

Based on Article 15, paragraph 1 of the Law on the National Bank of Serbia (RS Official Gazette, Nos 72/2003, 55/2004, 85/2005 – other law, 44/2010, 76/2012, 106/2012, 14/2015 and 40/2015 – CC decision) and Section 93, paragraphs 5 and 10 of the Decision on Capital Adequacy of Banks (RS Official Gazette, No 103/2016), the Executive Board of the National Bank of Serbia hereby adopts

## **GUIDELINES FOR THE IDENTIFICATION OF DEFAULT**

### **Introductory provisions**

1. These Guidelines set out in detail the manner of calculating a materially significant amount and the cases in which it is considered that the default status has occurred in accordance with Section 93, paragraphs 5 and 10 of the Decision on Capital Adequacy of Banks (hereinafter: Decision).

2. A bank shall apply these Guidelines regardless of whether it calculates risk-weighted exposures using the Standardised Approach in accordance with Chapter IV, Part 1 of the Decision or the IRB Approach in accordance with Chapter IV, Part 2 of the Decision.

A bank may apply the provisions of these Guidelines relating to the Standardised Approach to exposures for which it received consent for sequential introduction of the IRB Approach in accordance with Section 81 of the Decision or consent for permanent partial use of the IRB Approach in accordance with Section 83 of the Decision.

### **Counting of days past due in the identification of default**

3. An obligor shall be deemed past due if any amount of the principal amount, interest or fees with respect to a materially significant obligation was not paid at due date.

For exposures with changed terms of repayment, days past due shall be counted based on the changed repayment schedule.

Where the obligor, acting within the rights granted in the contract, changes the terms of repayment, a bank shall analyse the reasons why the changes were made, and assess whether there are indications that the obligor is unlikely to repay its obligation to the bank, its parent or subsidiaries under Section 93, paragraphs 1 and 3 of the Decision and these Guidelines.

If the settlement of the obligation was suspended due to possibilities or limitations prescribed by a law or another legal document, the days past due shall not be counted during that period, whereby the bank shall analyse the reasons why payment was suspended, and assess whether there are indications that the obligor is unlikely to fully repay its obligation.

If the existence of the obligation or its amount is the subject of a dispute between a bank and an obligor, the bank may stop counting days past due until the dispute is concluded, if the dispute was initiated before a court or another relevant authority whose decisions are legally binding in accordance with applicable law.

In case of a status change of an obligor that is a legal person or another similar transaction, days past due shall be counted from the moment when another person assumes the settlement of the obligation.

4. A bank shall regularly calculate the total amount of an obligor's due outstanding receivables to the bank, its parent or subsidiaries, so as to timely identify the occurrence of default.

If the bank does not count days past due on a daily basis, it shall ensure that the date of occurrence of default is the day when the obligor is past due for more than 90 days.

5. If the obligor is past due for more than 90 days, all exposures to that obligor shall be considered defaulted, except where the conditions to apply Section 93, paragraph 2 of the Decision are met.

### **Technical default**

6. Technical default shall not be considered a criterion for default in accordance with Section 93 of the Decision.

Technical default shall be considered to have occurred in one of the following cases:

1) if a bank has established that default has occurred due to a data or system error of the bank, including manual input errors in standardised processes, excluding errors in the decision-making process regarding loan approval;

2) if a bank has established that default has occurred due to a failure to execute, or an incorrect or untimely execution of a payment transaction based on an obligor's order, or if there is proof that the payment transaction was unsuccessful due to an error in the payment system;

3) if the nature of the transaction causes a desynchronisation between the receipt of a payment order in a bank and the allocation of that payment to the relevant account (lot), and as a consequence the payment order is received before the expiry of the 90-day deadline, but the funds are credited to the recipient's account after that deadline;

4) if the purchased receivable in a factoring arrangement was recorded on a bank's balance sheet and the materiality threshold was breached, but none of the obligor's receivables are past due for more than 30 days.

The bank shall immediately remove the defects in the data or the system, within the meaning of paragraph 2, item 1) hereof, and shall determine the obligor's status in line with these Guidelines.

If the bank applies the IRB Approach, technical default situations shall be removed from the reference data set of defaulted exposures for the purpose of risk parameter estimation.

### **Special provisions applicable to factoring**

7. In the case of factoring arrangements where purchased receivables are not recognised on the balance sheet of the factor-bank, if the factor-bank has assumed the risk of collection of receivables up to a set percentage amount of receivables, days past due shall be counted from the moment when the paid amount of fees for purchased receivables exceeds that amount.

To determine the obligor's obligations that are past due and the subject of cession, a bank shall:

1) determine whether the sum of receivables from the cedent of receivables with respect to the factoring arrangement and other cedent's due obligations in the balance sheet of the factor-bank exceeds the absolute materiality threshold referred to in Section 10 hereof;

2) determine whether the relation between the amount from item 1) of this paragraph and the total amount of fee paid to the cedent with respect to the cession of receivables and all other on-balance sheet exposures of the bank to the cedent of receivables exceeds the relative materiality threshold referred to in Section 10 hereof.

In case of factoring arrangements where the purchased receivables are recognised on the balance sheet of the factor-bank and the factor-bank is exposed to the obligor of the cedent – days past due shall be counted by the cedent from the moment when at least one receivable from the obligor becomes due for payment.

In the case from paragraph 3 hereof, if receivables with respect to the factoring arrangement are treated as purchased receivables and if the requirements under Sections 120 and 123 of the Decision for corporate receivables are met – the bank applying the IRB Approach may, for those receivables, use the definition of default for retail exposures in line with these Guidelines.

