

Pursuant to Article 44 paragraph (2) item 3) of the Central Bank of Montenegro Law (OGM 40/10, 06/13, 70/17, 125/23), Article 25 paragraph (2) of the Law on the Development Bank of Montenegro (OGM 99/24), the Council of the Central Bank of Montenegro, at its meeting held on 25 July 2025, passed the following

**DECISION  
ON THE CRITERIA AND THE MANNER OF CLASSIFICATION OF ASSETS AND  
CALCULATION OF PROVISIONS FOR POTENTIAL LOAN LOSSES OF THE  
DEVELOPMENT BANK OF MONTENEGRO**

**I. BASIC PROVISION**

**Subject matter**

**Article 1**

This Decision prescribes the criteria and the manner of classification of assets, as well as the calculation of provisions for potential credit losses of the Development Bank of Montenegro (hereinafter: the Development Bank).

**II. VALUATION OF BALANCE SHEET ITEMS AND OFF-BALANCE SHEET ITEMS**

**Implementation of International Accounting Standards/International Financial Reporting Standards**

**Article 2**

(1) The Development Bank shall value and disclose balance sheet items and off-balance sheet items in accordance with International Accounting Standards, and International Financial Reporting Standards, respectively.

(2) The following balance sheet items and off-balance sheet items are valued in accordance with the provisions of this Decision:

1) financial instruments that are in accordance with International Financial Reporting Standard 9 - Financial Instruments (hereinafter: IFRS 9), allocated to the following portfolios:

- financial assets measured at amortised cost;
- financial assets measured at fair value through other comprehensive result, other than equity instruments;

2) financial instruments which represent:

- lease receivables,
- loan commitments,
- liabilities under financial guarantee contracts; and

3) other exposures covered by IFRS 9, for which credit losses are determined.

## **Methodology**

### **Article 3**

- (1) The Development Bank shall determine a methodology for valuing and impairing financial assets in accordance with the IFRS 9.
- (2) The application of methodology referred to in paragraph (1) of this Article should ensure the following:
  - 1) all analyses, assumptions, estimates and other procedures in the process of estimating the amount of impairment of balance sheet items and probable loss on the basis of off-balance sheet items are explained and documented in detail;
  - 2) the assessment of the amount of impairment of balance sheet items and probable loss on off-balance sheet items is based on accurate and up-to-date information and that it takes into account all significant internal and external factors that may affect the collectability of receivables.
- (3) The Development Bank shall consistently apply the methodology referred to in paragraph (1) of this Article, review it at least once a year and, if necessary, adjust it to the results of the review, and adjust the assumptions on which the methodology is based.

## **Frequency of valuation**

### **Article 4**

- (1) The Development Bank shall assess the quality of assets at least quarterly, determine whether there is an objective evidence of impairment of balance sheet items or probable loss related to off-balance sheet items, and calculate the adequate amount of such impairment, and/or probable loss.
- (2) Objective evidence of impairment of balance sheet items or probable loss related to off-balance sheet items, within the meaning of paragraph (1) of this Article, shall be the information on one or more events that have an adverse effect on the debtor's ability to regularly meet its obligations towards the Development Bank.

## **Treatment of collateral when performing impairment**

### **Article 5**

- (1) When calculating the amount of impairment of balance sheet items and probable loss related to off-balance sheet items, the Development Bank may also take into account cash flows on the basis of collateral referred to in Articles 6, 7, 8, and 32 paragraph (2) of this Decision.
- (2) When estimating future cash flows based on the realisation of collateral referred to in Article 6 of this Decision, the Development Bank shall determine the appropriate impairment factors of market value of certain types of collateral, expressed as a

percentage, as well as adequate internally estimated deadlines for realisation of those types of collateral.

(3) The determination of impairment factors and deadlines referred to in paragraph (2) of this Article should be based on the practice and experience of the Development Bank in the realisation of collateral, conditions in the economic and legal environment in which the Development Bank operates and appropriate collateral characteristics.

(4) In determining the amount of the impairment factor and the length of deadlines referred to in paragraph (2) of this Article, the Development Bank shall take into account that different types of collateral reflect different levels of risk of realisation.

(5) The impairment factors and deadlines for realisation referred to in paragraph (2) of this Article may not be less than the minimum benchmarks given in Annex 1 which is attached to this Decision and makes an integral part thereof.

(6) The Development Bank shall, at least once a year, review the validity of assumptions about the initially determined term of realisation of collateral and correct them if necessary.

(7) The Development Bank may reduce the period of realisation of collateral on a quarterly basis in accordance with the passage of time, if:

- 1) it has undertaken actions for the realisation of collateral and if it estimates that the realisation of the collection of receivables is taking place in accordance with the previously estimated deadline; and
- 2) it can prove and adequately document the certainty of cash flows and if the final deadline for the realisation of collateral and the total amount of cash inflows that the Development Bank will realise on that basis can be reliably determined.

(8) The methodology referred to in Article 3 of this Decision shall also determine the manner of valuation of the collateral for which the Development Bank estimates the cash flows, as well as the expected deadline for the realisation of that collateral.

## **Treatment of collateral in the form of immovable property**

### **Article 6**

(1) The Development Bank may consider collateral in the form of immovable property when valuing assets, if it has documentation from which it can be concluded that the immovable property represents an efficient and adequate secondary source of collection of receivables.

(2) Collateral in the form of immovable property shall be considered an efficient and adequate secondary source of collection of receivables, within the meaning of paragraph (1) of this Article, if the Development Bank has evidence that there is a market that allows fast and efficient realisation of collateral at an adequate price.

(3) When assessing cash flows, and after determining the net present value of receivables for which impairment is determined in accordance with the provisions of this Decision, the Development Bank shall take into account the part of collateral value in the form of immovable property remaining after deducting all receivables secured by that immovable property, and that is registered in the immovable property cadastre as mortgages of a higher priority ranking, in relation to the claims of the Development Bank.

(4) The value of collateral in the form of immovable property shall be the assessment of the market value of the immovable property made by an independent appraiser in accordance with a regulation governing the assessment of the value of property.

(5) For collateral in the form of immovable property, the Development Bank shall have:

- 1) documentation on the registration of a mortgage or fiduciary transfer of ownership rights over a certain immovable property;
- 2) an updated excerpt from the cadastre of immovable property, with a registered mortgage or fiduciary transfer of property rights;
- 3) an insurance policy of a certain immovable property that is assigned in favour of the Development Bank (except when the immovable property is land on which there is no facility built that would serve as collateral); and
- 4) documentation on the valuation by an independent appraiser or the purchase contract for that immovable property, whichever is applicable.

(6) The Development Bank shall monitor the value of collateral in the form of immovable property that serves as collateral for the duration of the contractual relationship, as follows:

- 1) commercial property, at least once a year;
- 2) residential property, at least once in three years;
- 3) in deadlines shorter than the deadlines from items 1) and 2) of this paragraph, if market conditions are subject to significant changes.

(7) The Development Bank may use statistical methods to monitor the value of collateral in the form of immovable property and to determine the need for revaluation.

