BANKA QENDRORE E REPUBLIKËS SË KOSOVËS
CENTRALNA BANKA REPUBLIKE KOSOVA
CENTRAL BANK OF THE REPUBLIC OF KOSOVO

Pursuant to Article 35, paragraph 1, subparagraph 1.1 of the Law No. 03/L-209 of the Central Bank of the Republic of Kosovo (Official Gazette of the Republic of Kosovo, No. 77/16 August 2010), and articles 49 and 85 of the Law No. 04/L-093 on Banks, Microfinance Institutions and Non-Bank Financial Institutions (Official Gazette of the Republic of Kosovo, No. 11/11 May 2012), the Board of the Central Bank of the Republic of Kosovo at the meeting held on 28 march 2019, approved the following:

REGULATION ON CREDIT RISK MANAGEMENT

Article 1
Purpose and Scope

1. The purpose of this regulation is to establish the standard and minimum requirements for credit risk management, sound credit risk practices associated with the implementation and ongoing application of expected credit loss (ECL) accounting frameworks.
2. This Regulation applies to all banks and branches of foreign banks licensed by the CBK to operate in the Republic of Kosovo.

Article 2
Definitions

1. All terms used in this Regulation are as defined in the Law No.04/L-093 on Banks, Micro-finance Institutions and Non-Bank Financial Institutions (hereinafter: *the Law on Banks*) and/or as further defined herein for the purpose of this Regulation:
    1.1. **Allowances -** means the stock of lending exposure loan loss provisions that has been recognised in the balance sheet of the credit institution, in accordance with the IFRS;
    1.2. **Derivative** – means a financial instrument the price of which derives from a different aset;

1.3. **Expected credit loses (ECL) -** means a probability-weighted estimate of credit losses over the expected life of the financial instrument.

1.4. **Exposure -** any asset or off-balance sheet item, including without limitation a loan or direct or indirect commitment to disburse money in exchange for a right to repayment of the amount disbursed and outstanding and to the payment of interest or other charges on such amount, any deferment of the due date of a debt, any guarantee or letter of credit issued, debt securities, and similar forms of credits or credit commitments granted by a bank to a client, as well as shares, participation in the capital, and other types of investments in a legal entity by a bank;

1.5. **Lending exposures -** means loans, loan commitments and financial guarantee contracts to which an ECL framework applies;

1.6. **Off-balance sheet items** – means the contingent liabilities of a bank including direct credit substitutes issued by it such as guarantees of indebtedness, standby letters of credit and other contingencies which must be disclosed as footnotes on its balance sheet but for which no definite risk value is available for purposes of inclusion in the principle part of its balance sheet;

1.7. **Temporary adjustments to an allowance -** adjustments to an allowance used to account for circumstances when it becomes evident that existing or expected risk factors have not been considered in the credit risk rating and modelling process as of the reporting date.

Article 3
Credit Risk Management Systems

1. Banks should have in place a system for credit risk management, adequate for the nature, volume and complexity of the banks' activities.
2. A credit risk management system shall consist of the policies, procedures, rules and banks' structures used to manage the credit risk.
3. A credit risk management system should provide the ongoing assessment of credits and other assets quality on a timely basis, including determining the adequacy of allowances to cover losses related to this risk.

Article 4
Strategy and Policy

1. Banks should develop the strategy and policy to manage their credit risk. The credit risk strategy and policies should be effectively communicated throughout the bank. All relevant personnel should clearly understand the bank's approach to granting and

managing credit and should be held accountable for complying with established policies and procedures.

2. The very basic purpose of a credit risk strategy is to determine the risk appetite of the bank. Once it is determined, the bank should develop a plan to optimize return while keeping credit risk within predetermined limits. Credit risk strategy shall minimally consist of:

   2.1. A statement of the banks's willingness to grant credit based on various client segments and products, exposure type (trade, production, consumer, real estate, etc.), economic sector, geographic location, currency, maturity and anticipated profitability;

   2.2. The identification of target markets and the overall characteristics that the bank plans to achieve with its loan portfolio, including levels of diversification and concentration tolerance;

   2.3. The recognition to the goals of credit quality, earnings and growth;

   2.4. Provide continuity with the approach which needs to take into account the cyclical aspects of the economy and the resulting shifts in the composition and quality of the overall loan portfolio.

3. The credit risk strategy shall be reviewed on a regular basis, at least annually.

4. Policies on credit risk management shall be reviewed on a regular basis, at least annually, and shall minimally include following elements:

   4.1. Mission statement;

   4.2. Definition of acceptable and unacceptable types of credit exposures;

   4.3. Limitation on total loan outstanding in relation to total assets, total deposits or capital;

   4.4. Desired portfolio mixture;

   4.5. Desired portfolio maturity distribution;

   4.6. Market segment defined;

   4.7. Lending terms: pricing, maturity and down payment/capital requirements;

   4.8. Financial information requirements;

   4.9. Definition of a qualified borrower;

   4.10. Acceptable collateral and margins;

   4.11. Lending authorities and approval process;

   4.12. Limitations on large exposures;

   4.13. Lending limits for loan officers;

4.14. Exposures to insiders and their related interests;

4.15. Guidelines for restructuring credit;

4.16. Internal reports related to credit risk management;

4.17. Organization of the credit function;

4.18. Guidelines for purchases and sales of participations/syndications.

Article 5
Organizational Structure for Credit Risk Management

1. Banks should establish an adequate organizational structure for the management of credit risk, by clearly defining the authorities and responsibilities of the board of directors and senoir management.

