

Ordinance No. 9
of 3 April 2008
on the Evaluation and Classification of Risk
Exposures of Banks and the Allocation of Specific
Provisions for Credit Risk

(Issued by the Bulgarian National Bank on 3 April 2008; published in the Darjaven Vestnik, issue 38 of 11 April 2008; effective as of 11 April 2008; amended, issue 21 of 2009)

Chapter One

General Provisions

Subject

Article 1. (1) This Ordinance shall determine the criteria and manners of evaluating and classifying risk exposures of banks and for the allocation of specific provisions for credit risk, as well as the supervision exercised by the Bulgarian National Bank on the compliance with these requirements.

(2) This Ordinance shall be applied by banks using a Standardized Approach for credit risk pursuant to Ordinance No. 8 of the Bulgarian National Bank of 2006 on the Capital Adequacy of Credit Institutions (Darjaven Vestnik, issue 106 of 2006).

(3) Specific provisions for credit risk, allocated according to this Ordinance, shall be deducted from the own funds (capital base) pursuant to Ordinance No. 8 of 2006.

(4) The requirements under this Ordinance shall be applied on a non-consolidated and consolidated basis.

Risk Exposures

Article 2. Within the meaning of this Ordinance, risk exposures shall be all loans and other claims of a bank, regardless of the ground for their occurrence and the financial instrument used, for which there is a risk of losses and which are measured at amortized cost.

General Requirements

Article 3. (1) Banks shall assess and classify their risk exposures where there exist indications of deterioration of the debtor's financial state or circumstances which led to losses or may lead to losses from future events.

(2) Where a bank has more than one exposure to persons who may be treated as presenting joint risk, these exposures shall be classified into the group of the person with the highest risk level.

(3) Banks may apply a more detailed and more stringent internal classification of their risk exposures.

(4) On each exposure, banks shall maintain comprehensive documentation containing all material conditions and circumstances of the transaction, as well as the respective information about evaluation, classification and the manners of determining the amount of the specific provisions for credit risk.

(5) The system for monitoring risk exposures shall allow for evaluation and classification individually and on a portfolio basis.

(6) (new, Darjaven Vestnik, issue 21 of 2009) Risk exposure or aggregate of risk exposures to a separate person, with a value in excess of BGN 100,000 must be evaluated and classified on an individual basis.

Risk Exposure Evaluation Policy and an Internal Body of a Bank

Article 4. (1) Each bank shall develop a policy on risk exposure evaluation and shall establish an internal body which shall monitor, evaluate, classify and determine specific provisions for credit risk.

(2) The structure and powers of the body under paragraph 1 shall be specified in the internal rules which shall ensure independence of the process of approval and management of the loans.

(3) In accordance with Article 72, paragraph 1 of the Law on Credit Institutions, both the policy on risk exposure evaluation under paragraph 1 and the internal rules shall be submitted to the Banking Supervision Department of the Bulgarian National Bank within ten days after their adoption, or amendment respectively.

(4) The policy on risk exposure evaluation under paragraph 1 and internal rules shall be approved by the management body of the bank. They should be applied on an ongoing basis and include at least the following:

1. roles and responsibilities of the bank's departments in relation to implementation of the policy on allocation of specific provisions for credit risk;

2. written procedures and internal controls the bank employs in determining specific provisions for credit risk, which shall include the following:

(a) a classification system which consistently identifies changes in the risk characteristics and prompts appropriate actions;

(b) sufficient internal controls to ensure that all relevant information is appropriately considered in determining specific provisions for credit risk;

(c) clear formal communication and coordination between bank's departments, related to determination and review of specific provisions;

(d) (new, Darjaven Vestnik, issue 21 of 2009) an approach to calculating specific provisions on a portfolio basis for a group of loans with similar risk characteristics, which shall guarantee that such calculation does not lead to systematic underestimation of the specific provisions for this portfolio.

3. methodology for assessing credit risk;

4. credit risk management system which includes description of the following:

(a) credit risk classification system (loan grading system), including control of credit limits;

(b) required collaterals and guarantees;

(c) internal process for periodic review of the exposures and collaterals and for monitoring overdue credits.

Chapter Two

Classification of Risk Exposures

Criteria for Risk Exposure Evaluation and Classification

Article 5. (1) Risk exposures shall be evaluated and classified based on the period of delay of amounts due, the assessment of the debtor's financial state and the main sources for repayment of the debtor's obligations and other additional criteria according to this Ordinance.

(2) Assessment of the debtor's financial state shall be based on the information required from and made available by the debtor periodically in compliance with Article 61 of the Law on Credit Institutions, including financial statements and other documents. Assessment of the financial state shall include a qualitative and quantitative analyses reflecting all circumstances which may affect debt repayment according to the clauses of the loan agreement.