(8) If the Development Bank, based on monitoring the value of collateral in the form of immovable property using statistical methods, determines that there could be a significant decrease in the value of collateral compared to general market prices, it shall provide a revaluation of the collateral value by an independent appraiser.

(9) Notwithstanding paragraph (6) of this Article, for exposures exceeding 5% of the Development Bank's own funds or exceeding EUR 1,000,000 (whichever is lower), secured by immovable property as collateral, the Development Bank shall provide an appraisal of the value of the immovable property by an independent appraiser, at least every three years.

## Treatment of collateral in the form of movable property

### Article 7

(1) The Development Bank may use movable assets as collateral to calculate the amount of impairment of balance sheet items and probable loss related to off-balance sheet items, if:

- 1) there is a liquid market that enables fast and efficient realisation of collateral at an adequate price;
- 2) market prices are available for the corresponding movable property;
- 3) the operational conditions for the sale of that property are met;
- 4) the pledge agreement enables collection from collateral within a reasonable period of time determined in accordance with the internal act of the Development Bank;
- 5) there is a right of priority of the Development Bank in the order of collection in relation to other creditors;
- 6) the value of collateral is adjusted to market prices at least once a year, and more often if necessary;
- 7) the agreement on approved on-balance sheet or off-balance sheet exposure contains a description of collateral;
- 8) the Development Bank has determined eligible types of collateral in the form of movable property and defined in its internal acts the procedures for determining eligible collateral, including the acceptable ratio between the value of receivables and collateral;
- 9) the Development Bank has established in its policies the rules of exposure towards the debtor, the requirements regarding the timely realisation of collateral and regarding the adequacy of the price or market value of collateral;
- 10) the initial assessment of the value of movable property and all subsequent assessments of the value of movable property as a whole take into account the impairment of its value and the need for re-assessment;
- 11) the pledge is registered in accordance with the law governing the pledge as a security instrument; and
- 12) movable property is secured by an insurance policy pledged in favour of the Development Bank.

(2) The Development Bank shall ensure that movable property with the value exceeding EUR 500,000 at the moment when negotiating collateral is assessed by an independent appraiser at least every three years, in accordance with the regulation referred to in Article 6 paragraph (4) of this Decision.

(3) Notwithstanding paragraph (2) of this Article, the Development Bank may, for other collateral in the form of movable property, use the purchase value of that property minus the depreciation, the value of movable property from the insurance policy, or the market value that is readily available, transparent, and determined in accordance with the standards of the profession.

## Other types of collateral

### Article 8

(1) The Development Bank may, in addition to the collateral referred to in Articles 6 and 7 of this Decision, use the following types of collateral:

- 1) security instruments referred to in Article 32 paragraph (2) of this Decision;
- 2) debt securities of institutions that do not have a credit assessment by external credit risk assessment institutions (hereinafter: ECAI), if all conditions from Article 34 paragraph (3) of the Decision on Capital Adequacy of the Development Bank (hereinafter: Decision on Capital Adequacy of the Development Bank);
- 3) credit insurance policies against non-payment risk and life insurance policies with redemption value;
- 4) other instruments whose quality on the basis of appropriate evidence can be equated with the quality of security instruments from items 1), 2) or 3) of this paragraph.
- 5) guarantee and other sureties;
- 6) credit default swaps.

(2) When estimating future cash flows based on collection from debt securities, the Development Bank shall apply appropriate haircuts with respect to the market price taking into account the volume and frequency of trading in those debt securities, collection experience, as well as economic conditions, and regulations applicable in the country where the issuer has a head office, where the haircut may not be less than 10% for debt securities referred to in paragraph (1) item 2) of this Article, or less than 20% for instruments referred to in paragraph (1) item 4) of this Article.

### Assessment of impairment of balance sheet items on an individual basis

### Article 9

(1) The Development Bank shall perform individual assessment of impairment of balance sheet items and probable loss related to off-balance sheet items in respect of individually significant receivables.

(2) An individually significant receivable, within the meaning of paragraph (1) of this Article, shall be the total gross exposure of the Development Bank to one person or a group of connected persons exceeding EUR 300,000.

(3) Notwithstanding paragraph (2) of this Article, the Development Bank may, in its internal act, determine a lower amount of total exposure to a single person or a group of connected persons as a threshold beyond which the exposure shall be considered an individually significant receivable.

(4) The individual assessment of impairment of balance sheet items shall include determining the existence of objective evidence of impairment, estimating the present

value of future cash flows, and calculating the amount of that impairment, for each individually significant receivable included in the assessment.

(5) It shall be considered that there is an objective evidence of impairment of balance sheet items on an individual basis, if:

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

### **Determining impairment amount for balance sheet items**

#### **Article 10**

(1) The amount of impairment of balance sheet item shall be determined as the difference between the carrying amount of the receivable and the present value of expected future cash flows from that receivable.

(2) Notwithstanding paragraph (1) of this Article, if the deadline for a specific receivable in which future cash flows are expected is shorter than one year, the Development Bank need not calculate the present value of expected future cash flows, but may determine the amount of impairment of that balance sheet item as a difference between the carrying amount of the receivable and the expected future cash flows on such receivable.

### **Assessment of the probable loss related to off-balance sheet items**

#### **Article 11**

(1) The assessment of the probable loss related to off-balance sheet items on an individual basis includes assessment of future cash outflows that can be recovered for each off-balance sheet liability and a calculation of the amount of probable loss for each individual off-balance sheet item included in this assessment.

(2) Future non-recoverable cash outflows shall be the nominal amount of expected cash outflow related to off-balance sheet obligations less the amount reasonably estimated to be recovered by the counterparty or to be compensated by the realisation of collateral.

### **Amount of probable loss related to off-balance sheet items**

#### **Article 12**

(1) 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.

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

### **Collective assessment of receivables**

#### **Article 13**

(1) The Development Bank shall perform collective assessment of balance sheet items for impairment and/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.

(2) The Development Bank shall perform collective assessment for the following receivables:

- 1) those where individual assessment showed no objective evidence of impairment, or probable loss or if no amount of impairment of balance sheet assets or probable loss related to off-balance sheet items has been determined at individual level;
- 2) those that do not represent individually significant receivables referred to Article 9 paragraph (2) of this Decision.

(3) The Development Bank may perform individual 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.

(4) When performing collective assessment, the Development 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 14**

(1) The Development Bank shall debit the amount of impairment loss calculated for balance sheet assets as expense and credit it to the allowances for the impairment.

(2) The Development 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.

### III. CLASSIFICATION OF BALANCE SHEET ITEMS AND OFF-BALANCE SHEET ASSETS

#### Classification items

##### Article 15

(1) The Development Bank shall classify, at least once a month, balance sheet items and off-balance sheet items exposing the Development Bank to credit risk and calculate loan loss provisions.

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

- 1) loans and receivables from credit institutions (including funds placed with credit institutions, interests and fees);
- 2) loans and receivables from clients (including interests and fees, receivables based on factoring);
- 3) financial assets carried at fair value through profit or loss;
- 4) securities measured at amortised cost and securities at fair value through other comprehensive income;
- 5) guarantees issued;
- 6) credit obligations given (approved, unused loans);
- 7) bill of exchange security and bill of exchange acceptances;
- 8) other sureties;
- 9) uncovered letters of credit;
- 10) other items that expose the Development Bank to credit risk.

