

Order # 142/04
Of 5 July 2018
Of the President of the National Bank of Georgia
Tbilisi

On Approval of Regulation on Assets Classification and the Creation of Reserves for Possible Losses by Microfinance Organizations

Pursuant to article 15 (1)(g), article 48 (3), article 50 (1)(h) of the *Organic Law of Georgia on the National Bank of Georgia*,

I order:

Article 1

To approve the attached *Regulation on Assets Classification and the Creation of Reserves for Possible Losses by Microfinance Organizations*.

Article 2

The order shall enter into force on 1 September 2018.

**Vice-Governor
of National Bank of Georgia (Acting Vice-Governor)**

Archil Mestvirishvili

**Regulation on Assets Classification and the Creation of Reserves
for Possible Losses by Microfinance Organizations**

Article 1. General Provisions

1. The purpose of this Regulation is for Microfinance Organizations to ensure the development and implementation of internal procedures and reporting requirements for the classification of their assets and provisioning obligations. This will facilitate the identification of a Microfinance Organization's realistic financial condition, and its understanding by the Microfinance Organization's depositors, management, shareholders, potential investors, the National Bank of Georgia (hereinafter – the National Bank) and other interested parties.

2. A Microfinance Organization's financial reporting shall present accurate, complete and up-to-date information on its financial condition, including the quality of its assets that shall also be quarterly submitted for consideration to the Supervisory Board of a Microfinance Organization.

3. For supervisory purposes, a Microfinance Organization shall be obliged to provide risk-based assets classification and create adequate reserves for possible losses. A Microfinance Organization shall establish and maintain written policies and procedures approved by its Supervisory Board for credit risk management. It shall submit monthly information to the National Bank on assets classification and created reserves for possible losses under this Regulation, based on the accounting format approved by the National Bank.

4. In case of failure to observe the requirements under this Regulation by a Microfinance Organization, the national Bank shall be entitled to exercise sanctions against the Microfinance Organization envisaged by laws of Georgia.

Article 2. Definition of Terms

The terms used in this Regulation shall have the following meanings:

- a) Microcredit/microloan – (hereafter – the loan) a sum of money issued by a microfinance organization to a borrower or a group of borrowers according to the conditions of repayment, valuation, guarantee and timing envisaged by the credit/loan contract;
- b) Past due loan - a loan, where the repayment of principal (its portion) or interest, or any installment of either, remains unpaid beyond the date agreed in the applicable loan documentation.
- c) Liquid collateral - material sources, standard gold bars, government securities, debt securities owned by a microfinance organization;
- d) Blank loan – loan for which security does not exist or if it exists, it does not have any market value, or/and despite its value, it is not executable due to its incorrect registration or any other reason. Also, a loan which has been issued by securing with own assets or/and share/assets of the affiliated organization;
- e) Restructured loan - a loan the repayment terms of which have been changed because of the borrower's legal or financial difficulties.
- f) Refinanced loan – a loan the repayment terms of which have been changed not because of the borrower's legal or financial difficulties.
- g) Adversely classified asset - an asset classified as Watch, Substandard, Doubtful and Loss;
- h) Non-performing asset - an asset classified as Substandard, Doubtful and Loss;
- i) Loan-to-value ratio (LTV ratio) – the loan(s)' ratio against the market value of collateral.
- j) Market value –the estimated amount for which the immovable property should exchange/alienate on the date of valuation between willing parties in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.
- k) Reserve for possible asset losses - a reserve account established against a Microfinance Organization's assets which represents the amount estimated to cover loan and non-loan assets and contingent liabilities. This reserve includes both specific and general reserves.
- l) Specific reserve -a reserve directly tied to or corresponding to a specific, identified asset.
- m) General reserve - a reserve established against a group of assets associated with general or common risks.
- n) Group of borrowers – the relationship between two or more borrowers when the borrowers represent one risk for the microfinance organization, have common purposes or/and collateral or/and one of them directly or indirectly controls the other one(s) or/and such a financial bond when financial problems of one borrower would cause difficulties for the other borrower(s).
- o) Steadily secured loan – loan which has been secured by mortgage and its LTV coefficient is equal or less than 75% or/and loan, which has been secured with gold, jewelry and liquid security and its LTV coefficient is equal or less than 90% or/and loan which has been secured by movable property and its LTV coefficient is equal or less than 40%;
- p) Unsteadily secured loan – loan which is not secured firmly.

Article 3. Rules for Creation and Use of Asset Loss Reserves

- 1. Microfinance Organization shall establish asset loss reserves in accordance with this Regulation (Annex 1).
- 2. Assets classification according to categories shall be based on standards and components related to each category.
- 3. Assets shall be classified only after the thorough analysis of circumstances and possibilities affecting the quality of assets.
- 4. Each current requirement of a borrower or a group of borrowers shall be given one category. Exceptional cases shall be fully explained and documented.
- 5. Each Microfinance Organization shall establish adequate reserves on a monthly basis in accordance with the rule set forth under this Regulation.