(3) (amended; Darjaven Vestnik, issue 21 of 2009) The bank's risk exposures which have been evaluated on an individual basis shall be classified into four classification groups according to the criteria under Articles 8–11 of this Ordinance.

(4) (amended; Darjaven Vestnik, issue 21 of 2009) Reclassification of an exposure to a legal entity into a classification group of standard exposures is permissible only if all past-due amounts have been paid off; three standard installments on principal and/or interest have been made according to the contractual installment plan and if the exposure satisfies the conditions of Article 8, paragraph 2, items 2 and 3 of this Ordinance.

(5) (amended; Darjaven Vestnik, issue 21 of 2009) Reclassification of an exposure to a natural person into classification group of standard exposures is permissible only if all overdue amounts are paid off (principal and/or interest).

(6) Where the bank does not have sufficient information on the debtor's financial state and on the sources for repayment of his obligations, as well as other docu-

mentation relating to his activity, the risk exposure shall be classified into the next higher-risk classification group.

Exposures to an Individual Country

Article 6. (1) Each bank shall allocate specific provisions for credit risk on a portfolio basis on exposures to an individual country related to country risk, excluding the risk exposures for which there are indications of individual deterioration in the amounts specified in the risk exposure evaluation policy according to Article 4 of this Ordinance.

(2) Exposures with an original term (maturity) of up to six months, to non-residents in Bulgaria, to foreign banks' branches and to foreign banks with investment rating assigned by an External Credit Assessment Institution (ECAI) recognized by the Bulgarian National Bank shall not be provisioned to cover country risk.

Specific Provisions

Article 7. (1) Specific provisions for credit risk shall mean the excess of the balance sheet value calculated according to the applicable accounting standards over exposure's risk value calculated pursuant to Article 12 of this Ordinance.

(2) (amended; Darjaven Vestnik, issue 21 of 2009) Specific provisions for credit risk shall be allocated against particular exposures classified as watch, non-performing or loss.

(3) (amended; Darjaven Vestnik, issue 21 of 2009) Specific provisions for credit risk may be allocated also on an exposure group with similar risk characteristics to cover existing losses and risks which may not be specifically determined for each individual exposure.

(4) Specific provisions for credit risk under this Ordinance shall not be an element of the accounting expenses.

Standard Exposures

Article 8. (1) Standard risk exposures shall be those risk exposures which are serviced and information on the debtor's financial state gives no ground to assume that the debtor will not repay in full his debts.

(2) A risk exposure shall be classified as standard provided that all of the following conditions obtain:

1. the principal and interest are repaid in accordance with the contractual agreement terms, or payments on them have been past-due up to 30 days, provided the delay is justified or accidental;

2. the debtor uses the loan for the purposes stipulated in the loan agreement;

3. the bank has sufficient updated information on the debtor's financial state and on the sources for repayment of his liabilities, as well as other documents relating to his activity.

(3) Banks may not classify as standard those balance sheet exposures which have

arisen from the performance of off-balance sheet commitments.

Watch Exposures

Article 9. (1) Watch exposures shall be the risk exposures where insignificant weaknesses exist with respect to their servicing or there is a possibility of deterioration in the debtor's financial state which may question the full repayment of the obligation.

(2) A risk exposure shall be classified as watch provided that it satisfies the general conditions under paragraph 1 or one of the following conditions obtains:

1. (amended; Darjaven Vestnik, issue 21 of 2009) principal or interest arrears payments have been past-due 31 to 90 days;
2. the debtor uses the loan for purposes other than those specified in the loan agreement;
3. the final maturity of the loan with bullet repayment, granted to a newly established company with a poor credit history, has been renegotiated.

Non-performing Exposures

(Title amended, Darjaven Vestnik, issue 21 of 2009)

Article 10. (1) (amended; Darjaven Vestnik, issue 21 of 2009) Non-performing exposures shall be the risk exposures where significant weaknesses exist with respect to their servicing, or the available information points to the debtor's unstable financial state, current and anticipated proceeds are insufficient for the full repayment of his obligations to the bank and to other creditors, as well as where weaknesses have been found with the distinct possibility that the bank will sustain some loss.

(2) (amended; Darjaven Vestnik, issue 21 of 2009) A risk exposure shall be classified as non-performing, provided that it satisfies the general conditions under paragraph 1 or one of the following conditions obtains:

1. principal or interest arrears payments have been past-due 91 to 180 days;
2. the debtor's financial state has substantially deteriorated and may result in inability to repay his obligations.