(3) Balance sheet items and off-balance sheet items which do not expose the Development Bank to 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) holdings in the capital of other legal persons;
- 5) financial assets included in trading book, for which the Development Bank calculates capital requirement for market risks in accordance with the Decision on Capital Adequacy of the Development Bank;
- 6) guarantees obtained;
- 7) credit obligations obtained;
- 8) written-off loans and receivables;
- 9) collateral obtained;
- 10) revocable off-balance sheet liabilities.
- 11) other risk-free items.

(4) The Development Bank shall determine if all balance sheet 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 16**

During the contractual relationship, the Development Bank shall assess the quality of credit exposure and classify those exposures into corresponding risk groups based on the following criteria:

- 1) debtor's creditworthiness;
- 2) debtor's regularity in meeting its obligations towards the Development Bank and other creditors; and
- 3) other relevant factors for classification.

### **Debtor's creditworthiness**

#### **Article 17**

(1) The assessment of debtor's creditworthiness shall be based on the assessment of the capacity and readiness of the debtor to completely and timely meet their obligations to the Development Bank from primary sources of debt repayment.

(2) The primary sources of debt repayment mean, in particular, cash from debtor's operating and other activities.

(3) When assessing debtor's creditworthiness, the Development Bank shall analyse:

- 1) assessment of the adequacy of the level of recorded cash flows with respect to its liabilities over the previous period;
- 2) assessment of future cash flows;
- 3) assessment of indebtedness of the debtor that is a natural person, or business indicators based on the indicators of profitability, liquidity, indebtedness, i.e. capitalisation, if the debtor is a legal person;
- 4) assessment of the quality of the investment plan and programme for the implementation of which the Development Bank provides financial support, in the case of investment or project financing;
- 5) exposure to foreign exchange and interest rate risk based on receivables with a currency clause, receivables in foreign currency and receivables contracted with a variable interest rate, including off-balance sheet liabilities with a currency clause and off-balance sheet liabilities in foreign currency.

(4) When assessing indebtedness of the debtor that is a natural person referred to in paragraph (3) item 3) of this Article, the Development Bank should consider at least the following indicators:

- 1) LTI (loan-to-income), represents a ratio of the loan granted to total annual income of the debtor that is a natural person, given as percentage.
- 2) DTI (debt-to-income), represents a ratio of the total debt arising from loans to total annual income of the debtor that is a natural person, given as percentage.
- 3) LSTI (loan-service-to-income), represents a ratio of annual loan repayment cost to total annual income of the debtor that is a natural person, given as percentage.
- 4) DSTI (debt-service-to-income), represents a ratio of annual repayment cost of total debt arising from loans to total annual income of the debtor that is a natural person, and
- 5) LTV (loan-to-value), represents a ratio of a granted loan to estimated value of collateral.

(5) The total annual income of the debtor that is a natural person referred to in paragraph (4) of this Article shall include gross wages and salaries, compensations and other income of the debtor that is a natural person that can be proven, less taxes and other obligations arising from that income.

(6) The annual loan repayment cost and the annual repayment cost of total debt arising from loans referred to in referred to in paragraph (4) items 3) and 4) of this Article shall be the total amount paid by the debtor that is a natural person, expressed annually.

(7) The Development Bank shall, on the basis of the indicators referred to in paragraph (4) of this Article used for credit risk management, determine the acceptable level of indebtedness when granting loans to natural persons.

(8) The Development Bank shall analyse credit risk for exposures referred to in paragraph (3) item 5) of this Article from the aspect of possible change in the financial position of the debtor, which could occur due to changes in the euro exchange rate against other currencies and changes in interest rates, that is from the aspect of debtor's ability to meet its contractually agreed credit obligations towards the Development Bank in potentially changed circumstances.

### **Delay in repayment**

#### **Article 18**

The delay in repayment shall be calculated for matured receivables whose amount exceeds EUR 50 – for natural persons, and EUR 200 – for other debtors.

### **Assessment of other relevant factors**

#### **Article 19**

- (1) Other relevant factors for classification of 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 origination with the Development Bank's policies and procedures.

(2) When classifying balance sheet items, the Development Bank shall take into account the relations within the group of connected persons and identify in its internal acts situations in which loans of other entities from the same group should be classified in the same category due to the classification of loans of one debtor from the group of connected persons into the category of non-performing loans.

### **Classification groups**

#### **Article 20**

The Development Bank, shall, depending on probability of incurring losses, classify balance sheet items into one of the following classification categories:

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

### **Classification category "A"**

#### **Article 21**

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

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

- 1) loan granted to central governments, central banks, development banks and international organisations which receive a 0% risk weight pursuant to the Decision on Capital Adequacy of the Development Bank;
- 2) loan which has the following characteristics:
  - the loan is granted in accordance with the Development Bank's internal acts;
  - 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 group "B"**

### **Article 22**

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

(2) 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 not complete;
- 2) the loan has not been granted in accordance with the internal acts of the Development 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.

(3) A loan that is over 30 days past due may not be classified into higher classification category 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 or sub-category other than sub-category "B2".

## **Classification category "C"**

### **Article 23**

(1) 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.

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

- 1) primary sources of repayment are insufficient to repay debt and the Development 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) the Development Bank does not possess required and updated financial information to determine financial ability of customer to repay the debt;
- 6) loan is over 90 days past due.

(3) A loan that is over 90 days past due may not be classified in higher classification category 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 or sub-category other than sub-category "C2".

### **Classification category "D"**

#### **Article 24**

(1) 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 realisation of collateral.

(2) A loan classified into classification category "D" shall have some of the following characteristics:

- 1) a legal person, which is loan beneficiary is illiquid with insufficient amount of capital, highly leveraged, non-profitable, has serious difficulties or shows permanent non-competitiveness without any perspective for further development, and the like;
- 2) bankruptcy proceedings have been initiated against the debtor;
- 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 Development Bank initiated foreclosure of additional instruments of security, and the like);
- 4) loan is over 270 days past due.

(3) A loan that is over 270 days past due may not be classified in higher classification category or subcategory other than sub-category of category "D".

### **Classification category "E"**

#### **Article 25**

(1) A loan shall be classified into classification category E – "loss" if it is fully uncollectible or if it will be collected in an insignificant amount.

(2) 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.

### **Classification of small loans**

#### **Article 26**

(1) The Development Bank may classify loan that does not belong to a category of individually significant receivable referred to in Article 9 paragraph (2) of this Decision into appropriate classification category based on the information on debtor's regularity in meeting its obligations to the Development Bank.

(2) When there is default, loan under paragraph (1) of this Article shall not be classified into higher into classification category 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.

### **Assessment of creditworthiness of loan beneficiary for investment projects**

#### **Article 27**

(1) In the process of classifying loan granted for the investment project, the Development Bank may base its assessment of debtor's credit capacity on the analysis of profitability of such investment project.