8. Events related to dilution risk shall not be considered a precondition for the default of the obligor. If the value of receivables was reduced as a result of events related to dilution risk, such as discounts, deductions or netting on the part of the cedent – days past due shall be counted relative to the reduced value of purchased receivables.

If repayment of obligations is the subject of a dispute between the obligor and the cedent and such event is related to dilution risk, the counting of days past due shall be suspended until the dispute is resolved.

Events related to dilution risk not considered by the bank to be indications of unlikeliness that the obligor will fully repay its obligation shall be included by the bank in the calculation of minimum and internal capital requirements for dilution risk. In case it identifies a considerable number of events related to dilution risk, the bank shall analyse and document the reasons for such events, and take them into account as possible indications of unlikeliness that the obligor will fully repay its obligation within the meaning of Section 93, paragraphs 1 and 3 of the Decision and the provisions of these Guidelines.

9. If the cedent did not adequately inform the obligor about the cession of a receivable, and the factor-bank has evidence that the obligor has settled its obligation to the cedent – the factor-bank shall not consider that receivable due and uncollected.

If the obligor that has been adequately informed about the cession of the receivable has settled its obligation to the cedent, the factor-bank shall continue counting days past due in line with the repayment schedule for that obligation.

In case of a factoring arrangement where the obligor has still not been informed about the cession of the receivable, and the factor-bank has disclosed the receivable in the balance sheet – days past due shall be counted from the moment when it was agreed that the cedent transfers to the factor-bank the payments made by the obligor.

## **The manner of calculating a materially significant amount**

10. A materially significant amount shall be the amount greater than the relative and absolute materiality thresholds.

The relative materiality threshold shall equal 1% of total balance sheet exposures of a bank, its parent or subsidiaries to an obligor, excluding equity exposures.

The absolute materiality threshold shall equal 1,000 dinars for obligors from the class of retail exposures and 10,000 dinars for other obligors.

A bank may define a lower materiality threshold for default than the threshold referred to in paragraphs 1 to 3 of this Section, provided that it can prove that the threshold is relevant for identifying unlikeliness that the obligor will fully repay its obligation to the bank, its parent or subsidiaries, and that its application will not lead to an excessive number of defaulted obligations that will soon after lose that status, or to a reduction of capital requirements.

If the total amount of all past due exposures of a bank, its parent or subsidiaries to the obligor exceeds the absolute and relative materiality thresholds determined in the manner referred to in paragraphs 1 to 3 of this Section for longer than 90 days, the obligor shall be considered defaulted.

To determine the relative materiality threshold referred to in paragraph 2 hereof, the bank that applies the definition of default referred to in Section 93, paragraph 1 of the Decision at the level of an individual exposure shall use the total amount of exposures of the bank, its parent or subsidiaries to the obligor based on a single product, whereby for the purposes of paragraph 5 hereof, absolute and relative materiality thresholds shall be compared to the total amount of all past due exposures of the bank, its parent or subsidiaries to the obligor based on a single product.

## **Indications of unlikeliness to pay**

*The bank puts interest, commission and fees income on non-accrued status*

11. To determine the circumstances referred to in Section 93, paragraph 3, item 1) of the Decision, a bank shall consider whether it is unlikely that the obligor will repay its obligation, if the bank put interest income and commission and fees income owed by the obligor on non-accrued status in the income statement as a result of a significant decline in the credit quality of the receivable.

### *Specific credit risk adjustments*

12. To determine the circumstances referred to in Section 93, paragraph 3, item 2) of the Decision, specific credit risk adjustments relating to the following losses shall be considered a result of a significant decline in credit quality and treated as indications of unlikelihood to pay:

– losses recognised in the bank's income statement for instruments measured at fair value that represent credit risk impairment in accordance with the IFRS/IAS;

– recognised losses resulting from current or past events affecting a significant individual exposure or exposures that are not individually significant and are individually or collectively assessed.

Specific credit risk adjustments including losses for which historical experience and currently available data suggest that the loss has occurred, but the bank is not yet aware which individual exposure has suffered the loss, shall not be considered indications of unlikelihood that the obligor will fully repay its obligation to the bank, its parent or subsidiaries.

If a bank treats an exposure as credit-impaired, it shall be considered that it is unlikely that the obligor will fully repay its obligation to the bank, its parent or subsidiaries, and that an event of default has occurred, regardless of whether there are specific credit risk adjustments with respect to that exposure.

If a bank treats an exposure as credit-impaired under IFRS 9 – Financial Instruments and classifies it as Stage 3 in the manner defined by that standard, it shall treat such an exposure as defaulted, except in the case when the exposure is considered credit-impaired due to a delay in the repayment by the obligor and when one of the following requirements has been met:

1) the materiality threshold from these Guidelines has not been breached;

2) a technical default occurred on the exposure in line with Section 6 of these Guidelines.

### *Cession of receivables*

13. To determine the circumstances referred to in Section 93, paragraph 3, item 3) of the Decision, a bank shall take into account the character and materiality of the losses related to the cession of receivables, in line with these Guidelines. Transactions of traditional securitisation with significant risk

transfer, and any intragroup cession of receivables shall be considered cession of receivables within the meaning of these Guidelines.

A bank shall analyse the reasons for cession of receivables and the reasons for losses on those grounds. Where the reason for the cession of receivables is unrelated to credit risk (e.g. the bank's need for additional liquidity or a change in the bank's strategy) and the bank does not perceive the credit quality of those receivables as declined – the loss incurred by the cession shall not be considered loss within the meaning of Section 93, paragraph 3, item 3) of the Decision, provided that the justification of the treatment of that loss is adequately documented.