Loss

(Title amended; Darjaven Vestnik, issue 21 of 2009)

Article 11. (1) (amended; Darjaven Vestnik, issue 21 of 2009) Exposures, classified as a loss shall be those risk exposures where as a result of the debtor's deteriorated financial state it is expected his obligations to become uncollectible, even though they have partial recovery value that may be realized in the future.

(2) (amended; Darjaven Vestnik, issue 21 of 2009) A risk exposure shall be classified as a loss provided it satisfies the general conditions under paragraph 1 or one of the following conditions:

1. principal or interest arrears payments have been past-due over 180 days;
2. the debtor suffers a permanent shortage of money;
3. the debtor has been declared bankrupt or is in a liquidation procedure, and there is a risk of leaving creditors unsatisfied;
4. the claim reported as a balance-sheet item is subject to court proceedings or the court has awarded it to the bank but it has not been collected;
5. other conditions providing grounds to consider that the risk exposure is jeopardized by non-repayment.

Chapter Three

Allocation of Exposure's Risk Value

Risk Value

Article 12. (1) The risk value of the exposure shall be determined by:

1. reducing the contractually agreed cash flows by the loss risk per cent depending on the classification group of the exposure:

- (a) for watch exposures not less than 10 per cent;
- (b) (amended; Darjaven Vestnik, issue 21 of 2009) for non-performing exposures not less than 50 per cent;
- (c) (amended; Darjaven Vestnik, issue 21 of 2009) for exposures classified as a loss not less than 100 per cent.

2. discounting the estimated cash flows under item 1 by applying the corresponding effective interest rate and summing after that the discounted cash flows.

(2) (amended; Darjaven Vestnik, issue 21 of 2009) Risk value of the exposure which has eligible collateral or guarantees under § 1, item 1, 'a' of the Additional Provision shall set up as follows: the value of the eligible collateral or guarantees under BNB Ordinance No. 8 of 2006 shall be added to the risk value under paragraph 1 after applying the calculation procedures under this Ordinance.

(3) (new; Darjaven Vestnik, issue 21 of 2009) Where the exposure has collateral under § 1, item 1, 'b' and 'c' of the Additional Provision, half of its net realizable value shall be added to the risk value under paragraph 1.

Chapter Four

Restructuring of Risk Exposures

Article 13. (1) An exposure shall be considered restructured where the original agreement terms are amended by the bank to alleviate terms for the debtor due to deterioration of debtor's financial state that led to impossibility to repay in a due term the full amount of the debt and which allowances would not have been given by the bank under other circumstances.

(2) (amended; Darjaven Vestnik, issue 21 of 2009) The original agreement terms are deemed for amended under paragraph 1 where there is a debt reduction (principal and/or interest), substitution of the part of the debt against ownership, refinancing or other financial allowances by the bank, except for changes in contractual interest rates resulting from market interest rate changes.

(3) (amended; Darjaven Vestnik, issue 21 of 2009) An exposure shall not be restructured where the following conditions are met:

1. there is an agreement for prolonging, with no more of two years totally of the term of principal and/or interest repayments, without reduction in a net present value of the cash flows under the provisions of additional agreements;

2. bank has a reason to assume that it will collect both the principal and the interest;

3. there are no circumstances indicating that the financial state of the debtor has been deteriorated.

(4) The restructured exposure shall be classified in the classification group, corresponding to its indications of deterioration before restructuring, according to the criteria under Articles 9–11.

(5) A bank may restructure a claim only on the basis of a motivated written proposal of the internal body under Article 4 of this Ordinance.

Chapter Five

Supervision over Evaluation and Classification of Risk Exposures and Allocated Specific Provisions for Credit Risk

Reports on Classified Risk Exposures and Allocation of Specific Provisions for Credit Risk

Article 14. (1) Banks shall prepare a report on the classified risk exposures and allocated specific provisions for credit risk as of the last day of each quarter. The report shall be submitted to the Banking Supervision Department of the Bulgarian National Bank prior to the 15th day of the month following the reported period.

(2) Banks shall also submit to the Bulgarian National Bank an annual report on the classified risk exposures and allocated specific provisions for credit risk as an integral part of their annual supervisory reports.

(3) Banks shall prepare consolidated report on the classified risk exposures and allocated specific provisions for credit risk pursuant to Ordinance No. 12 of 2007 of the Bulgarian National Bank on the Supervision on a Consolidated Basis (Darjaven Vestnik, issue 107 of 2007).

(4) Banks shall keep actual data for evaluation and classification of the risk exposures and specific provisions for credit risk allocated pursuant to this Ordinance.

Additional Information

Article 15. The Deputy Governor of the Bulgarian National Bank heading the Banking Supervision Department may require from banks additional information and analytical breakdown of each item in the reports, including by individual risk exposure.

