days past due.

Treatment of collateral in classification

Article 38

Deleted (Decision Amending the Decision on Minimum Standards for Credit Risk Management in Banks OGM 42/19)

Impact of other relevant factors on classification

Article 39

Where it is proven that the factors set out under Article 31 of this Decision, either individually or as combined, affect the increase in debtor’s probability of default, the bank shall classify such a loan into the classification category and/or subcategory that is at least one grade lower than the classification category and/or subcategory under which such a loan would be classified based on the assessment of debtor’s credit capacity.

Classification of small loans

Article 40

A bank may classify loan that does not belong to a category of individually significant receivable referred to in Article 19 paragraph 2 of this Decision into appropriate classification category based on the information on debtor's regularity in meeting its obligations to the bank.

When there is default, loan under paragraph 1 of this Article shall not be classified into higher into classification category and/or sub-category other than:

- 1) sub-category "B1", if the debtor is over 30 days past due,
- 2) sub-category "B2", if the debtor is over 60 days past due,
- 3) sub-category "C1", if the debtor is over 90 days past due,
- 4) sub-category "C2", if the debtor is over 150 days past due,
- 5) subcategory "D", if the debtor is over 270 days past due,
- 6) sub-category "E", if the debtor is over 365 days past due.

The default in repayment shall be calculated only for matured receivables exceeding 20 euro for natural persons, and/or 200 euro for other debtors.

Assessment of credit capacity of loan beneficiary for investment projects

Article 41

In the process of classifying loan granted for the investment project, a bank may base its assessment of debtor's credit capacity on the analysis of profitability of such investment project.

Profitability analysis of the investment project shall include, as a minimum, the following:

- 1) assessment of reality of business plan and financial projections;
- 2) assessment of period required for return on funds invested in the project;
- 3) project risk sensitivity;
- 4) assessment if cash flows arising from the project implementation ensure regular fulfilment of debtor's obligations in accordance with the agreed loan repayment dynamics.

Investment project, within the meaning of this Article, shall be the project from the production or services sectors aimed at promoting the existing activity of the loan applicant, introduction of new products and services, and the like.

Classification of loan under paragraph 1 of this Article may be performed only by a bank that has adequate methodology for the assessment of business plans set forth in its internal document.

A bank shall regularly monitor projected implementation of the investment project, and based on the analysis of compliance of actual and projected implementation of the investment project and other criteria for asset classification, it shall classify loan into adequate classification category and/or subcategory.

Multiple loan holder

Article 42

If one person holds more loans with a bank, and one or more of those loans are classified into category of non-performing loans, a bank shall classify all receivables to such a person into the lowest classification category and/or subcategory.

By way of derogation from paragraph 1 of this Article, if more than 90% of total carrying amount of all loans referred to in paragraph 1 above, including outstanding interest, has been classified into the classification categories "A" or "B" (hereinafter: "group of performing loans"), a bank may keep such loans within the same classification categories

Restructured loans

Article 43

A bank is deemed to have restructured a loan if, due to deterioration in the borrower's credit capacity, it has:

- 1) extended principal or interest repayment dates;
- 2) reduced the interest rate on the granted loan;
- 3) acquired the debtor's liabilities to a third party, either against full or partial repayment of its loan;
- 4) reduced the amount of debt, principal or interest;
- 5) capitalised interest on the loan granted to the debtor;
- 6) replaced the existing loan with a new loan (loan renewal), or
- 7) made other similar arrangements that alleviate the debtor's financial position.

The following shall not be considered to be loan restructuring:

- 1) change in conditions for principal repayment due to contingencies that are out of the debtor's control (for instance, delays in project completion), provided that the effective interest rate remains the same as agreed, as long as the interest is paid on time;
- 2) reduction of interest rate or capitalisation of interest which are not the result of deterioration in the debtor's credit capacity.

In the procedure of loan restructuring, a bank shall:

- 1) analyse the debtor's financial position in order to assess whether the debtor will record cash flows sufficient for principal and interest repayment after the loan restructuring;
- 2) provide adequate information on the results of restructuring in accordance with the International Accounting Standards and/or the International Financial Reporting Standards, that is:
 - define and determine the fair value at which the bank will account for assets obtained in the process of loan restructuring and precisely recognise any loss associated with the loan restructuring, and
 - provide up-to-date accounting of all elements of transactions performed in the process of loan restructuring;
- 3) apply the concept of fair value assessment for assets acquired against debt collection, provided that:
 - when there is a stable market, the fair value assessment of assets shall be equal to their market value,
 - when the market is unstable or the value of acquired assets cannot be determined, a bank shall ensure the fair value assessment of such assets in accordance with professional standards.