If the subject of cession is an instrument measured at fair value traded on an organised market, the bank may consider that loss unrelated to the receivable's credit quality.

If the loss incurred by the cession of receivables is related to the credit quality of those receivables, the bank shall analyse the materiality of those losses and, where the loss is material, this shall be considered an indication of default.

The bank shall set the materiality threshold referred to in paragraph 4 hereof, which may not exceed 5%, and shall be calculated according to the following formula:

$$L = \frac{E - E \cdot P}{E}$$

where:

L = loss related to the cession of receivables (expressed as a percentage);

E = total outstanding amount of the receivable that is ceded, including interest and fee;

P = agreed level of fee for the cession of the receivable.

To assess the materiality referred to in paragraph 4 hereof, the bank shall calculate the loss and compare it to the threshold referred to in paragraph 5 hereof. Where the loss is higher than this threshold, the bank shall consider the obligations defaulted.

If the bank uses the IRB Approach, it shall, regardless of the moment of cession, if the cession was related to a material credit-related loss, appropriately document and store information for the purpose of the estimation of risk parameters.

If the cession of a receivable at a material credit-related loss occurred before the identification of default, the moment of cession shall be considered the moment of default. In case of partial cession of the total receivables from the obligor, where the cession is associated with a material credit-related loss, all receivables from the obligor shall be treated as defaulted, except in case of a natural person obligor where the bank applies the definition of default at the level of an individual exposure for retail exposures in line with Section 23 of these Guidelines.

In case of cession of a portfolio of exposures, the treatment of individual exposures in that portfolio shall be determined according to the manner in which the price for that portfolio was set. If the price for the total portfolio was set by specifying the discount on individual exposures, the bank shall assess the materiality of credit-related losses individually for each exposure in the portfolio. If the price was set only at the level of the entire portfolio, the bank may estimate the materiality of credit-related losses at the level of the portfolio – in that case, if the threshold specified in paragraph 5 hereof is breached, the bank shall treat all exposures from the portfolio as defaulted at the moment of cession.

#### *Distressed restructuring*

14. To determine the circumstances referred to in Section 93, paragraph 3, item 4) of the Decision, distressed restructuring shall be considered to have occurred when concessions have been extended towards an obligor facing or about to face difficulties in settling its obligations, as specified in the decision governing the classification of bank balance sheet assets and off-balance sheet items.

The obligor shall be considered defaulted where the distressed restructuring is likely to result in a diminished receivable.

The bank shall calculate the materiality threshold for the diminished receivable caused by the write-off of a part of debt, or postponement of repayment of principal, interest or fees according to the following formula, whereby the threshold may not exceed 1%:

$$DO = \frac{DO}{NPV_0} \leq 1\%$$

where:

DO = amount of diminished receivable expressed as a percentage;

NPV<sub>0</sub> = net present value of cash flows (including unpaid interest and fees) expected before the changes in terms and conditions of the contract discounted using the customer's original effective interest rate;

$NPV_1$  = net present value of cash flows expected after the changes in terms and conditions of the contract discounted using the customer's original effective rate.

To determine the circumstances referred to in Section 93, paragraph 3, item 4) of the Decision, the bank shall, for each distressed restructuring, calculate the amount by which that receivable was reduced and compare it to the threshold referred to in paragraph 3 hereof. If the amount of the reduction exceeds that threshold, the exposures shall be considered defaulted.

If the diminished receivable is lower than the threshold referred to in paragraph 3 hereof, and particularly if the net present value of expected cash flows at changed terms and conditions of the contract is higher than the net present value of expected cash flows at current terms and conditions of the contract – the bank shall take into account other indications of unlikeliness that the obligor will fully repay its obligation.

If the bank considers it unlikely that the obligor will fully repay its obligation according to the changed terms and conditions of the contract, the obligor shall be considered defaulted.

Indications that may suggest unlikeliness that the obligor will repay its obligation to the bank, its parent or subsidiary include:

- 1) a large lump sum payment envisaged at the end of the repayment schedule;
- 2) a repayment schedule where significantly lower payments are envisaged at the beginning of repayment schedule;
- 3) a significant grace period at the beginning of the repayment schedule;
- 4) where the receivables from the obligor have been subject to distressed restructuring more than once.

If it extends concessions to an obligor already in default, the bank shall treat such a receivable as subject to distressed restructuring in accordance with Section 93, paragraph 3, item 4) of the Decision.

All forbore exposures classified as non-performing in accordance with the decision governing the classification of bank balance sheet assets and off-balance sheet items – shall be classified as defaulted and subject to distressed restructuring.

*Procedures similar to bankruptcy*

15. To assess the fulfilment of the requirements under Section 93, paragraph 3, items 5) and 6) of the Decision, a bank shall take into

consideration procedures similar to bankruptcy; such procedures are those that encompass all creditors or all creditors with unsecured receivables, initiated before a competent court or another body, which lead to temporary suspension of payments or partial write-off of debt, involve some sort of control over the management of the obligor and its assets, and if they are not implemented, the obligor is likely to be terminated (e.g. forced liquidation, receivership).

*Other indicators of unlikelihood to pay*

16. A bank shall specify in its internal acts other indications of unlikelihood to pay per type of exposure, according to their characteristics, for all business lines, legal persons or geographical locations.

If there are indications referred to in paragraph 1 hereof, the bank shall treat the exposure as defaulted or assess whether there is a need for such treatment on a case-by-case basis.