Verification of the Information

Article 16. (1) The banking supervision authorities of the Bulgarian National Bank shall conduct examinations to verify the authenticity of the reports drawn up under Article 14, including on-site inspections.

(2) Auditors under Article 76, paragraph 1 of the Law on Credit Institutions shall conduct an examination and give an opinion on the compliance of the reports drawn up by the bank under Article 14 with the requirements of this Ordinance.

Supervisory Reclassification of Risk Exposures

Article 17. Banking supervision authorities may reclassify risk exposures where the latter have not been evaluated and classified by the banks according to the requirements of this Ordinance and may also require from the banks allocation of specific provisions for credit risk according to this Ordinance.

Measures and Sanctions

Article 18. Where an individual bank violates the requirements of this Ordinance, the Deputy Governor heading the Banking Supervision Department shall enforce the sanctions and enforcement administrative measures stipulated in Articles 103 and 152 of the Law on Credit Institutions.

Additional Provision

§ 1. Within the meaning of this Ordinance:

1. (amended; Darjaven Vestnik, issue 21 of 2009) ‘eligible collateral and guarantees’ shall be:

(a) credit protection pursuant to Chapter Six ‘Credit Risk Mitigation’ and collaterals under Article 39, paragraph 2 of BNB Ordinance No. 8 of 2006 for the purpose of calculating the capital requirements for credit risk under the Standardized approach, with the exception of credit protection which receives 100 per cent or higher risk weight pursuant to this Ordinance;

(b) real estate, outside the scope of Article 39, paragraph 2 of BNB Ordinance No. 8 of 2006, where the following two conditions are simultaneously met:

- i. it is insured against risks of an accidental perish;
- ii. first mortgage has been established on it;
- iii. it is located in a residential, administrative, trade or hotel building;
- iv. it may be sold within six months at its net realizable value; the realization term

starts running at exposure past-due over 180 days.

(c) land in regulation on which first mortgage has been established, provided the land may be sold within six months at its net realizable value; the realization term starts running at exposure past-due over 180 days.

2. 'country risk' shall be a possibility of non-payment of obligations or impeding transfer of funds on claims of individuals of specific country due to economic, political or other reasons;

3. 'exposure to a country' shall be the exposure of an individual bank or banking group comprising of all its claims on individuals from the respective country;

4. 'entities presenting joint risk' shall be:

(a) spouses;

(b) entities, one of whom exercises control over the other;

(c) entities whose activities are controlled by a third party or its subsidiary company;

(d) entities that jointly control a third party or its subsidiary company;

(e) entities related financially (economically) to each other in such a way that in case of financial problems with one of them, another entity or all other entities may suffer difficulties in repaying their obligations.

5. 'net realizable amount of collateral' shall be the selling price of the asset in a secondary liquid market reduced by the additional expenses that are directly related to the release (sale) of the respective asset.

6. (repealed; Darjaven Vestnik, issue 21 of 2009).

Transitional and Final Provisions

§ 2. This Ordinance is issued on the grounds of Article 43 in connection with § 13 of the Transitional and Final Provisions of the Law on Credit Institutions, and is adopted by Resolution No. 16 of 3 April 2008 of the Governing Council of the Bulgarian National Bank.

§ 3. This Ordinance shall enter into force on the day of its publication in the Darjaven Vestnik and shall repeal Ordinance No. 9 on the Evaluation of Risk Exposures of Banks and the Allocation of Provisions to Cover the Impairment Loss adopted by the Bulgarian National Bank on 19 December 2002 (published in the Darjaven Vestnik, issue 2 of 2003; amended, issue 71 of 2003, issue 11 of 2004, in force as of 1 April 2004, issues 37, 62 and 93 of 2005, issues 19 and 102 of 2006, issue 7 of 2007).

§ 4. The first report pursuant to this Ordinance shall be submitted to the Bulgarian National Bank with data as of 30 June 2008.

§ 5. The Deputy Governor of the Bulgarian National Bank heading the Banking Supervision Department shall issue instructions on enactment of this Ordinance.

Ordinance on Amendment

Ordinance No. 9 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk

(published in the Darjaven Vestnik, issue 21 of 2009)

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Transitional and Final Provisions

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§ 11. Within the meaning of Article 13, paragraph 3, item 1, agreed extension is the extension of the term after the entry of this Ordinance into force.

§ 12. This Ordinance is issued on the grounds of Article 16, item 5 of the Law on the Bulgarian National Bank and Article 43 in connection with § 13 of the Law on Credit Institutions and is adopted by Resolution No. 25 of 26 February 2009 of the Governing Council of the Bulgarian National Bank.

§ 13. According to these amendments, the first report under Ordinance No. 9 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk submitted to the Bulgarian National Bank shall include data as of 31 March 2009.