2. Banks shall ensure that the loan sales function be clearly separated from organizational and operational functions, as well as from the supporting operational and control functions of credit risk, including protections from any potential influence from the senior levels of board of directors and senoir management.

3. Banks shall ensure the appropriate structures for assessing, measuring and controlling credit risk concentration by sectors, by geography/locations, by currency and by credit type, etc.

4. A bank's board of directors is responsible for approving and regularly reviewing a bank's credit risk management strategy and significant policies and processes for identifying, measuring, evaluating, monitoring, reporting and mitigating credit risk consistent with the approved risk appetite set by the board. In addition, a bank's board will require senior management to adopt and adhere to sound practices with respect to sound underwriting and credit management.

5. The Board of Directors of Banks, with respect to the credit risk management is responsible to:

   5.1. Approve credit risk strategy;

   5.2. Approve credit risk management policy and monitor its implementation;

   5.3. Review the appropriateness of the adopted policy and procedures at least on an annual basis;

   5.4. Review the credit risk reports;

   5.5. At least every quarter, the Board of Directors should be briefed on the overall credit risk exposure (including off-balance sheet items) of the Bank and should review, at the very minimum, the following:

5.5.1. The amount of exposures undertaken in credit activities, broken down by categories (type of exposures, products and level of credit grades);

5.5.2. Large concentrations of credit;

5.5.3. Past due loan list which identifies problems and bank's potential loss on each significant past due loan;

5.5.4. Status of significant rescheduled loans;

5.5.5. Credit areas with high rapid growth in the loan portfolio;

5.5.6. Significant credit exception reports.

5.6. On an annual basis, the board of directors should be given a report containing a list of all existing credit products. The report should contain, at the minimum, the target markets of the credit products, their performance and their credit quality.

5.7. On an annual basis, or more frequently as needed, the Board of Directors should review the results of stress-testing for:

5.7.1. Improving the strategy and policy of credit risk management;

5.7.2. Drafting and improving the required regulatory framework to address the main issues related to the exposure against credit risk;

5.7.3. Forecasting in a timely manner the requirements for capital growth and the identification of the most efficient ways for its accumulation;

5.8. The Board of Directors of Banks, with respect to the credit risk management is also responsible to:

5.8.1. Approve the credit risk exposure limits in accordance with the CBK regulation on large exposures;

5.8.2. Define possible exceptions from the defined limits and assign responsibility for deciding on the application of such exceptions;

5.8.3. Monitor the efficiency of internal controls, as an integral part of the credit risk management system.

6. The Risk Management Committee shall:

6.1. Monitor the credit risk management policy and give proposals for its continual review and revision;

6.2. Assess the credit risk management system;

6.3. Analyze the reports of the banks' credit risk exposure and monitor the management of this risk;

6.4. Determine and regularly revise the internal credit indicators and credit risk exposure limits;

6.5. Establish clear delineation of lines of authority and responsibility for the managing of credit ris

7. The Bank Management shall:

7.1. Approve and monitor implementation of credit risk management procedures;

7.2. Create an environment for following the credit risk management policy;

7.3. Establish an adequate system of reporting to the Board of Directors and the Risk Management Committee on any noncompliance with the credit risk exposure limits;

7.4. Establish proper channels of communication to insure that the credit risk management policy and credit risk tolerances are clearly communicated to and adhered by all appropriate levels of the bank;

7.5. Ensure that adequate and effective operational procedures, internal controls and systems for identifying, measuring, monitoring and controlling credit risks are in place, to implement the credit risk management policies approved by the board of directors;

7.6. Establish a comprehensive credit risk reporting process;

7.7. Establish an effective management information system to insure timely, accurate and informative reporting of credit risk exposures;

7.8. Ensure that sufficient resources and competent personnel are allocated to manage and control the daily operations and credit risk management functions effectively;

7.9. Perform periodically an independent assessment of the banks' credit granting functions;

7.10. Develop and maintain appropriate processes, which should be systematic and consistently applied, to determine appropriate allowances;

7.11. Report periodically the results of the credit risk assessment and measurement processes, including estimates of its ECL allowances.