In assessing whether there are indications referred to in paragraph 1 hereof based on internal information, the bank shall take into account in particular the following:

- 1) an obligor's sources of recurring income are no longer sufficient to meet the payments of instalments;
- 2) there are justified concerns about an obligor's future ability to generate stable and sufficient cash flows;
- 3) the obligor's overall leverage level has significantly increased or there are justified expectations of such changes to leverage;
- 4) the obligor has breached the covenants of a credit contract;
- 5) the bank has called any collateral, including guarantees and warranties;
- 6) for exposures to a natural person, if default occurred in relation to the operations of that person in the form of an entrepreneur or a company, where this person provided a personal guarantee for all obligations of that company, in accordance with the law governing companies;
- 7) for retail exposures, where the default definition is applied at the level of an individual exposure, a significant part of total obligations of the obligor is defaulted;
- 8) if the exposure is classified as non-performing in accordance with the decision governing the classification of bank balance sheet assets and off-balance sheet items.

In assessing whether there are indications referred to in paragraph 1 hereof based on the information and data available from external sources (external data), including the data from the credit bureau or another credit

register, macroeconomic indicators, public information sources and financial analysts' reports, the bank shall in particular take into account the following:

- 1) significant delays in payments to other creditors have been recorded in the credit bureau;
- 2) a crisis of the sector in which the obligor operates combined with a weak position of the obligor in this sector;
- 3) disappearance of an active market for the obligor's financial instruments because of the financial difficulties of the obligor;
- 4) a petition for initiation of bankruptcy or similar procedure of the obligor has been filed.

In assessing whether there are indications of unlikelihood that the obligor will fully repay its obligation to the bank, its parent or subsidiaries, the bank shall take into consideration the relations within the group of related persons. The bank shall define in its internal acts the cases when the default of one obligor within the group of related persons has a contagious effect on other persons within that group, in accordance with the criteria for assignment of exposures into rating grades referred to in Section 87, paragraph 1, item 4) of the Decision.

If an obligor belonging to the group of related persons not included in cases referred to in paragraph 5 hereof defaults, the bank shall estimate, on a case-by-case basis, whether there are indications of unlikelihood that other persons from the group will repay their obligations to the bank, its parent or subsidiaries.

If it has purchased or placed financial assets at a material discount – the bank shall assess whether that discount reflects the deteriorated financial condition and/or creditworthiness of the obligor, and whether there are any indications of unlikelihood that the obligor will fully repay its obligation in accordance with these Guidelines, whereby the assessment of whether there are those indications relates to the total amount owed by the obligor, regardless of the price that the bank has paid for the financial asset.

The assessment referred to in paragraph 7 hereof may be based on the due diligence before the purchase of the financial asset, or based on an analysis performed for accounting purposes so as to determine whether the asset is credit-impaired.

Credit fraud identified before default shall be considered an indication of unlikelihood that the obligor will fully repay its obligation to the bank, its parent or subsidiaries.

## **Return to a non-defaulted status and the new occurrence of default**

17. For the purposes of Section 93, paragraph 9 of the Decision, a bank shall apply all of the following:

1) consider that the conditions for return to a non-defaulted status are met, where at least three months have passed since the moment that the conditions referred to in Section 93, paragraphs 1 and 3 of the Decision cease to be met;

2) take into account the behaviour of the obligor during the period referred to in item 1) hereof;

3) take into account the financial condition and/or creditworthiness of the obligor during the period referred to in item 1) hereof;

4) after the period referred to in item 1) hereof, perform an assessment and, where it still finds that the obligor is unlikely to fully repay its obligation without recourse to realising security, the exposure shall continue to be classified as defaulted until the bank is satisfied that the improvement of the credit quality is factual and permanent;

5) the conditions referred to in items 1) to 4) hereof shall also be met with regard to new exposures to the obligor, regardless of whether previous defaulted exposures to this obligor were sold or written off.

The bank may apply the period referred to in paragraph 1, item 1) hereof to all exposures or apply different periods for different types of exposures, where the periods may not be shorter than three months.

By way of derogation from paragraph 1 hereof, where distressed restructuring applies to a defaulted exposure, regardless of whether such restructuring was carried out before or after the identification of default, the bank shall consider that default has ceased if at least one year has passed from the latest occurrence of one of the following events:

1) restructuring of a receivable;

2) classification of an exposure as defaulted;

3) end of the grace period included in the restructuring arrangements.

The bank may consider the defaulted status of an obligation ended after the expiry of the period referred to in paragraph 3 hereof, if the following conditions are met:

1) during that period the obligor made regular payments (payments in the past twelve months made on time or with a delay no longer than 30 days) in accordance with the changed terms and conditions of repayment, thus making a material payment at least equal to the amount that was previously due (if there were due amounts) or written off (if there were no due amounts),

as an element of the changed terms and conditions of repayment or if the obligor showed in another manner that it is capable of repaying the obligation;

2) there are no past due receivables in line with the changed terms and conditions of repayment;

3) there are no indications of unlikeliness that the obligor will fully repay its obligation to the bank, its parent or subsidiaries;

4) the bank considers it likely that the obligor will fully repay its credit obligation according to the schedule after the restructuring arrangements without recourse to realising security, including guarantees and warranties. The bank shall examine in particular the situations where a large lump sum payment is envisaged at the end of the repayment schedule;

5) the conditions referred to in items 1) to 4) hereof shall be met also with regard to new exposures to the obligor, regardless of whether the previous exposures to this obligor that were defaulted because of restructuring were sold or written off.

In case the obligor – legal person changes status, or another similar transaction occurs, the period referred to in paragraph 1, item 1) hereof shall cease to pass and the bank shall start counting that period again from the moment of that change or transaction.

