

11
DECREE
of the National Bank of Slovakia
dated 8 June 2010

**stipulating methods of valuing positions recorded in the banking book
and details of the valuation of positions recorded in the banking book including the
frequency of such valuations**

The National Bank of Slovakia, in accordance with Article 39 (15) (h) of Act No. 483/2001 Coll. on Banks and on amendments and supplements to certain laws, as amended (hereinafter referred to as the “Act”) stipulates the following:

Article 1

(1) For the purposes of considering the credit risk exposure of a bank when complying with the procedure in accordance with Article 39 (7) of the Act, the positions recorded in the banking book representing items of the bank’s property and the positions recorded in the banking book representing items not recorded in the bank’s balance sheet are valued on a monthly basis according to their status as at the next working day of the calendar month by methods in accordance with Paragraphs 2 and 3.

(2) The positions recorded in the banking book representing the bank’s liabilities are valued in accordance with a special law.¹⁾

(3) For the purposes of the present Decree:

- a) homogeneous bank’s assets means those items of the bank’s property and items not recorded in the bank’s balance sheet with the same debtor risk, the same deal risk, the same features of the debtor and the same features of the deal,
- b) the debtor’s creditworthiness means the sum of the debtor’s features providing proof of the capacity to repay liabilities, while the capacity to repay liabilities largely depends on
 1. the significance of the debtor’s financial problems,
 2. whether the contract was violated by default or delayed repayment of interest or principal,
 3. granting relief to the debtor on the basis of the debtor’s request, namely for economic or legal reasons on the part of the debtor which the creditor would not otherwise take into consideration,
 4. the probability that, on the basis of the debtor’s application, bankruptcy may be declared over the debtor’s property or the debtor accedes to financial restructuring,
 5. whether the financial market in which the debtor deals has not been closed,
- c) margin of prudence means a special value relating to the expected error rate in the estimate of the probability of default and the estimate of loss in the event of default²⁾ which also takes into consideration the potential events or future changes in economic conditions identified by the bank that could have adverse effects on the debtor’s

¹⁾ Act No. 431/2002 Coll. on Accounting, as amended.

²⁾ Article 73 of Decree of the National Bank of Slovakia No. 4/2007 on banks' own funds of financing and banks' capital requirements and on investment firms' own funds of financing and investment firms' capital requirements (Announcement No. 121/2007 Coll.) as amended by Decree No. 17/2008 (Announcement No. 443/2008 Coll.)

creditworthiness and the overall value of the bank's property and the assessment of the bank's ability to withstand such changes; if the results of the estimates of the probability of default²⁾ and the estimates of losses in the event of default²⁾ are less satisfactory from the perspective of the bank and the error rate expected by the bank in the results of estimates of the probabilities of default²⁾ and the estimates of the losses in the event of default²⁾ are greater than the bank originally expected, then this special value is also higher; this special value also increases if the unfavourable effects of events and changes in economic conditions on the debtor's creditworthiness and overall value of the bank's property are of greater scope than the bank originally expected,

- d) the effect of appropriate protection means the effect of funded protection or unfunded protection permissible as a means of alleviation of credit risk from the receivable or future receivable entering into calculations of the bank's credit risks by a standardised approach for a credit risk,
- e) the representative sample of debtors or the bank's exposures refers to the sample of the bank's clients or receivables of which the risk features are identical with the risk features of the basic set of the bank's clients or receivables to which the estimate of the probability of default and estimate of loss in the event of default shall apply.

Article 2

(1) The positions recorded in the banking book representing the items of the bank's property and items not recorded in the bank's balance sheet entering into the classes of the bank's exposures or parts of the classes of the bank's exposures included in the calculation of risk-weighted exposures by the approach of internal ratings based on the prior approval of the National Bank of Slovakia in accordance with Article 33 of the Act, for the purposes of considering the bank's credit risk exposure in its compliance with the procedure in accordance with Article 39 (7) of the Act, are valued in compliance with the internal ratings approach.