(2) 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 the 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.

(3) Investment project, within the meaning of paragraph (1) of this Article, means 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.

(4) The classification of loans referred to in paragraph (1) of this Article may be performed only by the Development Bank that has adequate methodology for the assessment of business plans set forth in its internal act.

(5) The Development 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 or subcategory.

### **Multiple loan holder**

#### **Article 28**

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

(2) 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) of this Article, including outstanding interest, has been classified into the classification categories "A" or "B", the Development Bank may keep such loans within the same classification category.

### **Loan restructuring**

#### **Article 29**

(1) The Development Bank is deemed to have restructured a loan to a debtor if, due to deterioration in the debtor's creditworthiness, 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.

(2) 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.

(3) In the procedure of loan restructuring, the Development 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 Development 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, the Development Bank shall ensure the fair value assessment of such assets in accordance with professional standards.

(4) For managing non-performing and forbearance exposures, the Development Bank shall apply guidelines referred to in Annex 2 of this Decision which makes an integral part thereof.

### **Classification of other balance sheet items**

#### **Article 30**

The classification of balance sheet items other than loans shall be performed in line with the applicable criteria referred to in Article 16 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 31**

(1) The classification of off-balance sheet items that expose the Development 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 the Development Bank.

(2) The classification of agreed but undrawn loan shall be made if the Development Bank was irrevocably obliged to meet outstanding liabilities for that loan arrangement.

### **Provisioning**

#### **Article 32**

The Development Bank shall calculate loan loss provisions for balance sheet and off-balance sheet items by applying the following percentages:

- 1) 0.5% for category A – “Pass”;
- 2) 2% for category B – “Special mention” - sub-category B1;

- 3) 7% for category B – “Special mention” - sub-category B2;
- 4) 20% for category C – “Substandard” - sub-category C1;
- 5) 40% for category C – “Substandard” - sub-category C2;
- 6) 70% for category D – “Doubtful”;
- 7) 100% for category E – “Loss”.

(2) The base for calculating loan loss provisions in line with paragraph (1) of this Article for individual balance sheet item or off-balance sheet item shall be the carrying amount of such an item deducted by the amount secured by:

- 1) cash deposit placed with the Development Bank and/or credit institution, if it has been agreed that it will be used as collateral for certain receivables of the Development Bank, and its maturity is not shorter than the maturity of receivable and it is solely at the disposal of the Development 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% credit risk weight in accordance with the Decision on Capital Adequacy of the Development Bank;
  - multilateral development banks and international organisations that are assigned 0% risk weight in accordance with the Decision on Capital Adequacy of the Development Bank.

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

### **Treatment of provisions and allowances for impairment**

#### **Article 33**

(1) The Development Bank shall determine the difference between the amount of provisions for estimated and potential losses calculated in accordance with Article 32 of this Decision and the sum of the amount of allowances for impairment for balance sheet items, calculated in accordance with Article 10 of this Decision and the amount of probable loss for off-balance sheet items calculated in line with Article 11 of this Decision.

(2) The positive difference between the amount of calculated provisions for estimated and potential losses and the sum of the amount of impairment for balance sheet assets and probable loss for off-balance sheet items shall be the provisions required for estimated and potential losses.

## **IV. CLASSIFICATION OF ASSET ITEMS FOR THE PURPOSE OF ADDITIONAL MONITORING OF ASSET QUALITY**

### **Classification obligations**

#### **Article 34**

The Development Bank shall, for the purpose of additional monitoring and reporting on asset quality, classify asset items into the group of performing or non-performing assets, as well as determine the status of restructured loans in accordance with Articles 35 to 37 of this Decision.

### **Non-performing and performing assets**

#### **Article 35**

- (1) The Development Bank shall classify asset items as non-performing assets, if:
- 1) the debtor is over 90 days past due on that asset item;
  - 2) the Development Bank, based on the assessment of the financial situation, i.e. creditworthiness of the debtor, estimates that the debtor will not be able to settle obligations under that item in full without the realisation of collateral, regardless of whether the debtor settles its obligations on time or not;
  - 3) a receivable under that item is considered impaired in accordance with IFRS 9, and is classified in Stage 3 or represents an asset purchased or originated at impairment.
- (2) An asset item for which some of the conditions from paragraph (1) of this Article are not fulfilled, shall be classified in the category of performing assets.
- (3) An asset item shall be deemed to have ceased to be non-performing if:
- 1) the exposure is not considered impaired in accordance with the IFRS 9;
  - 2) the debtor's position has improved in such a way that the Development Bank can collect the receivable in full in accordance with the originally established or, if applicable, in accordance with the changed conditions; and
  - 3) the debtor has no obligations from the maturity of which more than 90 days have passed.
- (4) The classification of a non-performing asset as a fixed asset held for sale in accordance with IFRS 5 does not terminate its classification as a non-performing exposure.

### **Classification of restructured loans into the category of performing loans**

#### **Article 36**

- (1) A restructured loan that belongs to the category of non-performing assets may be classified by the Development Bank into the category of performing loans following 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.

- (2) A 12-month period referred to in paragraph (1) of this Article 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.

(3) After the expiry of grace period referred to in paragraph (1) of this Article, the restructured loan may be classified into the category of performing loans only where the Development Bank has determined that:

- 1) a restructured loan meets the requirements for its classification into the category of performing loans by applying the criteria referred to in Article 16 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 37 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.

(4) 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.

### **Termination of the status of restructured loans**

#### **Article 37**

(1) The Development 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 category 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; and
- 3) there are no arrears in repayment longer than 30 days under any of the obligations to the Development Bank.

(2) A probation period referred to in paragraph (1) of this Article means a period of two years that begins from the moment when a restructured loan is classified into the category of performing loans.

(3) 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.

(4) 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 category of non-performing loans until the expiry of such a period.

(5) The Development 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.

(6) The Development Bank may continue to classify a receivable that was classified into the category 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 category of non-performing loans.

(7) In addition to the restructured loans classified into the category of non-performing loans in the moment of restructuring, The Development Bank shall classify the following into the same category:

- 1) loans that met the requirements to be classified into the category of non-performing loans before the restructuring;
- 2) restructured loans from the category of non-performing loans that were classified into the category of performing loans in accordance with Article 36 paragraph (1) of this Decision and for which the Development Bank made additional concessions for the debtor during the probation period referred to in paragraph (2) of this Article, 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 Development Bank made additional concessions for the debtor after the second restructuring.

## **V. REPORTING TO THE CENTRAL BANK OF MONTENEGRO**

### **Article 38**

(1) The Development Bank shall submit to the Central Bank of Montenegro reports on the classification of balance sheet items and off-balance sheet items, information on the amount of calculated loan loss provisions and information on non-performing assets and restructured loans in accordance with the decision governing the reporting to the Central Bank.

(2) If the Central Bank of Montenegro, as part of the supervision procedure, has ordered the Development Bank a stricter classification of balance sheet items or off-balance sheet items, it may require the Development Bank to state the new classification also in the reports from the previous reporting period, as at examination and post examination date.