6. Reserves for possible asset losses shall be established in the national currency to cover assets formed in any currency. All new provisions to accounts for reserves for possible asset losses shall be entered as expenditures and be reflected in the profit and loss statement of a current year.
7. Assets classified as "Loss" shall be written off by debiting the reserve account for possible losses and crediting the assets account.
8. In specific cases, the National Bank has a right to require a Microfinance Organization to create a general reserve considering the risks of the whole portfolio or its part.
9. Based on the business model, a Microfinance Organization shall be entitled to create reserves with different methodology only if the reserving policy shall be more conservative than the requirements of the given rule.
10. Differences between classification decisions of the National Bank of Georgia with respect to any asset and those of the classifying Microfinance Organization may be the subject for discussion between them but the decision of the National Bank of Georgia shall be final for all purposes. The National Bank of Georgia may require any change in the classification of any asset and, in addition, may require additional provisioning of the reserve for possible losses if the facts and circumstances so warrant in the sole judgment of the National Bank of Georgia. Reasons for the changes may include:
 - a. Deterioration of the general condition of the Microfinance Organization 's loan portfolio;
 - b. A change in the Microfinance Organization's lending procedures or lack of adequate credit risk management policies;
 - c. The disability (insufficient action) of the Microfinance Organization's management to collect problem loans;
 - d. Other conditions revealed as a result of an examination by the National Bank of Georgia with respect to the financial condition of the debtor or of the bank itself, etc.
11. The Microfinance Organization shall keep a credit history on each borrower, make them accessible upon request to examiners of the National Bank of Georgia and include the following documents/information according to the type of loan:
 - Application on receipt of a loan;
 - Legal documentation about collateral;
 - A loan agreement, conclusion about the loan extension and resolution;
 - Information on loan monitoring, etc.;
12. The Microfinance organization shall keep detailed registry of restructured and refinanced loans.

Article 4. Assets Classification Categories

1. There shall be five categories of assets:
 - a) Standard – 0% reserve rate;
 - b) Watch – 10% reserve rate;
 - c) Substandard – 30% reserve rate;
 - d) Doubtful – 50% reserve rate;
 - e) Loss – 100% reserve rate.
2. Loan secured by mortgage shall be deemed steadily secured if the size of the mortgage (LTV) is 75% or less of the market value of the collateral.
3. Loan secured by gold and liquid shall be deemed steadily secured if the size of the mortgage (LTV) is 90% or less of the market value of the collateral.

4. Loan secured by other movable property shall be deemed steadily secured if the size of the mortgage (LTV) is 40% or less of the market value of the collateral.
5. Any type of interest, fine, penal or other similar request that is still on the microfinance Organization's balance sheet and is overdue for more than 30 days, shall be written-off the balance and moved to the relevant account of the balance-off accounting sheet.
6. If the loan is classified as "Inactive", charging of interest, penalty and fines shall be stopped on balance and continued on the relevant account of the balance-off accounting sheet.
7. A restructured loan, as usual, is classified as adverse except for the cases when the loan is fully secured with a liquid asset.
8. The Decision on improvement of classification on any requirement should be based on specific factors that should be fully documented and be made accessible to the auditors of the National Bank.
9. A loan classified as "adverse" may be reclassified as less adverse/standard only if the loan fully and unconditionally meets the requirements of the relevant category and in addition to this, last 6 consecutive payments have been executed. In case of existing seasonal incomes, reclassification into less adverse/standard category is permitted only after considering the information of one new cycle/season. In addition, as a result of the new cycle/season, financial obligations shall be actually covered and visible.
10. A Microfinance Organization shall ensure the identification of the standard loans, which have been reclassified from "adverse" to "standard" no more than 1 year.

Article 10. Classification of and Provisioning for Non-loan Assets and Creation and Use of Reserves for their Possible Losses

1. Repossessed immovable and movable property should be accounted for on the date of transfer to the Microfinance Organization's books at the lower of the amount of the recorded asset of the underlying loan or the market value if the market value is less than the value of the accounted asset.
2. The market value of immovable and movable asset that shall be determined by a recognized independent auditor with a relevant qualification, skills and experience. The National bank is authorized to require valuation/revaluation of the asset.
3. A Microfinance Organization shall be obligated to alienate immovable property owned for more than 3 years from the date of its acquisition, classify the repossessed immovable property as "doubtful" after entering the immovable property on the balance account and create reserve account, write the asset off its balance sheet after two years and be established and keep records on balance-off accounting sheet.
4. A Microfinance Organization shall classify immovable and movable property immediately after its appropriation as "substandard" and if the balance value is more than the market value of the appropriated property, difference shall be classified as "loss".
5. A Microfinance Organization shall alienate repossessed movable property after 180 days from the date of its acquisition. A Microfinance Organization shall classify repossessed movable property as

“doubtful” after 90 days from the date of its accounting on balance and create reserve account, and write the property off balance after 180 days.

6. A Microfinance Organization shall alienate shall be obligated to alienate its own immovable property that have not been used for main activities for more than 1 years from the date of its non-usage for the above purposes. In the contrary case, the Microfinance Organization shall classify the property as “doubtful”, establish appropriate reserves, classify the property as “loss” after two years, write the property off its balance sheet and keep accounting on off-balance account.

Days overdue	Steadily secured	Non-steadily secured	Blank
0-30	0%	0%	0%
30-60	10%	10%	30%
60-90	10%	30%	50%
90-120	30%	30%	50%
120-150	30%	50%	100%
150-180	50%	50%	100%
More than 180	100%	100%	100%