Classification of restructured loans

Article 43a

A restructured loan that belongs to the category of non-performing assets may be classified by a bank into the group of performing loans the expiry of a period of at least 12 months and provided that the conditions referred to in paragraph 3 of this Article have been met.

A 12-month period referred to in paragraph 1 above shall start from:

- 1) The moment of loan restructuring, if the restructuring arrangement has not specified grace period for loan repayment; or
- 2) The expiry of grace period specified under the debt restructuring arrangement, whereby grace period shall be the period during which no principal and interests are made or only interest payment is made.

After the expiry of grace period referred to in paragraph 1 above, the restructured loan may be classified into the group of performing loans only where the bank has determined that:

- 1) a restructured loan meets the requirements for its classification into the group of performing loans by applying the criteria referred to in Article 26 of this Decision;
- 2) a regular repayment of restructured loan was established in the period of at least 12 months and in accordance with amended repayment plan;
- 3) a debtor repaid a significant amount of debt within the meaning of Article 43b paragraph 3 of this Decision or the analysis of debtor's financial situation determined its ability to repay the debt in full in accordance with the restructuring arrangement.

A regular repayment of restructured loan, within the meaning of paragraph 3 item 2 of this Article, shall be the loan repayment that is not more than 30 days past due.

Status of restructured loans

Article 43b

A bank may stop treating the loan as a restructured loan if the following conditions have been met at the end of probation period:

- 1) Restructured loan is classified in the group of performing loans;
- 2) A debtor has repaid a significant portion of debt through regular principal or interest payments during at least half of the probation period;
- 3) There are no arrears in repayment longer than 30 days under any of the obligations to the bank.

A probation period referred to in paragraph 1 of this Article shall be a period of two years that begins from the moment when a restructured loan is classified into the group of performing loans.

The significant amount of debt, within the meaning of paragraph 1 item 2 of this Article, shall be deemed to be repaid if the debtor has paid, in accordance with regular payments under the restructuring arrangement, total amount that is equal to the amount of previous outstanding debt (if any) or the amount that was written-off (where no outstanding liabilities existed) under the restructuring arrangement.

If the requirement referred to in paragraph 1 item 1 of this Article has been met at the end of the probation period referred to in paragraph 2 of this Article, and any of the requirements referred to in paragraph 1 items 2 and 3 of this Article have not been met, the probation period shall be extended until the fulfilment of those requirements, and the loan shall be treated as a restructured loan that do not belong to the group of non-performing loans until the expiry of such a period.

A bank shall check the fulfilment of the requirements referred to in paragraph 1 items 2 and 3 of this Article at least on quarterly basis.

A bank may continue to classify a receivable that was classified into the group of performing loans in the moment of restructuring into the same category if the restructuring has not led to the fulfilment of the requirements for classifying such a receivable into the group of non-performing assets.

In addition to the restructured loans classified into the group of non-performing loans in the moment of restructuring, the bank shall classify the following into the same category:

- 1) Loans that met the requirements to be classified into the group of non-performing loans before the restructuring;
- 2) Restructured loans from the group of non-performing loans that were classified into the group of performing loans in accordance with Article 43a paragraph 1 of this Decision and for which the bank made additional concessions for the debtor during the probation period referred to in paragraph 2 of this Article, and/or if the debtor repays obligations under such a receivable in arrears longer than 30 days;
- 3) Loans classified in accordance with paragraph 6 of this Article for which the bank made additional concessions for the debtor after the second restructuring.

Multiple classifications

Article 44

Deleted. (Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks, OGM 86/18).

Classification of other balance sheet items

Article 45

The classification of balance sheet asset items other than loans shall be performed in line with the applicable criteria referred to in Article 26 of this Decision, as well as based on other facts that are important for establishing the level of potential risk of loss arising from these asset items.

Classification of off-balance sheet items

Article 46

The classification of off-balance sheet items that expose bank to credit risk shall be performed in line with the loan classification criteria set out in this decision by applying those criteria on potential debtor of a bank.

The classification of agreed but undrawn loan shall be made if bank was irrevocably obliged to meet outstanding liabilities for that loan arrangement.

Ordering stricter classification

Article 47

A bank shall apply stricter classification of balance sheet asset items and/or off-balance sheet items, if the Central Bank estimated during the examination that the bank did not perform the classification in accordance with the provisions of this Decision.

When the Central Bank orders stricter classification of balance sheet asset items and/or off-balance sheet items, a bank shall perform the requested correction immediately upon receiving such an order and inform the Central Bank thereof.

With a view to ensuring quality documentation base for bank supervision and analysis of the bank's condition, the Central Bank may order the bank to disclose the new classification performed in accordance with paragraph 2 of this Article in the reports for the prior reporting periods.