## **VI. TRANSITIONAL AND FINAL PROVISIONS**

### **Commencement of application of the provisions on the treatment of collateral in the valuation of exposures**

#### **Article 39**

The provisions of Articles 5–9 of this Decision shall apply as of 1 January 2027.

### **Transitional provision for the classification of performing assets**

#### **Article 40**

Notwithstanding Article 32 paragraph (1) item 1) of this Decision, the Development Bank may, until 31 December 2025, apply a 0% rate when calculating provisions for estimated and potential losses on balance sheet and off-balance sheet items classified in category A “Pass”.

### **Entry into force**

#### **Article 41**

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**

**CHAIRPERSON  
GOVERNOR**

**Irena Radović, m.p.**

Decision number: 0101-5891-5/2025

Podgorica, 25 July 2025

## ANNEX 1

**OVERVIEW**  
**of collateral with impairment factors**  
**and expected realisation period**

No.	Collateral	Impairment factor	Realisation period (years)
<b>IMMOVABLE PROPERTY</b>			
1	Residential buildings *	10	2
2	Residential buildings for sale and/or rent **	20	3
3	Commercial facilities (shopping malls, warehouses, shops, car dealers...)	20	3
4	Business premises (offices)	40	4
5	Industrial facilities (factories, industrial plants, buildings, farms ...)	50	4.5
6	Agricultural real estate (mills, silos...)	40	3
7	Construction land	45	3
8	Agricultural land	50	4
9	Built tourist facilities in operation	30	2
10	Construction right	50	3
11	Unfinished commercial premises – commercial	60	5
12	Unfinished commercial premises – residential/mixed	60	5
13	Unfinished tourist premises	60	4
<b>MOVABLE PROPERTY</b>			
14	General purpose equipment and devices	60	3
15	Special purpose equipment and devices	60	3
16	Personal vehicles	40	1.5
17	Vehicles (commercial)	40	1.5
18	Ships and other vessels	60	5
19	Airplanes and helicopters	60	5
20	Inventories not under the control of the Development Bank	70	3

21	Inventories under the control of the Development Bank	65	3
22	Precious metals, works of art - not deposited with the Development Bank	60	3
23	Precious metals, works of art - deposited with the Development Bank	40	3
24	Construction machinery	60	3
25	Production machinery	60	3
26	Agricultural machinery	60	3

Notes:

\* individual apartments

\*\* provided that the building is completed and has a use permit  
Encumbrances are deducted after determining the fair value

## ANNEX 2

**GUIDELINES ON MANAGEMENT OF NON-PERFORMING AND FORBORNE EXPOSURES****I. SUBJECT MATTER, SCOPE AND DEFINITIONS**

1. These guidelines specify sound practices applied by the Development Bank with respect to managing non-performing loans (NPLs)<sup>1</sup>, forborne exposures (FBEs) and foreclosed assets.
2. Where the gross NPLs to total gross loans ratio is equal to or greater than 8% (on a consolidated, sub-consolidated, or solo level), the Development Bank shall apply Chapters II and III of these guidelines to exposures to entities that have NPL ratios exceeding the set threshold.
3. Where the gross NPLs to total loans ratio is below the 8% level but has a high share or material amount of NPLs in an individual portfolio or individual portfolios with a specific concentration of NPLs in a geographical region, an economic sector or a group of connected clients, the Development Bank shall apply chapters II and III at the level of these portfolios.
4. Where the gross NPLs to total loans ratio of the Development Bank is below the threshold specified in item 2) of these Guidelines, the Development Bank shall apply the provisions of chapters II and III of these Guidelines if signs of deteriorating assets quality have been determined. For the purposes of identifying whether the deterioration of asset quality has been occurred, the Development Bank shall consider the following elements and their interaction:
  - a) increased inflows of NPLs;
  - b) a high or increased level of FBEs;
  - c) a high or increased level of foreclosed assets;
  - d) low coverage ratios;
  - e) breached early warning indicators;
  - f) an elevated Texas ratio;
  - g) the quality and appropriateness of workout activity.
5. Terms and definitions applied in this guidelines shall have the following meaning:
  - a) **Cure period** – a 12-month period since the date defined in Article 36 paragraph (2) of the Decision on the criteria and the manner of classification of assets and calculation of provisions for potential loan losses of the Development Bank;
  - b) **Forbearance measures** - concessions by the Development Bank towards an obligor that is experiencing or is likely to experience difficulties in meeting its

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<sup>1</sup> For the purposes of these guidelines, the term “non-performing loans” refers to all non-performing exposures.

financial commitments. A concession may entail a loss for the Development Bank and shall refer to either of the following actions:

- a modification of the terms and conditions of a debt obligation, where such modification would not have been granted had the obligor not experienced difficulties in meeting its financial commitments;
  - a total or partial refinancing of a debt obligation, where such refinancing would not have been granted had the obligor not experienced difficulties in meeting its financial commitments;
- c) **Forborne exposures** - exposures in respect to which forbearance measures have been applied;
- d) **Foreclosed assets** - assets obtained by taking possession of collateral and which remain recognised on the balance sheet. Foreclosed assets can be obtained through judicial procedures, through bilateral agreement with the borrower or through other types of collateral transfer from the borrower to the Development Bank. Foreclosed assets may include financial and non-financial assets and should include all collateral obtained irrespective of accounting classification;
- e) **NPL ratio (NPL %)** - the gross NPLs and advances divided by the gross total loans and advances;
- f) **NPL framework** - policies, processes, controls and systems for risk management of NPLs;
- g) **Portfolio** - a group of exposures with similar credit risk characteristics;
- h) **Probation period** - period determined in Article 37 paragraph (2) of the Decision on the criteria and the manner of classification of assets and calculation of provisions for potential loan losses of the Development Bank;
- i) **Risk appetite framework** - the overall approach, including policies, processes, controls and systems, through which risk appetite is established, communicated and monitored. It includes a risk appetite statement, risk limits and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the risk appetite framework. Risk appetite framework aligns with the Development Bank's general strategy;

## II. NPL STRATEGY

### 2.1. Developing and implementing NPL strategy

6. The Development Bank shall have in place an adequate framework to identify, measure, manage, monitor and mitigate NPLs, including through workout activities.
7. The NPL strategy should target a time-bound reduction of NPLs over a realistic but sufficiently ambitious time horizon (NPL reduction targets). The NPL strategy should lay out the approach and objectives regarding effective management to maximise recoveries and ultimately a reduction in NPL stocks in a clear, credible and feasible manner for each relevant portfolio.

