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Sarajevo, March 23rd, 2021



TO ALL BANKS IN THE FEDERATION OF BIH

Attn: Bank Management Chairwomen / Chairmen



Subject: Request for action – managing non-performing assets and managing other risks that are related to the effects of the "COVID-19" virus disease pandemic

The Decision on the Temporary Measures to Be Applied by Banks for Recovery from the Adverse Effects Caused by "COVID-19" Virus Disease ("Official Gazette of the Federation of BIH", nos. 60/20 and 21/21) sets a requirement for the banks to enhance monitoring of the risks arising from the portfolio of clients to whom special measures were approved, which may potentially point to the difficulties in meeting the credit obligations. The Decision on Credit Risk Management and Determination of Expected Credit Losses ("Official Gazette of the Federation of BIH", no. 44/19 and 37/20) lays down a requirement for the banks to set up an adequate framework for treatment of non-performing exposures and for the level of coverage of non-performing exposures to be appropriate to the risk profile of the loan portfolio.

Proper management of credit risk and other risks requires the following:

- 1. The bank shall maintain business continuity and efficient processes for handling the temporary measures relating to "COVID-19", immediately and on an ongoing basis until the termination of the measures;**

The Decision on the Temporary Measures to Be Applied by Banks for Recovery from the Adverse Effects Caused by "COVID-19" Virus Disease ("Official Gazette of the Federation of BIH", nos. 60/20 and 21/21) sets the framework and time limits for the bank's handling of the temporary measures. In the period of the validity of the decision, the bank shall set up adequate processes, which includes keeping the business network within the bank and clients fully and properly informed about the provisions from the decisions. The FBIH Banking Agency (hereinafter: Agency) requires you to proceed without a delay with the implementation of the decisions in order to preserve the stability of the banking system, avoid further adverse

economic effects of the pandemic on the banks, economy and citizens. Special attention must be paid to industries, entities and citizens who have suffered immediate and instantaneous effects of the ban or restriction on performance of business activities, in accordance with the Agency's decisions.

2. The bank shall perform a review, fitness check and updating of the framework for management of non-performing exposures in accordance with Article 11 of the Decision on Credit Risk Management and Determination of Expected Credit Losses ("Official Gazette of the Federation of BiH", numbers 44/19 and 37/20), no later than by June 30th, 2021.

In order to create conditions for subsequent recovery and mitigation of the adverse economic effects caused by the pandemic on business viability, the bank shall carry out all required activities to adequately manage credit risk and adapt to the current and temporary business circumstances. For this purpose, the bank is expected to update the existing framework for handling non-performing exposures from Article 11(1) of the Decision on Credit Risk Management and Determination of Expected Credit Losses, including updating of the processes for an ongoing analysis of the loan portfolio composition, quality and trends, as well as updating the Strategy for Managing Non-Performing Exposures.

The Agency expects from the bank to apply an active strategy for forbearance and adjustment of credit exposures, according to the expected pace and recovery options for economic activities, in order to avoid uncontrolled growth of non-performing exposures in the bank's portfolio moving forward.

The bank should perform a comprehensive analysis of its loan portfolio with a special focus on material exposures, i.e., exposures affected by the adverse economic effects of the pandemic, as well as identify in a timely fashion and in an adequate manner those debtors who have a potential for further support and recovery. With a special care and while avoiding the activities which may undermine recovery options, the bank should identify those debtors who are not expected to recover their business activities and classify them adequately into an appropriate credit risk level.

The bank is responsible for timely adjustment of its business processes and management of risks that are related to non-performing exposures which originated in earlier periods, for further measures aimed at addressing the existing share of non-performing exposures and prevention of its future emergence and accumulation. It is especially important that the risks that are either faced or will be faced by the bank are adequately expressed in the strategic regulations of the bank, risk management processes and financial statements. This also entails collateral management and timely market reevaluation serving as security for exposure.

In order to actively monitor credit risk in accordance with Article 11(2) of the Decision on Credit Risk Management and Determination of Expected Credit Losses, it should be noted that



the bank shall analyze the impact of non-performing exposures on own funds, profitability, liquidity and other performance indicators.

3. The bank shall perform a review, fitness check and updating of the plans and other regulations for acquisition, management and sale of foreclosed assets in accordance with Article 32 of the Decision on Credit Risk Management and Determination of Expected Credit Losses ("Official Gazette of the Federation of BiH", numbers 44/19 and 37/20), no later than by June 30th, 2021.

In the conditions when a growth of the share of non-performing assets is expected, growth of expected credit losses, instability of secondary markets and collateral value, the existing regulations that are related to the bank's management of the foreclosed assets that the bank does not intend to use for its own purposes. The bank is expected to take a prudent approach and avoid circumstances under which priority is given to plans to take over or keep foreclosed assets. Based on the experience so far, the Agency would refer you to the approach according to which foreclosed assets and other business assets have their demonstrable value only if they are used for justified and lawful business purposes.

Consistent and full implementation of the regulatory framework and coordinated action will allow adequate risk management in the conditions of the extended impact of the pandemic, reduce a risk of loan portfolio quality deteriorating and increase chances for economic recovery in the coming period.

Sincerely,

DIRECTOR

Jasmin Mahmuzic