8. Banks should have an effective internal control system for credit risk assessment and measurement which should include:

8.1. Measures to comply with applicable laws, regulations, internal policies and procedures;

8.2. Measures to provide oversight of the integrity of information used and reasonably ensure that the allowances reflected in the bank's financial statements and its supervisory reports are prepared in accordance with IFRS;

8.3. Well defined credit risk assessment and measurement processes that are independent from (while taking appropriate account of) the lending function, which contain:

8.3.1. An effective credit risk rating system that is consistently applied, accurately grades differing credit risk characteristics, identifies changes in credit risk on a timely basis, and prompts appropriate action;

8.3.2. An effective process which ensures that all relevant and reasonable and supportable information, including forward-looking information, is appropriately considered in assessing and measuring ECL. This includes maintaining appropriate reports, details of reviews performed, and identification and descriptions of the roles and responsibilities of the personnel involved;

8.3.3. An assessment policy that ensures ECL measurement occurs not just at the individual lending exposure level but also when necessary to appropriately measure ECL at the collective portfolio level by grouping exposures based on identified shared credit risk characteristics;

8.3.4. An effective model validation process to ensure that the credit risk assessment and measurement models are able to generate accurate, consistent and unbiased predictive estimates on an ongoing basis. This includes establishing policies and procedures which set out the accountability and reporting structure of the model validation process, internal standards for assessing and approving changes to the models, and reporting of the outcome of the model validation;

8.3.5. Clear formal communication and coordination among a bank's credit risk staff, financial reporting staff, senior management, the board and others who are involved in the credit risk assessment and measurement process for an ECL accounting framework, as applicable (evidenced by written policies and procedures, management reports and minutes);

8.3.6. An internal audit function that independently evaluates the effectiveness of the bank's credit risk assessment and measurement systems and processes, including the credit risk rating system.

Article 6
Stress Testing

1. Bank, through the conducting of stress testing, shall assess, on an ongoing and adequate basis, their exposure against credit risk, by considering possible future changes in the

risk factors which could affect their credit portfolio's quality and the banks' financial situation as it affects net income and the capital adequacy ratio.

2. Banks shall set forth periodic results of their stress testing, at least on annual basis, through reports to senior management, consistent with the activity size, data on exposure against credit risk and their share in the market. The CBK may request the banks to conduct stress testing in more frequent periods and/or by scenarios with additional and/or different assumptions.

3. Stress testing conducted by Bank should at least include the use of particular and/or combined scenarios, based on factors such as: economic downturns, rapid change of market conditions (market risk conditioned by the exchange rate fluctuations, interest rates, etc.) Which could have unfavorable effects on the regular payment of the liability (debt), or scenarios of credit portfolio deterioration, notwithstanding the definition of risk factors which may serve as a reason for the occurrence of unfavorable situations.

4. Bank shall set forth the methodology for stress testing, the assumptions, and the actions that might be taken, given the results, including:

   4.1. Implementation, analysis of stress tests scenarios and their periodicity;

   4.2. Stress testing for particular and individual scenarios and combined scenarios, given the potential for simultaneous occurrence of some scenarios;

   4.3. Documentation and regular review of the assumptions used for stress testing;

   4.4. The reporting and frequency of the output of the tests to the management;

   4.5. Actions to be taken by the management and/or special structures assigned for credit risk management, based on the stress tests' results.

Article 7
Credit risk rating process and grouping

1. A bank should have a credit risk rating process in place to appropriately group lending exposures on the basis of shared credit risk characteristics.

2. Banks should have in place comprehensive procedures and information systems to monitor the quality of their lending exposures.

3. The credit risk rating process should include an independent review function.

4. Banks should take into account a number of criteria when assigning the credit risk grade upon initial recognition of a lending exposure including, to the extent relevant, product type, terms and conditions, collateral type and amount, borrower characteristics and geography or a combination thereof.

5. The credit risk rating system should capture all lending exposures to allow for an appropriate differentiation of credit risk and grouping of lending exposures within the credit risk rating system, reflect the risk of individual exposures and, when aggregated across all exposures, the level of credit risk in the portfolio as a whole.
6. In describing the elements of its credit risk rating system, a bank should clearly define each credit risk grade and designate the personnel responsible for the design, implementation, operation and performance of the system as well as those responsible for periodic testing and validation (ie the independent review function).
7. Credit risk grades should be reviewed whenever relevant new information is received or a bank's expectation of credit risk has changed. Credit risk grades assigned should receive a periodic formal review at least annually to reasonably ensure that those grades are accurate and up to date. Credit risk grades for individually assessed lending exposures that are higher-risk or credit-impaired should be reviewed more frequentely than annually.
8. ECL estimates must be updated on a timely basis to reflect changes in credit risk grades for either groups of exposures or individual exposures.
9. Banks should group exposures with shared credit risk characteristics in a way that is sufficiently granular to be able to reasonably assess changes in credit risk and thus the impact on the estimate of ECL for these groups.
10. A banks's methodology for grouping exposures to assess credit risk (such as by instrument type, product terms and conditions, industry/market segment, geographical location) should be documented and subject to appropriate review and internal approval by senior management.
11. Exposures must not be grouped in such a way that an increase in the credit risk of particular exposures is masked by the performance of the group as a whole.
12. Banks should have in place a robust process to ensure appropriate initial grouping of their lending exposures. The grouping of exposures should be re-evaluated and exposures should be re-segmented if relevant new information is received or a credit institution's changed expectations of credit risk suggest that a permanent adjustment is warranted. If a bank is not able to re-segment exposures on a timely basis, a temporary adjustment should be used.