8. The implementation of NPL strategy entails:
  - a) assessing the operating environment and external conditions in the context of their impact on the level of NPLs and the ability to achieve objectives in this segment;
  - b) developing the NPL strategy over short-, medium- and long-term time horizons;
  - c) implementing the operational plan;
  - d) fully embedding the NPL strategy into the management processes of the Development Bank, including regular review.
9. The Development Bank should be able to calculate a detailed assessment of the impact of the planned NPL strategy from capital, risk exposure amount, profit or loss, and impairment perspectives for each of the reduction drivers.
10. In order to successfully operationalise the NPL strategy, the Development Bank should consider at least the following non-mutually exclusive implementation options for different portfolios and under different conditions:
  - a) hold/forbearance strategy: this option is linked to the assessment of debtor's creditworthiness, Development Bank's operational capacity to manage non-performing loans, forbearance and write-off policies, etc.;
  - b) active portfolio reductions: sales, or in the case of NPLs that are deemed unrecoverable, write-offs. This option is strongly linked to adequacy of impairments, collateral valuations, quality of exposure data and investors' demand for NPLs;
  - c) change of type of exposure or collateral, including foreclosure, debt to equity swapping, debt to asset swapping or collateral substitution;
  - d) legal options: including insolvency proceedings or out-of-court solutions.

## **2.2. Targets**

11. Before commencing the short- to medium-term target-setting process, the Development Bank should establish a view of reasonable long-term NPL levels, both at portfolio level and at aggregate level.
12. The Development Bank should clearly define realistic yet ambitious quantitative targets in its NPL strategy regarding non-performing loans and foreclosed assets, supported by an appropriate and comprehensive operational plan. These targets should lead to a concrete reduction in NPLs, at least in the medium term.
13. The Development Bank should establish NPL targets as followings:
  - a) by time horizons (short-term (indicative one year), medium-term (indicative three years) and possibly long-term);

- b) by main portfolios;
- c) by implementation options.

### **2.3. Operational plan**

14. The NPL strategy of the Development Bank should be supported by an operational plan. The NPL strategy and operational plan should be defined, approved and reviewed by the competent management body and reviewed at least annually.
15. The operational plan should clearly define how the Development Bank will operationally implement its NPL strategy over a time horizon of at least one to three years (depending on the type of operational measures required).
16. The NPL operational plan should contain at least:
  - a) clear time-bound objectives and goals;
  - b) activities to be carried out on a portfolio basis;
  - c) responsibilities and accountabilities for the implementation of the operational plan, as well as reporting mechanisms for activities and outcomes;
  - d) method of monitoring the implementation of the operational plan;
  - e) employee and resource requirements;
  - f) required technical infrastructure and an enhancement plan;

### **2.4. Implementing NPL strategy**

17. The implementation of the NPL strategy operational plan should rely on suitable policies and procedures, clear lines of responsibility for their application, including escalation procedures, and deviation from the plan should be highlighted and promptly reported to the competent management body, to allow timely corrective actions to be taken.
18. All relevant components of the NPL strategy should be fully aligned with and integrated into the business plan and budget of the Development Bank, including all the relevant costs associated with the implementation of the operational plan, and also potential losses stemming from NPL workout activities.
19. The NPL strategy should be fully embedded in the risk management framework. In that context, special attention should be given to ensuring that the risk appetite and the NPL strategy are closely interlinked. In this regard, there should be clearly defined risk appetite indicators metrics and limits, approved by the competent management body, that are in alignment with the NPL strategy.

### III. NPL GOVERNANCE AND OPERATIONS

#### 3.1 Steering and decision-making

20. In order for Development Bank to be able to address its NPL issues in an efficient and sustainable manner, an appropriate governance structure and operational set-up should be in place.
21. In particular, the competent management body of the Development Bank should:
  - a) approve annually and regularly review the NPL strategy and operational plan in line with the overall risk strategy;
  - b) oversee the implementation of the NPL strategy;
  - c) monitor on a quarterly basis progress made in comparison with the targets defined in the NPL strategy and operational plan;
  - d) define adequate approval processes for NPL workout decisions
  - e) approve NPL-related policies and processes, review them at least annually and proceed with any necessary amendments,
  - f) ensure sufficient internal controls on NPL management processes, with a special focus on activities linked to NPL classifications, impairments, write-offs, collateral valuations and the sustainability of forbearance solutions;
  - g) have sufficient knowledge, experience and expertise with regard to the management of NPLs.
22. The Development Bank should develop, regularly review and monitor operations in accordance with its policies related to the NPL management framework. For the purpose of implementing the strategy (including the NPL strategy and the operational plan), the Development Bank shall define the following processes in its internal acts:
  - a) Arrears management;
  - b) Forbearance activities and procedures;
  - c) Debt recovery/enforcement activities and procedures;
  - d) Write-off rules and procedures;
  - e) Collateral rules and procedures;
  - f) NPL monitoring rules and procedures.
23. The Development Bank should have a policy in place that describes the recovery process for foreclosed assets, covering in particular the procedures of repossession, valuation of the collateral and realisation of various types of collateral through appropriate means.

### 3.2 NPL workout units

24. The Development Bank should establish dedicated NPL workout units (NPL WUs) that are independent from loan origination activities. This separation of duties approach should encompass not only client relationship activities (e.g. negotiation of forbearance solutions with clients) but also the decision-making process.
25. The Development Bank should have arrangements in place to ensure that regular feedback between loan origination units and NPL WUs is established.
26. The Development Bank should establish an adequate technical infrastructure that will enable the NPL WUs to:
  - a) Access all relevant data and documentation,
  - b) Efficiently process and monitor NPL workout activities
  - c) Define, analyse and measure NPLs and related borrowers:

### 3.3 Internal control framework

27. The competent management body of the Development Bank should be responsible for establishing effective and efficient internal controls over the processes related to the management of non-performing exposures, in order to ensure full alignment between the NPL strategy and the operational plan on the one hand, and the overall strategy of the Development Bank and its risk appetite on the other.
28. The competent management body should regularly review reports on NPL management submitted by the heads of control functions, which identify deficiencies as well as related relevant risks, assess their impact, and include recommendations and corrective measures to be undertaken.
29. The competent management body should follow up on the findings of the internal control functions in a timely and effective manner and require adequate remedial actions, whereat a formal follow-up procedure on findings and corrective measures taken should be put in place.
30. The control function should involve all three lines of defence. The roles of the different functions involved should be assigned and documented clearly to avoid gaps or overlaps. Key outcomes of second- and third-line of defence activities as well as defined mitigating actions and progress on those needs should be reported to the competent management body regularly.
31. The Development Bank should establish processes and procedures for NPL WUs (first line of defence)

32. The Development Bank should ensure continuous monitoring of the application of procedures for NPL management (second line of defense), in particular through:
- a) monitoring and measuring of NPL-related risks on a granular and aggregate basis,
  - b) reviewing the performance of the overall NPL operating model, as well as its elements
  - c) assuring quality across NPL loan processing, monitoring/reporting (internal and external), forbearance, impairments, write-offs, collateral valuation and NPL reporting
  - d) reviewing the alignment of NPL-related processes with internal policies and external guidelines, most notably related to NPL classification, provisioning, write-offs, collateral valuations, forbearance and early warning mechanisms.
33. The internal audit function – the third line of defense – should conduct periodic effectiveness and efficiency controls over NPLs, including controls of the first and second lines of defense. Based on the results of its controls, the internal audit function should provide recommendations to the competent management body, highlighting possible improvements.