(2) The positions recorded in the banking book representing those items of the bank's assets entering into the classes of the bank's exposures or parts of these classes of the bank's exposures included in the calculation of the risk-weighted expositions by a standardised approach for the credit risk, for the purposes of considering the bank's credit risk exposure in the compliance with the procedure in accordance with Article 39 (7) of the Act, are valued by the expected losses method in accordance with Article 3.

Article 3

(1) A zero coefficient of expected loss is assigned to an item of the bank's assets representing a receivable or future receivable from an EU Member State or its central bank, denominated and financed in any currency of any EU Member State, and an item of the bank's assets representing an exposure not of the nature of a credit liability, or in the event that the bank is unable to determine the contracting party. For other individual items of the bank's assets, the percentage coefficient of expected loss is calculated by the following formula

$EL = PD \times LGD$,
where

- a) EL (expected loss) represents the coefficient of expected loss
- b) PD (probability of default) represents the probability of default which is the probability that a default event will occur on the part of the debtor within one year,²⁾ the bank calculates the probability of default in accordance with its own estimate methods while meeting the requirements in accordance with paragraph 4,
- c) LGD (loss given default) represents the loss in the event of default which is the ratio of loss from the exposure as a result of default²⁾ of the bank's contracting party and the value corresponding to the outstanding part of the liability at the moment of default;²⁾ in the event of default, the loss is calculated according to the bank's own estimate methods while meeting the requirements in accordance with paragraph 4 in conjunction with the limitations for its determination in accordance with paragraphs 2 and 3, or it is determined in accordance with the minimum percentage levels stated in paragraphs 2 and 3.

(2) The loss in the event of default is determined from the aspect of what class of exposure or part of a class of exposure the individual item of the bank's assets belongs, while accordingly applying the provisions of special regulation³⁾ governing the details of assigning percentage values of loss in the event of default, if the bank had not been granted prior approval from the National Bank of Slovakia to use its own estimates in the event of default. The loss in the event of default determined according to the first sentence is not to fall below the level of 45 %, if it is not an item of the bank's assets representing

- a) a receivable or conditioned receivable secured by residential real estate
- b) a retail receivable or conditioned retail receivable or
- c) a receivable after its due date.

(3) The loss in the event of default for an item of the bank's assets which is

- a) a receivable or conditioned receivable secured by residential real estate is determined in accordance with the conversion table for the assignment of value of loss in the event of default stipulated by a special regulation⁴⁾
- b) a retail receivable or conditioned retail receivable not secured by residential real estate is determined at a minimum level of 75 %
- c) a receivable after its due date is determined at a minimum level of 50 %.

(4) For the purposes of the bank using its own methods for estimating the probability of default and estimate of loss in the event of default (hereinafter referred to as the "estimates of parameters"), the requirements are met if the following apply:

- a) the estimates of parameters are performed for anticipated losses in the next twelve months
- b) the time-sequences of data entered into the estimates of parameters are not shorter than one year,
- c) the estimates of parameters are used in subsequent calculations only in respect of those items of the bank's assets or homogeneous assets of the bank to which the data entered into such estimates correspond,

³⁾ Decree of the National Bank of Slovakia No. 4/2007 (Announcement No. 121/2007 Coll.) as amended

⁴⁾ Article 125 (8) of Decree of the National Bank of Slovakia No. 4/2007 (Announcement No. 121/2007 Coll.) as amended by Decree No. 17/2008 (Announcement No. 443/2008 Coll.).