Article 8
Allowance methodologies

1. A bank should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring credit risk on all lending exposures. The measurement of allowances should build upon those methodologies and

result in the appropriate and timely recognition of expected credit losses in accordance with IFRS 9.

2. The credit risk assessment and measurement process should provide the relevant information for senior management to make its experienced judgements about the credit risk of on balance sheet exposure and off-balance sheet items, and the related estimation of ECL.
3. Banks are required to leverage and integrate common processes that are used within a bank to determine if, when and on what terms credit should be granted; monitor credit risk; and measure allowances for both accounting and capital adequacy purposes.
4. A bank's allowance methodologies should clearly document the definitions of key terms related to the assessment and measurement of ECL. Information and assumptions used for ECL estimates should be reviewed and updated as required by IFRS.
5. Banks should have in place adequate processes and systems to appropriately identify, measure, evaluate, monitor, report and mitigate the level of credit risk.
6. Sound methodologies for assessing credit risk and measuring the level of allowances should include, in particular:
   - 6.1. A robust process that is designed to equip the bank with the ability to know the level, nature and drivers of credit risk upon initial recognition of the lending exposure to ensure that subsequent changes in credit risk can be identified and quantified;
   - 6.2. Criteria to duly consider the impact of forward-looking information, including macroeconomic factors;
   - 6.3. For collectively evaluated exposures, a description of the basis for creating groups of portfolios of exposures with shared credit risk characteristics;
   - 6.4. Identify and document the ECL assessment and measurement methods (such as a loss rate method, probability of default (PD)/loss-given-default (LGD) method, or another method) to be applied to each exposure or portfolio;
   - 6.5. Document the reasons why the selected method is appropriate, especially if different ECL measurement methods are applied to different portfolios and types of individual exposures. A bank should be able to explain to CBK supervisors the rationale for any changes in measurement approach and the quantitative impacts of such changes;
   - 6.6. Document the inputs, data and assumptions used in the allowance estimation process (such as historical loss rates, PD/LGD estimates and economic forecasts), how the life of an exposure or portfolio is determined (including how expected

prepayments and defaults have been considered), the time period over which historical loss experience is evaluated, and any adjustments necessary for the estimation of ECL in accordance with the IFRS 9;

6.7. Include a process for evaluating the appropriateness of significant inputs and assumptions in the ECL assessment and measurement method chosen;

6.8. Identify the situations that would generally lead to appropriate changes in ECL measurement methods, inputs or assumptions from period to period;

6.9. Consider the relevant internal and external factors that may affect ECL estimates, such as the underwriting standards applied to a lending exposure at origination and changes in industry, geographical, economic and political factors;

6.10. Address how ECL estimates are determined (like historical loss rates or migration analysis as a starting point, adjusted for information on current and expected conditions). A bank should have an unbiased view of the uncertainty and risks in its lending activities when estimating ECL;

6.11. Identify what factors are considered when establishing appropriate historical time periods over which to evaluate historical loss experience;

6.12. Determine the extent to which the value of collateral and other credit risk mitigants affects ECL;

6.13. Outline the bank's policies and procedures on write-offs and recoveries;

6.14. Require that analyses, estimates, reviews and other tasks/processes that are inputs to or outputs from the credit risk assessment and measurement process are performed by competent and well trained personnel and validated by personnel who are independent of the bank's lending activities;

6.15. Document the methods used to validate models for ECL measurement (backtests);

6.16. Ensure that ECL estimates appropriately incorporate forward-looking information, including macroeconomic factors, that has not already been factored into allowances measured on an individual exposure basis;

6.17. Require a process to assess the overall appropriateness of allowances in accordance with the IFRS, including a regular annually review of ECL models.

7. A bank's credit risk identification process should ensure that factors that impact changes in credit risk and estimates of ECL are properly identified on a regular basis. Also, consideration of credit risk inherent in new products and activities should be a key part of the risk identification process and the assessment and measurement of ECL.

8. Senior management should consider relevant facts and circumstances, including forward-looking information, that are likely to cause ECL to differ from historical experience and that may affect credit risk and the full collectability of cash flows.

9. With respect to factors related to the character, capacity and capital of borrowers, the terms of lending exposures and the values of assets pledged as collateral together with other credit risk mitigants that may affect the full collectability of cash flows, a bank could (depending on the type of exposure) consider:

9.1. Its lending policies and procedures, including its underwriting standards and lending terms, that were in effect upon initial recognition of the borrower's loan, and whether the loan was originated as an exception to this policy.