### **Application of the definition of default**

#### *Application of the definition of default in external data*

18. If a bank uses the IRB Approach and uses external data to estimate risk parameters, for the purposes of implementing Section 93 of the Decision, it shall:

1) verify whether the definition of default used in the external data is in line with Section 93 of the Decision;

2) verify whether the definition of default used in the external data is consistent with the definition of default as implemented by the bank for the relevant portfolio of exposures, including in particular the counting of the number of days past due that triggers default, the structure and level of the materiality of past due credit obligations, the definition of distressed restructuring, the type and level of specific credit risk adjustments that constitute circumstances taken into account by the bank in assessing the fulfilment of conditions that trigger default, and the criteria to return to non-defaulted status;

3) document sources of external data, the default definition used in external data, the performed analyses and all identified differences.

If the bank identifies differences in the definition of default by applying the provisions referred to in paragraph 1 hereof, the bank shall:

1) assess whether and how the adjustments to the internal definition of default would affect the default rate or whether that is impossible to determine;

2) perform appropriate adjustments in the external data, except in the case when it is able to demonstrate that the differences do not impact risk parameters and capital requirements.

Regarding the differences identified in the definition of default resulting from the assessment from paragraph 1 hereof and taking into account the adjustments performed in accordance with paragraph 2, item 2) hereof, the bank shall document that broad equivalence with the internal definition of default has been achieved, including, where possible, a comparison of the default rate of relevant types of exposures in internal data with those in external data.

Where the assessment from paragraph 1 hereof identifies differences in the definition of default which the assessment from paragraph 2 hereof reveals to be non-negligible but not possible to overcome by adjustments in the external data, the bank shall adopt an appropriate margin of conservatism in the estimation of risk parameters as referred to in Section 94, paragraph 1, item 6) of the Decision.

In the case referred to in paragraph 4 hereof, the bank shall ensure that the additional margin of conservatism reflects the materiality of the remaining differences in the definition of default and their possible impact on all risk parameters.

#### *Consistent application of the definition of default*

19. A bank shall ensure by its internal acts that the definition of default is implemented and used consistently, and shall, in particular, ensure:

1) that default of a single obligor is identified consistently across the bank in relevant information systems, taking into account all exposures to that obligor and exposures to that obligor in all relevant legal persons within the group at all geographical locations where the bank operates in accordance with Section 20 of these Guidelines or for retail exposures in accordance with Section 23 of these Guidelines;

2) the bank and its parent or subsidiaries use the same definition of default for all types of exposures or, if different definitions of default apply (either at the group level or by type of exposure) – the scope of application of each of the default definitions is clearly specified, in accordance with Section 21 of these Guidelines.

### *Consistent identification of default of a single obligor*

20. For the purposes of Section 19, item 1) of these Guidelines, a bank shall implement adequate procedures and mechanisms to ensure that the default of a single obligor is identified consistently across the bank with regard to all exposures to this obligor in all relevant information systems, including the exposures to that obligor in all the relevant legal persons within the group and the exposure to that obligor in all geographical locations where the bank operates in organisational forms other than as a legal person.

Where the exchange of client data among the bank, its parent or subsidiaries is prohibited by regulations governing the protection of financial service consumers, data secrecy, or other regulations resulting in inconsistencies in the identification of default – the bank shall inform the National Bank of Serbia thereof and, if it uses the IRB Approach, it shall also estimate the materiality of the inconsistencies in the identification of default and their possible impact on the estimates of risk parameters.

Where the identification of default of an obligor in a manner consistent across the bank, its parent or subsidiaries would be unnecessarily burdensome, requiring development of a centralised database of all clients or implementation of other mechanisms or procedures to verify the status of each client at the level of the group – the bank need not apply such mechanisms or procedures if it can demonstrate that the effect of non-compliance is immaterial because there are no or there is a very limited number of common clients among the relevant members of the group and the exposure to these clients is immaterial.

### *Consistent use of the definition of default across types of exposures*

21. For the purposes of Section 19, item 2) of these Guidelines, a bank, its parent or subsidiaries shall use the same definitions of default for the same types of exposures. Members of the group may use different definitions of default for different types of exposures, where this is justified by the application of significantly different risk management processes or by different applicable law in the territory of the country where that member operates, in particular if:

1) the competent regulatory body in the territory of the country where the group member operates set a different materiality threshold than that prescribed by these Guidelines;

2) the competent regulatory body in the territory of the country where the group member operates prescribed by applicable law the use of 180 days instead of the 90 days past due set in Section 93, paragraph 1, indent two of

the Decision for certain types of exposures to which the IRB Approach is applied;

3) there are other indications of unlikelihood that the obligor will fully repay its obligation to the bank, its parent or subsidiaries for certain companies, geographical locations or types of exposures.

For the purposes of Section 19, item 2) of these Guidelines, and where different definitions of default are applied across types of exposures in accordance with paragraph 1 hereof, the bank shall adopt and implement internal acts regulating the definition of default, ensuring both of the following:

1) that the scope of application of each definition is clearly specified;  
2) that the definition of default specified for a certain type of exposure, legal person or geographical location is applied consistently to all exposures within a given class, legal person, or geographical location.

For a bank that uses the IRB Approach, the use of different default definitions shall be adequately reflected in the estimation of risk parameters in the case of ratings systems which use different definitions of default.

*Manner of application of the definition of default for retail exposures*

22. A bank that uses the Standardised Approach may apply the definition of default at the level of an individual exposure that meets the criteria specified in Section 51 of the Decision, even when that exposure has been assigned to different exposure classes for the purposes of assigning a risk weight (e.g. exposures secured by mortgages on immovable property).

A bank that uses the IRB Approach may apply the definition of default to retail exposures at the level of an individual exposure, for all exposures classified as retail exposures in line with Section 76 of the Decision.