#### **3.4 Monitoring of NPLs and NPL workout activities**

34. The NPL monitoring systems should be based on the NPL targets approved in the NPL strategy and related operational plan, which are subsequently cascaded down to the operational targets of the NPL WUs. A related framework of NPL-related key performance indicators (KPIs) should be developed to allow the competent management body and other relevant managers to measure progress.
35. The Development Bank should define and monitor NPL-related KPIs. The NPL-related KPIs, should include, but not necessarily be limited to:
- a) NPL metrics - the Development Bank should closely monitor the relative and absolute levels of NPLs and FBEs, as well as foreclosed assets and early arrears less than 90 days. The analysis should include data on the aggregate level as well as the levels for different NPL portfolios as well as data on coverage with adjustments and deviations from the business plan.
  - b) Borrower engagement and cash collection - comparing actual results against the targets set for the NPL WUs;
  - c) Forbearance activities - To resolve or limit the impact of NPLs, the Development Bank should explore the possibilities with regard to granting forbearance measures. The Development Bank should monitor forbearance activities to ensure that the final outcome of the forbearance measures is the return of the borrower to sustainable repayment status, rather than the postponement of the assessment of the exposure as uncollectible or the postponement of the impairment.

- d) Liquidation activities – The Development Bank should monitor various liquidation activities (monitoring sales and sale prices of immovable property, duration of legal proceedings, volume of cases, recovery rates within those cases, etc.);
- e) Other – (for example, monitoring interest income from NPLs, differences between actual and expected interest payments, reporting on early-warning indicators, monitoring foreclosed assets, etc.)

### **3.5 Early warning system**

- 36. In order to monitor and prevent deterioration in loan quality, the Development Bank should implement certain procedures to identify and manage potential NPLs at an early stage.
- 37. The Development Bank should develop an appropriate set of early warning indicators for each portfolio. Key early warning indicators should be calculated at least monthly. The exception is certain specific early warning indicators (e.g. industry/segment/portfolio or borrower level research), which may be less frequently available.
- 38. In order to identify early signals of deterioration in quality clients, the Development Bank should monitor loans at two separate levels: at the portfolio level and at the transaction/borrower level.
- 39. The Development Bank should include early warning indicators at the transaction/borrower level in the loan monitoring process, so that collection actions can be activated immediately. Examples of early warning indicators may include internal ratings (including behavioural ratings), external ratings published by credit rating agencies, specialised sector surveys or macroeconomic indicators for companies operating in specific geographical areas.
- 40. The early warning system should analyse a wide range of inputs and produce clear outputs in the form of triggers for different types of early warning signals and measures.
- 41. In addition to early warning indicators at the borrower level, the Development Bank should also determine early warning indicators at the portfolio level. The first step in this process involves segmenting the credit risk portfolio into different categories, after which for each sub-category, a separate sensitivity analysis based on internal and external information is conducted to identify the parts of the portfolio that could be affected by potential shocks.

## **IV. FORBEARANCE**

### **4.1 Forbearance measures and their viability**

42. Forbearance measures should aim to return the borrower to a sustainable performing repayment status, taking into account the amount due and minimising expected losses.
43. The Development Bank should consider the following factors when assessing the viability of forbearance measures:
  - a) can demonstrate (based on objectively verifiable evidence) that the borrower can afford the forbearance solution, i.e. full repayment is expected;
  - b) the resolution of outstanding arrears is fully or mostly addressed and a significant reduction in the borrower's balance in the medium to long term is expected;
  - c) in cases where previous forbearance measures have been granted, the Development Bank should ensure that additional internal controls are implemented to ensure that this subsequent forbearance treatment meets the viability criteria;
  - d) Forbearance measures with a short-term time horizon are applied temporarily and the Development Bank is able to demonstrate, based on objectively verifiable evidence, that the borrower has the ability to repay the original or modified amount on a full principal and interest basis commencing from the expiry date of the short-term temporary arrangement;
  - e) the measure does not result in multiple consecutive forbearance measures having been granted to the same exposure.

### **4.2 Efficiency and effectiveness of forbearance activities**

44. The Development Bank should monitor the quality of forbearance activities to make sure that they are not used to delay an assessment that the exposure is uncollectable.
45. The Development Bank should measure the efficiency of the process for granting forbearance measures and monitor the duration of the decision-making process and the volumes of forbearance measures at each stage of the granting process.
46. The Development Bank should monitor effectiveness of forbearance measures, i.e. to measure the success of the implemented forbearances, using the following indicators:
  - a) forbearance cure rate and rate of exposure being reclassified as non-performing: the Development Bank should conduct a vintage analysis and

monitor the behaviour of FBEs from the date of modification to determine the cure rate.

- b) cash collection rate collected from FBEs.
- c) Write-off: as part of a forbearance solution, the Development Bank may implement a forbearance that includes a partial or full write-off of non-performing exposures. All NPL write-offs associated with the granting of these types of forbearance should be recorded and monitored against an approved loss budget. In addition, the net present value loss associated with the decision to write off unrecoverable loans should be monitored against the cure rate per loan segment and per restructuring solution offered. This information should be taken into account when designing forbearance strategies and policies.

### **4.3 Forbearance policy**

- 47. The Development Bank should develop a policy on their forbearance activities. The policy should cover at least:
  - a) the process and procedures for granting forbearance measures, including responsibilities and decision-making;
  - b) a description of available forbearance measures;
  - c) information requirements for assessing the viability of forbearance measures;
  - d) documentation of forbearance measures granted;
  - e) the process and metrics for monitoring the efficiency and effectiveness of forbearance measures.
  
- 48. The Development Bank should regularly review their forbearance policies and options based on the collective monitoring of the performance of different forbearance measures.
  
- 49. The Development Bank may implement the following forbearance measures:
  - a) Interest is paid only during a defined short-term period;
  - b) Reduced payments (decrease in the amount of repayment instalments);
  - c) Grace period/payment moratorium;
  - d) Arrears capitalisation/interest capitalisation;
  - e) Interest rate reduction;
  - f) Extension of maturity/term;
  - g) Additional collateral;
  - h) Sale by agreement/assisted sale
  - i) Rescheduled payments;
  - j) Conversion of currency;
  - k) Other alteration of contract conditions/covenants;
  - l) Refinancing / new credit facilities;
  - m) Debt consolidation; and
  - n) Partial or total debt forgiveness.

50. Before granting any forbearance measures, the Development Bank should assess the borrower's repayment capacity. This should include an adequate assessment of the borrower's financial situation, based on sufficient information and taking into account relevant factors such as the debt-servicing capacity and overall indebtedness of the borrower or the property/project.
51. The assessment of repayment capacity should be based on the adequately documented and verified amounts of the debtor's income and expenses. The Development Bank should demonstrate that it has applied a sufficiently conservative approach in relation to the variable elements of current income that have been taken into account.

#### **4.4 Forbearance targets and monitoring**

52. Forbearance contracts and documentation should include a well-defined borrower target schedule, detailing all necessary targets to be achieved by the borrower in order to repay the exposure over the course of the contract term. These milestones/targets should be credible, be appropriately conservative and take account of any potential deterioration in the borrower's financial situation. The performance of the forborne borrower, including the borrower's compliance with all agreed targets, should be closely monitored by the NPL WU responsible for granting the forbearance, at least for the duration of the probation period.