9.2. A borrower's sources of recurring income available to meet the scheduled payments;

9.3. A borrower's ability to generate a sufficient cash flow stream over the term of the financial instrument;

9.4. The borrower's overall leverage level and expectations of changes to leverage;

9.5. Unencumbered assets the borrower may pledge as collateral in the market or bilaterally in order to raise funds and expectations of changes to the value of those assets;

9.6. Reasonably possible one-off events and recurring behaviour that may affect the borrower's ability to meet contractual obligations; and

9.7. Timely evaluations of collateral value and consideration of factors that may impact the future value of collateral.

10. Where they have the potential to affect the bank's ability to recover amounts due, factors relating to the bank's business model and current and forecasted macroeconomic conditions could be considered, such as:

10.1. Competition and legal and regulatory requirements;

10.2. Trends in the banks's overall volume of credit;

10.3. The overall credit risk profile of the bank's lending exposures and expectations of changes thereto;

10.4. Credit concentrations to borrowers or by product type, segment or geographical market;

10.5. Expectations on collection, charge-off and recovery practices;

10.6. The quality of the bank's credit risk review system and the degree of oversight by the bank's senior management and board;

10.7. Other factors that may impact ECL such as, but not limited to, expectations of changes in unemployment rate, gross domestic product, benchmark interest rates, inflation, liquidity conditions or technology; and

10.8. The incentives or willingness of borrowers to meet their obligations.

11. Sound credit risk methodologies should consider different potential scenarios and should not rely purely on subjective, biased or overly optimistic considerations. A bank should develop and document its process to generate relevant scenarios to be used in the estimation of ECL. In particular:

    11.1. The bank should demonstrate and document how ECL estimates would alter with changes in scenarios, including changes to relevant external conditions that may impact ECL estimates or components of the ECL calculation (such as PD and LGD parameters);

    11.2. The bank should have a documented process for determining the time horizon of the scenarios and, if relevant, how ECL is estimated for exposures whose lives exceed the period covered by the economic forecast(s) used;

    11.3. Scenarios may be internally developed or outsourced;

    11.4. Backtesting should be performed to ensure that the most relevant economic factors that affect collectability and credit risk are being considered and incorporated into ECL estimates.

12. Bank should consider all reasonable and supportable information that is relevant to the product, borrower, business model or economic and regulatory environment when developing estimates of ECL.

13. Senior management should be able to demonstrate that it understands and is appropriately considering inherent risks when pricing lending exposures.

14. A bank's accounting policies should address, and its allowance methodology should include, criteria for restructurings/modifications of lending exposures and the treatment of purchased or originated credit-impaired lending exposures as defined under IFRS and Regulation on non-performing exposures and forbearance.

Article 9
Use of temporary adjustments

1. Banks may use temporary adjustments to the allowance to account for circumstances when it becomes evident that existing or expected risk factors have not been considered in the credit risk rating and modelling process.

2. Banks should use such adjustments only as a temporary solution.

3. Temporary adjustments should be directionally consistent with forward-looking forecasts, supported by appropriate documentation, and subject to appropriate governance processes.

Article 10
Loss allowance at an amount equal to 12-month ECL

1. A bank should measure ECL for all lending exposures. If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, a bank measure the loss allowance for that financial instrument at an amount equal to 12 -month expected credit losses as it is deteminde by the IASB's impairment standard for financial instruments.

2. A bank should adopt an active approach to assessing and measuring 12-month ECL that enables changes in credit risk to be identified in a timely manner and hence the timely recognition of those changes in ECL.

3. A bank should define default in a manner consistent with that used for internal credit risk management as it is required by IFRS 9 and also should have to take into account:

   3.1. A qualitative criterion by which "the bank considers that the borrower is unlikely to pay its credit obligations to the bank in full"; and

   3.2. An objective indicator where "the borrower is past due more than 90 days on any material credit obligation to the bank", equivalent to the rebuttable presumption in IFRS 9.

4. A default event shall be considered to have occurred with regard to a particular borrower when either of the criteria in paragraph 3 subparagraph 3.1 and 3.2 of this article is met, or both are met. In this context, a bank should identify default, in accordance with the 'unlikeliness to pay' criterion of the debtor, before the exposure becomes delinquent with the 90-days-past-due criterion.

5. For the purpose of paragraph 4 of this article, elements to be taken as indications of unlikeliness to pay shall include the following:

   5.1. The bank puts the credit obligation on non-accrued status;

   5.2. The bank recognises a specific credit adjustment resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure;

   5.3. The bank sells the credit obligation at a material credit- related economic loss;

   5.4. The bank consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or, where relevant fees. This includes, in the case of equity exposures assessed under a PD/LGD Approach, distressed restructuring of the equity itself;

   5.5. The bank has filed for the borrower's bankruptcy or a similar order in respect of an borrower's credit obligation to the bank, the parent undertaking or any of its subsidiaries;

5.6. The borrower has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the bank, the parent undertaking or any of its subsidiaries.

6. Where a bank originates high-credit-risk exposures and their allowances are initially measured at 12-month ECL, the bank should monitor these exposures closely for significant increases in credit risk to ensure a timely movement of the exposure to lifetime ECL measurement, in order to take into account that high risk exposures are likely to exhibit greater volatility and to experience a more rapid increase in credit risk.