The bank shall apply the definition of default at the level of an obligor or at the level of an individual exposure, for all retail exposures in a way that reflects its internal risk management practices.

The bank may apply the definition of default at the level of an obligor for some types of retail exposures and at the level of an individual exposure for other exposures, where this is justified by internal risk management practices at the bank (e.g. due to a different business model of subsidiaries) and where there is evidence that the number of situations where the same clients are subject to different definitions of default is kept to a strict minimum.

Where the bank uses different levels of application of the definition of default for different types of retail exposures, in accordance with paragraph 4

hereof, it shall ensure that the scope of application of each definition of default is clearly specified and that it is used consistently over time for different types of retail exposures. Where the bank uses the IRB Approach, the risk estimates shall correctly reflect the definition of default applied to each type of exposures.

If the bank uses different levels of application of the default definition with regard to certain retail portfolios, the treatment of common clients across such portfolios shall be regulated by internal acts. Where the exposures to which the definition of default at the obligor level applies meet either of the conditions referred to in Section 93, paragraph 1 of the Decision, all exposures to that obligor, including those subject to the application of the definition of default at the level of an individual exposure, shall be considered defaulted by the bank.

The bank shall apply the provisions of paragraph 6 hereof to the obligors treated under the Standardised Approach, where some exposures to an obligor meet the requirements referred to in Section 51 of the Decision, while other exposures to the same obligor are in the form of securities and therefore do not qualify as retail exposures. Where an exposure in the form of a security meets the conditions referred to in Section 93, paragraph 1 of the Decision, all exposures to that obligor shall be considered defaulted.

Where the exposure that meets the requirements referred to in Section 51 of the Decision also meets the requirements referred to in Section 93, paragraph 1 of the Decision, and the bank applies the definition of default at the level of an individual exposure – other exposures to the obligor shall not be automatically treated as defaulted exposures.

The bank may treat other exposures to the obligor referred to in paragraph 8 hereof as defaulted exposures based on other indications of unlikelihood that the obligor will repay its obligation to the bank, its parent or subsidiaries in the manner prescribed in Section 23 of these Guidelines.

*Application of the definition of default  
for retail exposures at the level  
of an individual exposure*

23. Where, in accordance with Section 93, paragraph 2 of the Decision, the definition of default has been applied at the level of an individual exposure with regard to retail exposures, the bank shall take into consideration that some indications are related to the condition of the obligor, rather than the status of an individual exposure, particularly indications of unlikelihood to repay obligations to the bank, its parent or subsidiaries, related to the filing of

the petition for initiation of an appropriate procedure against the obligor (e.g. bankruptcy proceedings, if possible, according to applicable law).

The bank shall consider other indications of unlikeliness that the obligor will fully repay its obligation to the bank, its parent or subsidiaries and specify, in line with its internal acts, all indications that reflect the condition of the obligor rather than that of an individual exposure.

Where indications referred to in paragraphs 1 or 2 hereof occur, all exposures to the same obligor shall be treated as defaulted by the bank, regardless of the level of application of the definition of default.

Where a significant part of the exposures to the obligor is defaulted, the bank may consider it unlikely that the obligor will fully repay its other obligations to the bank, its parent or subsidiaries without recourse to realising security, including guarantees and warranties, and may treat them as defaulted.

*Application of the definition of default  
for retail exposures at  
the obligor level*

24. The application of the definition of default for retail exposures at the obligor level implies that, where any obligation of the obligor meets the conditions referred to in Section 93, paragraph 1 of the Decision, the bank shall treat all exposures to that obligor as defaulted. The bank that applies the definition of default to retail exposures at the obligor level shall specify by its internal acts the treatment of joint credit obligations and default contagion between exposures.

The notion of a joint credit obligation, within the meaning of these Guidelines, does not extend to a credit obligation of an individual obligor secured by a warranty or guarantee of a natural or legal person or other credit protection.

Where the conditions referred to in Section 93, paragraph 1 of the Decision are met with regard to a joint credit obligation, the bank shall treat all other joint credit obligations of the same set of obligors, and all individual exposures to those obligors as defaulted, unless they can justify that the recognition of default on individual exposures is not appropriate because at least one of the following conditions apply:

1) the delay in the payment of a joint credit obligation results from a dispute between the individual obligors participating in the joint credit obligation that has been introduced to a court or another body whose decisions are legally binding in accordance with applicable law, and there is

no concern about the financial condition and/or creditworthiness of the individual obligors;

2) a joint credit obligation is an immaterial part of the total obligations of individual obligors.

The default of a joint credit obligation shall not cause the default of other joint credit obligations of individual obligors with other natural or legal persons, which are not involved in the credit obligation that has initially been defaulted. The bank shall also assess whether the default of a joint credit obligation constitutes an indication of unlikeliness that the obligor will fully repay its obligation to the bank, its parent or subsidiaries with regard to the other joint credit obligations.

Where the conditions referred to in Section 93, paragraph 1 of the Decision are met with regard to the obligation of an individual obligor, the contagious effect of this default should not automatically spread to any joint credit obligations of that obligor. The bank shall, taking into account the default in relation to that obligor, assess whether there are indications of unlikeliness that another obligor will fully repay its obligation to the bank, its parent or subsidiaries with respect to the joint credit obligation. Where all individual obligors of a joint credit obligation have a defaulted status, their joint credit obligation shall also be considered defaulted.

The bank shall identify the obligors that are legally fully liable for the full amount of the obligation, excluding individual obligations secured by a warranty or guarantee or another credit protection.

In case of full mutual liability for all obligations of the obligor (e.g. partners, general partners), the bank shall treat the default of one such obligor as an indication of unlikeliness that another obligor will fully repay its obligation to the bank, its parent or subsidiaries, and shall assess whether the individual and joint credit obligations of that obligor should be treated as defaulted.