Provisioning

Article 48

A bank shall calculate loan loss provisions for balance sheet and off-balance sheet asset items by applying the percentages under the table below:

No.	Classification categories and subcategories	Provisions in percentages
1.	Category A – “Pass”	0.5%
2.	Category B – “Special mention” sub-category B1 sub-category B2	2% 7%
3.	Category C – “Substandard”: sub-category C1 sub-category C2	20% 40%
4.	Category D – “Doubtful”	70%
5.	Category E – “Loss”	100 %

The base for calculating loan loss provisions referred to paragraph 1 of this Article for individual asset item and/or off-balance sheet items shall be the carrying amount of such an item deducted by the amount secured by:

- 1) Cash deposit placed with the bank if it has been agreed that it will be used as collateral for certain receivables of the bank, and its maturity is not shorter than the maturity of receivable and it is solely at the disposal of the bank;
- 2) Pledge of gold;
- 3) Debt securities, guarantees, counter-guarantees, other forms of surety or other similar instruments of unfunded credit protection, whose issuers are:
 - Central governments and central banks that are assigned 0% risk weight in accordance with the decision governing the capital adequacy of banks;
 - Multilateral development banks and international organisations that are assigned 0% risk weight in accordance with the decision governing the capital adequacy of banks;
 - Banks that would qualify for at least credit quality step 2 in accordance with the decision governing the capital adequacy of banks.

Provisions in the amount of 0.5% shall be allocated to the gross carrying amount of asset items and/or off-balance sheet items deducted in accordance with paragraph 2 of this Article.

2.2.3. Treatment of provisions and allowances for impairment

Article 49

A bank shall determine the difference between the amount of provisions for estimated losses calculated in accordance with Article 48 of this Decision and the sum of the amount of allowances for impairment and provisioning for off-balance sheet items calculated in accordance with the provisions of this Decision governing the manner of valuation of asset items by applying International Accounting Standards and International Financial Reporting Standards.

The positive difference between the amount of calculated provisions for estimated losses and the sum of the amount of allowances for impairment and provisioning for off-balance sheet items, determined by individual sub-accounts, shall be the provisions required for estimated losses.

The bank shall submit the reports to the Central Bank on the classification of balance sheet assets and off-balance sheet items, and on the amount of loss provisions calculated in accordance with the decision governing banks' reporting to the Central Bank.

Article 49a

Deleted. (Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks, OGM 82/17).

Article 49b

Deleted. (Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks, OGM 82/17).

III TRANSITIONAL AND CLOSING PROVISIONS

Article 50

Banks shall align their internal acts with the provisions of this Decision within six months following the effective date of this decision.

Article 51

Until the commencement of the implementation of this decision, the Central Bank shall regulate in more details in its Instructions the accounting of loan loss provisions and allowances for impairment, as well as the accounting of written-off items of the balance sheet assets when determining the opening balance in the banks' business books for 2013.

Article 52

The Decision on Minimum Standards for Credit Risk Management in Banks (OGM 60/08, 41/09) and Decision on Temporary Measures for Credit Risk Management in Banks (OGM 64/09, 87/09, 66/10, 70/10, 02/12) shall be repealed as of the day of entry into force of this Decision.

Article 53

This Decision shall enter into force on the eighth day following that of its publication in the Official Gazette of Montenegro, and it shall apply from 1 January 2020.

NOTE:

The unofficially consolidated version of the Decision does not contain provisions of Articles 6 and 7 of the Decision amending the Decision on Minimum Standards for Credit Risk Management in Banks (OGM 82/17), which are worded as follows:

“Article 6

When determining annual financial statements, banks may transfer funds from the accounts of reserves for estimated losses under regulatory requirement, fully or partially, to the account of retained earnings or keep them at that account.

Article 7

Banks shall disclose data on receivables from interim records, which are identified in accordance with Article 49b herein as at 31 December 2017, at the off-balance sheet account until the completion of their collection.

The collection process of the receivables shall be deemed completed, within the meaning of paragraph 1 above, when:

- 1) the decision on the completion of bankruptcy proceedings against debtor has become legally valid;
- 2) the bank has renounced a certain receivable (debt forgiveness) based on the confirmed debtor's reorganisation plan;

- 3) the decision has been made on the suspension of the execution proceedings since it is not possible to enforce the execution on the proposed case of execution, or
- 4) the bank has passed a decision on the completion of the collection process of a receivable due to economic non-viability of further collection (if the court expenses would exceed the amount of collected receivable, if the bank has, with the diligence of conscious custodian, unsuccessfully taken all actions for the collection of receivables, etc.).”

THE COUNCIL OF THE CENTRAL BANK