7. Banks should determine an amount equal to 12-month ECL measurement on an individual or collective basis.

8. A bank should adjust its estimate of 12-month ECL, even if an increase in credit risk is not judged to be significant, in order to appropriately reflect changes in credit risk that have taken place.

9. A bank should not group lending exposures in such way as to obscure the identification of significant increases in credit risk on a timely basis.

Article 11
Assessment of significant increases in credit risk

1. A bank should have in place sound governance, systems and controls, in accordance with this Regulation in order to consider whether an exposure has suffered a significant increase in credit risk and the measurement of required 12-month ECL and lifetime ECL.

2. Banks should have processes in place that enable them to determine a timely and holistic basis whether there has been a significant increase in credit risk subsequent to the intial recognition of lending exposure so that an individual exposure, or a group of exposures with similar credit risk characteristics, is transferred to LEL measurement as soon as credit risk has increased significantly, in accordance with the IFRS 9 impairment accounting requirements.

3. In order to recognise allowances on a timely basis in line with the IFRS 9 requirements, banks should:

   3.1. Assemble data and forward projections for the key drivers of credit risk in their portfolios; and

   3.2. Be able to quantify the credit risk in each of their exposures or portfolios based on these data and projections.

4. Banks should recognize lifetime expected credit losses before a financial instrument becomes past due. Bank’s analyses should take into account the fact that the

determinants of credit losses very often begin to deteriorate a considerable time (months or, in some cases, years) before any objective evidence of delinquency appears in the lending exposures affected.

5. In order to meet the requirments of paragraph 4 of this article a bank, should consider the linkages between macroeconomic factors and borrower attributes to the level of credit risk in a portfolio based on reasonable and supportable information.

6. Banks must have a clear policy including well developed criteria on what constitutes a “significant” increase in credit risk for different types of lending exposures.

7. In developing their approach to determining a significant increase in credit risk, banks consider each of the 16 classes of indicators as set out in IFRS 9 and, in addition, to consider whether there is further information that should be taken into account.

8. A bank should consider in particular the following list of indicators in assessing a significant increase in credit risk:

    8.1. A decision by the banks’s senior management such that, if an existing lending exposure were newly originated at the reporting date, the element of the price of the lending exposure that reflects the credit risk of the exposure would be is higher than it was when the loan was actually originated, because of an increase in the credit risk of the specific borrower or class of borrowers since inception;

    8.2. A decision by the banks’s senior management to strengthen collateral and/or covenant requirements for new lending exposures that are similar to lending exposures already originated, because of changes in the credit risk of those exposures since initial recognition;

    8.3. A downgrade of a borrower by a recognised credit rating agency, or within a bank’s internal credit rating system;

    8.4. For performing lending exposures subject to individual monitoring and review, an internal credit assessment summary/credit-quality indicator that is weaker than upon initial recognition;

    8.5. Deterioration of relevant determinants of credit risk (e.g. Future cash flows) for an individual borrower (or pool of borrowers); and

    8.6. Restructuring due to financial difficulties (forbearance).

9. When assessing whether there has been a significant increase in credit risk for a lending exposure, a bank should also take into account the following factors which are related to the environment in which a credit institution (a bank) or the borrower operates:

    9.1. Deterioration of the macroeconomic outlook relevant to a particular borrower or to a group of borrowers;

9.2. Deterioration of prospects for the sector or industries within which a borrower operates;

10. Banks should rigorously review the quality of their approach to assessing whether credit risk has increased significantly. A senior management should consider whether there are additional factors that should be taken into account in the assessment of significant increases in credit risk which would improve the quality of their approach.

11. Banks should ensure that modifications or renegotiations do not obscure increases in credit risk and thereby cause ECL to be underestimated and to delay the transfer to lifetime ECL for borrowers whose credit risk has significantly deteriorated, or inappropriately result in a move from lifetime ECL measurement back to 12-month ECL measurement.

Article 12
Use of practical expedients

1. IFRS 9 address the following practical expedients: the information set which an entity must consider in measuring ECL; the exception for ‘low’ credit risk exposures; and the 30-days-past-due rebuttable presumption.

2. Banks should make limited use of those practical expedients as addressed in paragraph 1 of this article. They should consider the need to make adjustments when using practical expedients to avoid any resulting bias, as they should take into account that the objective of IFRS 9 is to estimate expected credit losses to reflect an unbiased and probability-weighted amount.

3. Where a bank uses such practical expedients, justifications for the use of practical expedients should be clearly documented by the bank.

Article 13
Adequacy of the allowance

1. A bank’s aggregate amount of allowances, regardless of whether allowance components are determined on a collective or an individual basis, should be adequate and consistent with the objectives of the IFRS 9 framework.

2. Banks should implement sound credit risk methodologies with the objective that the overall balance of the allowance for ECL is developed in accordance with IFRS 9 and which adequately reflects ECL.