Where one or more joint and several obligors that are liable for all obligations of the obligor referred to in paragraph 7 hereof has a joint credit obligation with one or more other obligors, the bank shall assess whether there are indications of unlikeliness to pay.

The bank shall analyse the legal forms of companies and the extent of liability of their members and managers for the obligations of the companies, depending on their legal form. Where a natural person is fully liable for the obligations of a company, default of that company shall result in that person being considered defaulted as well. Where such full liability of the natural person does not exist, the bank shall assess whether there are indications of

unlikeliness that members that are significant shareholders in a defaulted company will fully repay their individual obligations to the bank, its parent or subsidiaries.

By way of derogation, in case of a natural person – entrepreneur that is fully liable for its commercial obligations with both private and commercial assets, the default of any of its private or commercial obligations shall cause all obligations of this person to be considered defaulted exposures as well.

Where the definition of default is applied at the level of an obligor for retail exposures, the materiality threshold shall also be applied at the level of an obligor.

The bank shall clearly specify in its internal acts the treatment of joint credit obligations in the application of the materially significant amount.

A joint obligor, i.e. a specific set of individual obligors that have a joint obligation towards a bank, its parent or subsidiaries shall be treated as a different obligor from each of the individual obligors of that joint obligation. In the case the delay in payment occurs on a joint credit obligation, the materiality of such delay shall be assessed in line with these Guidelines in relation to all joint credit obligations of this set of obligors, whereby individual exposures of obligors participating in a joint credit obligation, or exposures to other subsets of such obligors shall not be taken into account. However, where the materiality threshold for the observed set of joint obligors calculated in this way is breached, all joint credit obligations of this set of obligors and all individual exposures of obligors participating in a joint credit obligation shall be considered defaulted unless any of the conditions specified in paragraph 3 hereof is met.

When delay in payment occurs on an individual credit obligation, the bank shall assess the materiality of such delay by comparing the materiality threshold referred to in these Guidelines with each individual credit obligation of this obligor, without taking into account any joint credit obligations of that obligor and other natural or legal persons. Where the materiality threshold is breached, the bank shall consider all individual exposures to this obligor defaulted.

#### **Monitoring the fulfilment of conditions for classification into non-defaulted status**

25. For the purposes of Section 93, paragraph 9 of the Decision, a bank shall define in its internal acts the criteria and the manner of classifying an obligor's obligation back into non-defaulted status, and in particular:

- 1) when it can be considered that the improvement of the financial condition and/or creditworthiness of an obligor is sufficient to allow full and timely repayment of the credit obligation;
- 2) when the repayment is likely to be made.

The bank shall monitor and analyse on a regular basis the effectiveness of the criteria and manner of classifying an obligor's obligation back into non-defaulted status referred to in paragraph 1 hereof, in particular:

- 1) the changes of status of the obligors or exposures;
- 2) the impact of the prescribed criteria/manners of determining default on cure rates;
- 3) the impact of the prescribed criteria/manners of determining default on multiple defaults.

In case of an extensive number of multiple defaults in a short period following the return to a non-defaulted status, the bank shall re-examine the acts referred to in paragraph 1 hereof.

The bank shall take into account the analysis of the changes in status of the obligors or exposures, in particular for the purpose of specifying the periods referred to in Section 17 hereof. The bank may specify a longer period for the exposures that have been treated as defaulted in the preceding 24 months.

## **Documentation and the risk management process**

26. A bank shall document the status of default, including all triggers for identification of default and the criteria for classifying an obligation back into non-defaulted status. It shall also clearly identify the scope of application of the definition of default and, more in particular, it shall:

- 1) document the occurrence of all indications taken into account when determining the triggers for default in accordance with Section 93, paragraph 3 of the Decision, the manner or process of their identification, sources of information, frequency of monitoring and responsibilities for the identification of individual circumstances leading to the occurrence of default;
- 2) document the occurrence of criteria for reclassification of a defaulted obligation to a non-defaulted status, including procedures, sources of information and the responsibilities of relevant persons;
- 3) keep an updated register of all definitions of default, including all circumstances ensuring consistent and effective application of that definition, in particular the indications of unlikeliness to pay in accordance with Section 93, paragraph 3 of the Decision, and of all other indications of unlikeliness to

pay defined by the bank in relation to all types of exposures, for all business lines, legal persons and geographical locations.

For the purposes of paragraph 1, items 1) and 2) hereof, documenting implies a description of all applied automated and manual processes, and if qualitative indications of unlikeliness to pay or criteria for reclassification to a non-defaulted status are applied in the manual process – the description shall be sufficiently detailed so as to help all responsible persons understand the process and to facilitate its consistent application.

For the purposes of paragraph 1, item 3) hereof, the bank shall keep an updated register of all current and past versions of the default definition that includes at least the following information:

- 1) the scope of application of the default definition – if there is more than one default definition used within the bank, its parent or subsidiaries;
- 2) data on the bank's managing body that approved the definition or definitions of default and the date of approval of each of those definitions;
- 3) the period of implementation of each definition of default;
- 4) brief description of all changes performed relative to the last version;
- 5) if the bank uses the IRB Approach, the date of submission of the request for prior consent referred to in Section 69, paragraph 1 of the Decision, and for prior consent referred to in paragraph 6 thereof and, where applicable, the date those consents were given.