- d) the estimates of parameters for individual items of the bank's assets and groups of such items, differences in these estimates are demonstrated and it is shown why the estimates of parameters applying to individual items of the bank's assets differ from the estimates applying to groups of such items,
- e) with estimates of parameters for individual items of a bank and for a group of items of bank's assets, special consideration is to be accorded to the historical development of:
 - 1. the debtor's creditworthiness
 - 2. financial markets,
 - 3. indicators of quality of items of the bank's assets corresponding to homogeneous assets,
- f) when determining the debtor's creditworthiness, it is proved that
 - 1. the data used are a representative sample of its debtors or bank's exposures,
 - 2. the bank's units and employees responsible for risk management in the bank are continually involved in the process of determining the debtor's creditworthiness and regular review of the debtor's creditworthiness,
- g) with the estimates of parameters, the margin of prudence is applied,
- h) it is proved that the estimates of parameters take into consideration all the appropriate and available data, information and methods; the estimates of parameters are
 - 1. derived from historical experience as well as evidence based on observation and are not based solely on judgments,
 - 2. credible and based on material factors of the appropriate risk parameters,
- i) the fewer data the bank has at its disposal for the estimates of parameters, the more prudent it is in its estimate of parameters,
- j) if the bank's own data on defaults are followed in the estimates of parameters
 - 1. it can be proved that the appropriate internal regulations of the bank on the method of provision of loans are followed in the estimates of parameters,
 - 2. it is possible to demonstrate differences between the valuation of the debtors' creditworthiness from the period from which the data serving for the estimates of parameters originate and the valuation of debtors' creditworthiness made by the bank at that specific point in time,
- k) reverse testing⁵⁾ is used for verification of the accuracy and quality of the estimates of parameters
- l) the bank's own methods of estimates of parameters as well as their use, use of the margin of prudence and use of reverse testing are demonstrated by submitting detailed documentation updated at least once per calendar year.

(5) If it is shown that the bank does not have all the input data, methodology, software and organisation and management and other internal processes for use of the procedure in accordance with paragraphs 1 to 4, while by its activities it is supportably headed towards obtaining and creating them, it is possible, instead of using the procedure in accordance with paragraphs 1 to 4 for the purpose of determining the percentage coefficient of the expected loss, to assign to each individual item of the bank's assets the percentage coefficient of the expected loss based on the manner by which it is assigned to those items of the bank's assets not representing retail receivables or conditioned retail receivables, risk weight in the use of a standardised approach for credit risk, namely in the values determined in accordance with paragraph 6; the items of the bank's assets representing retail receivables or conditioned retail receivables may be assigned the percentage coefficient of the expected loss equal to the value of 0.6338 %.

⁵⁾ Article 88 (1) and (2) of Decree of the National Bank of Slovakia No. 4/2007 (Announcement No. 121/2007 Coll.).

(6) The values for the purposes of paragraph 5 are as follows:

| | | | | | | | | | |
|-----------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Risk weight in % | 0 | 10 | 20 | 35 | 50 | 75 | 100 | 150 | 200 |
| Coefficient of expected loss in % | 0,0000 | 0,0066 | 0,0210 | 0,0542 | 0,1028 | 0,2333 | 0,4784 | 1,8826 | 4,2293 |

(7) The accounting value of each individual item of the bank's property prior to adjustment of its valuation in the accounting and after consideration of the effects of appropriate protection is multiplied at the moment of valuation in the banking book by the percentage coefficient of expected loss "EL" calculated or determined in accordance with paragraphs 1 to 4 or by the percentage coefficient of expected loss "EL" assigned in accordance with paragraphs 5 and 6; the value of this multiple for each individual item of the bank's property represents the amount of expected loss for the item. The accounting value of each individual item not recorded in the bank's balance sheet after considering the amount of the appropriate conversion factor in accordance with Article 33 (6) of the Act corresponding to the use of the standardised approach for the credit risk and after consideration of the effects of appropriate protection is multiplied at the moment of valuation in the banking book by the percentage coefficient of expected loss "EL" calculated or determined in accordance with paragraphs 1 to 4 or the percentage coefficient of expected loss "EL" assigned in accordance with paragraphs 5 and 6; the value of this multiple for each individual item not recorded in the bank's balance sheet represents the amount of expected loss for the item.

(8) The valuation of the position in the banking book by the method of expected loss means adjustment of the individual item of the bank's assets by the amount of expected loss for the item.

Article 4 Transitional Provisions

(1) The procedure stipulated in Article 3 (5) and (6) may be applied by the bank at the latest up to 31 December 2011, with the exception detailed in paragraph 2.

(2) The procedure stipulated in Article 3 (5) and (6) may be applied by the bank also after 31 December 2011 for those items of the bank's assets as would comply with the conditions and requirements in accordance with Article 33 (20) of the Act.

Article 5
Effect

This Decree enters into effect on 1 January 2011.

Jozef Makúch, in his own hand,
Governor

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