3. Banks should consider the information that goes beyond historical and current data to consider relevant forward-looking information including macroeconomic factors that are relevant to the exposure being evaluated in accordance with the IFRS framework.

4. Banks may use individual or collective assessment approaches when they incorporate forward-looking information into the ECL estimate, regardless, the approach should be consistent with the relevant accounting requirements.

Article 14
ECL Model Validation

1. A bank should have policies and procedures in place to appropriately validate models used to assess and measure expected credit losses.
2. A bank should have robust policies and procedures in place to validate the accuracy and consistency of its model-based rating systems and processes and the estimation of all relevant risk components, at the outset of model usage and on an ongoing basis.
3. Banks should conduct model validation when the ECL models are initially developed and when significant changes are made to the models.
4. A bank should review annually its ECL models.
5. A sound model validation framework should include, but not be limited to, the following elements:
   - 5.1. Clear roles and responsibilities for model validation with adequate independence and competence;
   - 5.2. An appropriate model validation scope and methodology include a systematic process of evaluating the model's robustness, consistency and accuracy as well as its continued relevance to the underlying portfolio;
   - 5.3. Comprehensive documentation of the model validation framework and process;
   - 5.4. A review of the model validation process by independent specilalized parties (internal or external parties) to evaluate the overall effectiveness of the model validation process and the independence of the model validation process from the development process;
   - 5.5. The findings of the review should be reported in a prompt and timely manner to the appropriate level of the bank.

Article 15
Processes, systems, tools and data

1. Banks should have the necessary tools to ensure a robust estimate and timely recognition of ECL.
2. A bank's use of its experienced credit judgment must be documented in the bank's credit risk methodology and subject to appropriate oversight.

3. Banks should be able to demonstrate that the forward-looking information factored into the ECL estimation process has a link to the credit risk drivers for particular exposures or portfolios.
4. Macroeconomic forecasts and other relevant information should be applied consistently across portfolios where the credit risk drivers of the portfolios are affected by these forecasts/assumptions in the same way. Furthermore, when developing ECL estimates, banks should apply their experienced credit judgement to consider their point in the credit cycle, which may differ across the jurisdictions in which they have lending exposures.
5. A bank should exercise care when determining the level of ECL allowances to be recognised for accounting purposes to ensure that the resulting estimates are appropriate (consistent with neutrality and neither understated nor overstated).
6. A bank should have a sound credit risk assessment and measurement process that provides it with a strong basis for common systems, tools and data to assess credit risk and to account for expected credit losses.
7. Credit risk practices should not be static and should be reviewed periodically to ensure that relevant data available throughout a banking organisation are captured and that systems are updated as the bank's underwriting or business practices change or evolve over time.

Article16
Writte – Offs

1. Banks should develop policies that describe the bases on which credit exposures are considered as non-perfoming exposures in accordance with *Regulation on non-perfoming exposures and forbearance* and the policies and procedures on write-offs.
2. When a loan is classified as non-perfoming and the bank has allocated loan loss allowance at 100% should settle it out of the balance sheet by the following criteria and terms:
   2.1. Credit exposures not covered by collateral, either in pledge form or in mortgage form, classified as non-perfoming exposure shall be written off from the balance sheet within eighteen (18) months of the period when they are classified in this category;
   2.2. Credit exposures that are covered by pledged collateral classified as non-perfoming must be written off from the balance sheet within thrty-six (36) months of the period when they were classified non-perfoming;

2.3. Credit exposures that are covered by collateral in the form of mortgages classified non-perfoming exposure must be written off from the balance sheet within sixty (60) months from the period when they are classified as “non-perfoming”.

2.4. Credit exposures that are covered by combined collateral, in pledge form and in mortgage form, in cases where the mortgage covers more than fifty percent (50%) of the exposure at the time of approval, then for the purpose of repayment, the credit exposure be treated according to paragraph 2.3 of this article;

2.5. The list of loans repaid in accordance with the requirements of this article shall be reported on regular meetings with the Bank's Board of Directors. While writen-offs of exposures for persons related to the bank should be made only with prior approval by the Board of Directors of the bank.

Article 17
Collateral Recognition

1. In calculating the amount of impaiment of balance sheet assets and off-balance sheet exposures, a bank should take into account cash flow deriving from collateral (instruments) that secure the exposure in accordance with IFRS 9.

2. In this methodology, the bank shall determine collateral instrumnets to be taken into accout within the meaning of paragraf 1 of this article, the manner of deteiminig their value, and the expected period they will be cashed in.