27. The bank shall establish efficient processes allowing it to obtain the relevant information in order to identify defaults in a timely manner, and shall deliver the information in the shortest possible time, where possible, in an automated manner, to the employees responsible for taking credit decisions, and more in particular:

- 1) where it applies automated processes (e.g. counting of days past due), the identification of indications of default shall be performed on a daily basis;
- 2) where it implements manual processes (e.g. checking external sources of information and databases, analysis of the list of obligors requiring special monitoring by the bank, analysis of the list of forbore exposures, identification of specific credit risk adjustments), the information shall be updated with a frequency that guarantees the timely identification of default.

The bank shall verify on a regular basis that all exposures classified in the group of non-performing exposures and the subgroup of forbore exposures within the meaning of the decision governing the classification of

bank balance sheet assets and off-balance sheet items are treated as defaulted and subject to distressed restructuring.

The bank shall analyse on a regular basis whether exposures classified in the group of performing exposures and the subgroup of forbore exposures, within the meaning of the decision governing the classification of bank balance sheet assets and off-balance sheet items, show indications of unlikelihood that the obligor will fully repay its obligation to the bank, its parent or subsidiaries, in accordance with Section 93, paragraph 3 of the Decision and Section 14 of these Guidelines.

The control mechanism should ensure that the relevant information is used in the default identification process immediately after being obtained. All exposures to a defaulted obligor or all relevant exposures in case of the application of the definition of default at the level of an individual exposure for retail exposures shall immediately be marked as defaulted in all relevant information systems by the bank.

If delays occur in relation to the use of relevant information for default identification, such delays must not lead to errors or inconsistencies in the process of risk management, risk reporting, calculation of capital requirements or use of information in risk parameter quantification. In particular the bank shall ensure that the data in regulatory and internal reports reflect adequate treatment of all exposures.

### **Requirements in relation to the principles of management for banks applying the IRB Approach**

28. Banks that use the IRB Approach shall adopt adequate mechanisms and procedures in order to ensure that the definition of default is implemented in a correct manner, and shall in particular ensure that:

1) the definition of default and the scope of its application were approved by the managing board or a committee designated by it, and by the executive board in accordance with Section 104, paragraph 1 of the Decision;

2) the definition of default is used consistently for the purpose of calculating capital requirements and plays a meaningful role in the bank's risk management processes by being used at least to monitor exposures and in the reporting to the bank's managing bodies;

3) the internal audit of the bank regularly reviews the robustness and effectiveness of the process used by the bank for the identification of default, taking into account in particular the timeliness of the identification of default within the meaning of Section 27 hereof, and ensuring that the conclusions of the internal audit's review and the respective recommendations, as well as the measures taken to remedy the identified weaknesses are communicated

directly to the managing board or the committee designated by it, and to the executive board.

### **Transitional and final provisions**

29. The bank that uses the IRB Approach shall, before implementing these Guidelines, assess and accordingly adjust its rating system so that the estimates of risk parameters reflect the definition of default according to these Guidelines; to this end, it shall:

1) where possible, adjust the historical data to the definition of default according to these Guidelines, taking into account the materially significant amount set by these Guidelines;

2) assess the impact of the definition of default according to these Guidelines on all risk parameters and the amount of capital requirements in relation to those parameters, and amounts obtained using the previous definition, where applicable, after the relevant adjustments in historical data;

3) include an additional margin of conservatism in the estimates of risk parameters from the rating system so as to account for the possible distortions of risk estimates resulting from the inconsistent definition of default in the historical data used in internal models.

The changes referred to in paragraph 1 hereof, which are applied to the rating systems as a result of the application of these Guidelines, must be verified by the organisational unit in charge of validation of internal models and must be analysed for the purposes of Section 69, paragraphs 6 and 8 of the Decision.

For the purposes of appropriately implementing Section 69, paragraph 6 of the Decision, the bank shall define the final deadline for the submission of the request for approval of changes in the definition of default resulting from the application of these Guidelines and shall notify the National Bank of Serbia thereof by the date of application of these Guidelines at the latest. The National Bank of Serbia may assess that the final deadline for the submission of this request is inappropriate and order the bank to submit the request within a shorter deadline.

The bank that uses the IRB Approach, which has started to collect data for the purposes of alignment with the definition of default from these Guidelines shall, in the process of estimating risk parameters referred to in Section 94, paragraph 1, item 3) of the Decision, where justified, extend or move the window of historical data used for the risk quantification to include new data.

The bank that uses the IRB Approach shall, in considering the estimate of risk parameters, assess the adequacy of the level of the margin of

conservatism referred to in paragraph 1, item 3) hereof, until an adequate time period for observing historical data in line with the definition of default according to these Guidelines is reached.

Until the start of implementation of IFRS 9, the bank shall specify whether it treats exposures as defaulted in accordance with Section 12, paragraphs 1 to 3 of these Guidelines, or with paragraph 4 of that Section, and shall consistently treat them in that manner, after which it may apply only the conditions referred to in paragraph 4 of that Section.

30. Until the start of application of Section 10 hereof, the bank shall determine the materially significant amount in the manner prescribed by the decision governing the classification of bank balance sheet assets and off-balance sheet items.

31. The bank shall align its internal acts and its information systems with the provisions of these Guidelines by 1 January 2022 at the latest, except in relation to the application of Section 10 of these Guidelines, in which case it shall align and adjust these acts and systems by 1 January 2019.

32. These Guidelines shall enter into force on the eighth day following its publication in the RS Official Gazette, and shall apply as of 1 January 2022, except for Section 10 of these Guidelines, which shall apply as of 1 January 2019.

NBS Executive Board No 48

10 July 2017

Belgrade

Chairperson  
Executive Board of the  
National Bank of Serbia  
Governor  
National Bank of Serbia

Dr Jorgovanka Tabaković, sgd.