#### **4.5 Forbearance and performing status**

53. For the purpose of implementing forbearance measures, the Development Bank should be able to identify signs of possible future financial difficulties at an early stage. In order to do so, the assessment of the financial situation of the borrower should not be limited to exposures with apparent signs of financial difficulties. An assessment of financial difficulties should also be conducted for exposures with regard to which the borrower does not have apparent financial difficulties but in relation to which market conditions have changed significantly in a way that could impact the borrower's ability to repay.
54. The assessment of any financial difficulties on the part of a borrower should be based on the situation of the borrower only, disregarding collateral or any guarantees provided by third parties.
55. Exposures should not be identified as forborne when concessions are made to borrowers who are not in financial difficulties. The Development Bank should distinguish, based on a detailed financial assessment, between renegotiations or rollovers granted to borrowers not in financial difficulties and forbearance measures.

56. Granting new conditions such as a new interest rate more favourable than the rate borrowers with a similar risk profile could obtain may be considered an indication of such a concession when the Development Bank determines that the reasons for the new rate is the financial difficulties of the borrower. The provision of more favourable new conditions than those practised by the market should not be considered a prerequisite for the identification of concessions and therefore forbearance.
57. Borrowers may request modifications in the contractual conditions of their loans without facing or being about to face difficulties in meeting their financial commitments. The Development Bank should perform an assessment of the borrower's financial situation when such modifications to contractual conditions have an impact on payment performance.

#### **4.6 Classification of FBEs as non-performing**

58. Forbearance measures may be applied to both performing and non-performing exposures. When approving forbearance measures for performing exposures, the Development Bank should assess whether such measures lead to the need to classify the exposure as non-performing. However, approving forbearance measures for non-performing exposures does not remove their non-performing status: the exposures must continue to be classified as non-performing for at least one year from the moment defined in Article 36 paragraph (2) of the Decision on the Criteria and the Manner of Classification of Assets and Calculation of Provisions for Potential Loan Losses of the Development Bank, i.e. during the recovery period.

#### **4.7 Cure/exit from non-performing status**

59. The Development Bank should reclassify NPLs, including FBEs into performing in accordance with Articles 35 to 37 of the Decision on the criteria and the manner of classification of assets and calculation of provisions for potential loan losses of the Development Bank.
60. The Development Bank's policies for the reclassification of non-performing FBEs should specify practices for dispelling concerns regarding the borrower's ability to comply with the post-forbearance conditions. These policies should establish criteria in terms of payments made during the cure period of at least one year and define the borrower's ability to comply with post- forbearance conditions (to the extent that full repayment of the debt is likely) without being reliant on the realisation of collateral at least by demonstrating payments of a not insignificant amount of principal.
61. In addition, where a borrower has other exposures to the Development Bank that are not the subject of a forbearance measure, the Development Bank should

consider the impact and the performance of these exposures in its assessment of the borrower's ability to comply with post-forbearance conditions. The consideration of arrears should not change the level of application of non-performing status. Only exposures to which forbearance measures have been applied should be identified as FBEs.

#### **4.9 Identification of exposures as performing FBEs**

62. Once FBEs are classified as performing, either because they have met the conditions for being reclassified from the non-performing category or because the granting of forbearance measures did not lead to the classification of the exposure as non-performing, they should continue to be identified as forborne until all the conditions for the discontinuation of the classification of exposures as forborne have been met.
63. The Development Bank shall classify performing FBEs that have been reclassified out of the non-performing category to the non-performing category. The same should apply when there is a liability arising from forborne exposure, which is more than 30 days past due.

#### **V. COLLATERAL VALUATION OF IMMOVABLE AND MOVABLE PROPERTY PLEDGED FOR NPLs.**

64. The Development Bank should have in place a written policy and procedures governing the valuation of property collateral. The policy and procedures should be fully aligned with the Development Bank's RAF. The policy and procedures should be approved by the competent management body and should be reviewed at least on an annual basis.
65. The Development Bank should monitor and review the valuations performed by internal or external appraisers, and during internal quality control, the following aspects should be taken into account:
  - a) the quality control process is carried out by a function that is independent from the function conducting the initial valuation, loan processing, loan monitoring and the underwriting process;
  - b) the independence of the external appraiser selection process should be tested on a regular basis as part of the quality control process;
  - c) a similar sample of internal and external valuations should be compared with market observations on a regular basis;
  - d) back-testing of both internal and external valuations should be carried out on a regular basis;

66. The internal audit function should regularly review the consistency and quality of the immovable property valuation policy and procedures, the independence of the appraiser selection process and the appropriateness of the valuations carried out by both external and internal appraisers.
67. The Development Bank should monitor the value of immovable property collateral on a frequent basis and at a minimum as specified in Article 30 of the Decision on Capital Adequacy of the Development Bank.
68. Valuations and revaluations of immovable property collateral should be performed on an individual and a property-specific basis. Valuations and revaluations of immovable property collateral should not be carried out using a statistical model as the sole means of undertaking the review of the property valuation.
69. All valuations of immovable property, including updated valuations, should be performed by an independent and qualified appraiser, who possesses the necessary qualifications, ability and experience to execute a valuation.
70. The Development Bank should update valuations of all secured exposures in accordance with the requirements of Article 30 of the Decision on Capital Adequacy of the Development Bank.
71. The Development Bank should define criteria in their collateral valuation policy and procedures for determining if a significant decline in collateral value has taken place. Where possible, these will include quantitative thresholds for each type of collateral, based on the observed empirical data and any relevant qualitative experience of the Development Bank, bearing in mind relevant factors such as market price trends or the opinion of independent appraisers.
72. The Development Bank should have appropriate processes and systems in place to flag outdated valuations and to trigger revaluation reports.
73. The Development Bank should have defined collateral valuation approaches for each collateral product type; these should be adequate and appropriate for the type of collateral in question.
74. All immovable property collateral should be valued on the basis of market value or mortgage lending value, as specified under Article 30 of the Decision on Capital Adequacy of the Development Bank.
75. Movable property should be valued at its market value.

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76. The Development Bank should have databases of collateral to enable the proper assessment, monitoring and control of credit risk, and to respond to requests from competent management authority and the Central Bank, and to provide information in periodic reports and other timely and comprehensive documentation.
  77. Databases should comply with the following requirements:
    - a) sufficient depth and breadth, in that they cover all the significant risk factors;
    - b) accuracy, integrity, reliability and timeliness of data;
    - c) consistency – they should be based on common sources of information and uniform definitions of the concepts used for credit risk control;
    - d) traceability, such that the source of information can be identified.
  78. These databases should include all the relevant information on properties and other collateral for the Development Bank's transactions and on the links between collateral and specific transactions.
  79. Foreclosed assets received should be valued at the lower of:
    - a) the amount of the financial assets applied, treating the asset foreclosed or received in payment of debt as collateral;
    - b) the fair value of the repossessed asset, less selling costs.