3. Eligible collateral for purpose of this article is defined as:

3.1. Financial collateral:

3.1.1. Cash collateral or fully collected deposit account balances in the possession of the banks and subject to a validly executed collateral pledge agreement;

3.1.2. Any cash margin deposit held at the bank to secure a letter of credit or guarantee;

3.1.3. Securities issued or guaranteed by the Government of the Republic of Kosovo to the extent that the market value of these securities is at least 100% (one hundred percent) of the exposure, provided that such securities are in the possession of the bank and subject to a validly executed collateral pledge agreement, and are revalued on a regular basis;

3.1.4. Securities issued or guaranteed by countries rated by international rating agencies, which are equal to S&P ratings “A” or better or issued by their Central Banks to the extent that the market value of these securities is at least 100% (one hundred percent) of the exposure, provided that such are in the possession of the bank and subject to a validly executed collateral pledge agreement, and are revalued on a regular basis;

3.1.5. Other marketable securities issued by financial institutions rated by international rating agencies, which are equal to S&P ratings “A” or better (shares or bonds that are listed and actively traded on an organized exchange for which market prices can be readily obtained) to the extent that the market value of those securities is at least 125% (one hundred twenty-five percent) of the exposure, provided that such securities are in the possession of the bank, subject to a validly executed collateral pledge agreement, and are revalued on a regular basis;

3.1.6. An unconditional guarantee by another financial institution that rated by international rating agencies, which are equal to S&P ratings “A” or better by an internationally known and reputable credit rating agency.

3.2. Appropriate instruments of collateral in a form of real-estate

3.2.1. A bank should take into account appropriate instruments of collateral in a form of real estate in the ECL estimates if it has at its disposal all the required documentation from which it is evident that the respective real estate represents an efficient and proper secondary source of collection. An instrument of collateral in a form of real estate shall be deemed to have these characteristics if a bank has been provided with the evidence that there is a market allowing for an expeditious and economically efficient (at an adequate price) liquidation of the instrument of collateral.

3.2.2. When assessing future cash flows based on collections from real estate, a bank shall apply appropriate impairment factors to the market value and relevant internally assessed collection period. The impairment factors and collection period shall take into account banks' practices and past experience in the collection of appropriate instruments of collateral, economic and legal environment in which a bank operates and relevant characteristics of instruments of collateral.When determining the impairment factor level and the length of collection period, a bank shall take into account the fact that various types of instruments of collateral reflect different levels of risk.

3.2.3. Banks should, at least once a year, review the validity of assumptions about the initially set collection periods and adjust them, where necessary.

3.2.4. A bank may reduce the collection period each quarter in accordance with the time passed only after actions have been taken to call on an instrument of collateral, if it assesses that the collection is carried out in accordance with the initially set period. This reduction can only be made in the cases where a bank can prove the certainty of cash flows by adequate documentation and where it is possible to reliably measure the final settlement period and the total amount of cash flows into the bank on that basis.

3.2.5. A bank shall, when estimating cash flows and after determining the present value in accordance with the provisions of this Regulation, take into account that portion of the value of the instrument of collateral in a form of real estate property, which remains after deducting all liabilities secured by the same real estate property, which are registered in the land registry with a higher priority rank or after deducting a proportional part of liabilities that have the same priority rank as the receivables of the respective bank.

3.2.6. The value of the instrument of collateral shall be the valuation of the real estate property market value executed by an independent valuer.

3.2.7. A bank shall have all necessary legal documents related to the real estate property used as an instrument of collateral for receivables;

3.2.8. In the course of a contractual relationship, a bank shall continuously monitor the value of real estate accepted as an instrument of collateral for its exposures, at a minimum once every year for commercial real estate and once every three years for residential real estate. A bank shall carry out more frequent monitoring of the value of real estate property where the market is subject to significant changes in conditions.

Article 18
Public disclosures

1. A bank's public disclosures should promote transparency and comparability by providing timely, relevant and decision-useful information.
2. Financial and credit risk management disclosures should be made in accordance with IFRS and supervisory frameworks.
3. Banks should provide an explanation of significant changes to the estimation of ECL from period to period in order to improve the quality and meaningfulness of information disclosed for ECL estimates.
4. Bank's management should regularly review its disclosure policies to ensure that the information disclosed continues to be relevant to its risk profile, product concentrations, industry norms and current market conditions.

Article 19
Supervisory Review

CBK as part of its supervisiory activity assesses the effectiveness of the bank's credit risk management practices, policies, processes and procedures as well as the methods used by the bank in determining loan loss provisions for the adequate measurement of expected credit losses.

Article 20
Reporting to the Central Bank of the Republic of Kosovo

Banks shall submit to CBK reporting forms prescribed by CBK according to the Regulation on Bank Reporting to CBK.

Article 21
Transitional provisions

The banks should comply with the requirements of this Regulation by 01 January 2020.

Article 22
Enforcement, Remedial Measures and Civil Penalties

Any violation of the provisions of this Regulation shall be subject to corrective and punitive measures, as defined in the Law on the Central Bank and the Law on Banks.

Article 23
Abrogation

Upon the effective entry into force of this Regulation, it shall abrogate the Regulation on Credit Risk Management issued by the CBK Board on August 31, 2016, and any other provisions that may be in conflict with this Regulation.

Article 23
Entry into force

This Regulation shall enter into force fifteen (15) days from the date of its approval.

The Chairman of the Board of the Central Bank of the Republic of Kosovo

Prof. Dr. Flamur Mrasori