PN-ABU-465

Deloitte Touche Tohmatsu

Technical Assistance for Ceskosloveska Obchodni Banka

Workplan for the Strengthening of the Problem Loan Department

Delivery Order No. 31

Contract No. EUR-0014-I-00-1056-00
Eastern Europe Enterprise Restructuring and Privatization Project

USAID

U.S. Agency for International Development
EUR/ENI

February 1995

Deloitte Touche Tohmatsu International

Deloitte Touche Tohmatsu

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Telephone (202) 879-5600
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March 6, 1995

Mr. Lawrence Camp
AID/ENI/PER/EP
Room 3206, SA-15
Washington, DC 20523

**Re: Contract No. EUR-0014-I-00-1056-00, Delivery Order No. 31,
Technical Assistance to the CSOB,
Report on Function B: Problem Loan Department**

Dear Lawrence:

In accordance with Article IV of the above Delivery Order, we are providing you with four copies of the report on the Problem Loan Department fulfilling the deliverables for Function B of the workplan. For this task we carried out activities including a review of relevant legislation; help with the establishment of departmental and functional responsibilities and authority; and assistance with the development of an early warning system for identification of under performing credits.

Also included is the "Problem Loans Policies and Procedures Manual" addressing issues of how specific problem loans should be handled.

Additional assistance to CSOB in this area is being provided under an extension to the Delivery Order. Deliverables for work performed under this extension are described in the updated workplan.

If you have any questions regarding this report, please call Adrienne Brombaugh at (202) 879-5650.

Sincerely,

Lizann Prosser
Senior Manager

Deloitte Touche
Tohmatsu
International

OCT-07-1994 15:41 FROM AID-W--EUR-PEP TO P.02

OPTIONAL FORM 99

FAX TRANSMITTAL

Adrienne Brombaugh | Ken K...

DTT | 202-647-913...

| 202-647-...

Deloitte Touche Tohmatsu

ICA Group Ltd.
1001 Pennsylvania Avenue, NW
Suite 350N
Washington, DC 20004-2594 USA

October 5, 1994

Lawrence Camp
USAID - ENI/PER/EP
320 21st Street, N.W.
Washington, D.C. 20523

Re: **Contract No. EUR-0014-I-00-1056-00, Delivery Order No. 31, Ceskoslovenska Obchodni Banka (CSOB) - Draft Workplan**

Dear Lawrence:

As required by Article IV of the above-referenced delivery order, we are submitting for your approval the attached draft workplan for technical assistance to the problem loan department of CSOB. If this workplan is acceptable, please indicate your approval by signing below and returning a copy to us via fax for files. If you have any questions regarding this request, please call Adrienne Brombaugh at (202)879-5650.

Sincerely,

Lizann Prosser
Senior Manager
Central & Eastern Europe

Lawrence Camp/Concur

10/07/94
Date

(With addition of 'process manual as delineated in letter to Ray Farmer of same date.)

Deloitte Touche
Tohmatsu
International

BEST AVAILABLE DOCUMENT

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USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

October 5, 1994

Ran Farmer
Deloitte & Touche
Prague, Czech Republic

VIA FAX

Dear Ran,

I have reviewed the work plan for the 'Strengthening of the Problem Loan Department' function of the CSOB project. It is an excellent job and I appreciate the attention and thought which obviously went into it.

I agree in virtually all respects, but there is one task which I am not sure is proposed. Although I know that it is always dangerous to suggest 'formulaic' approaches, it was my intent in Task 3 that a sort of work book or process manual be developed that can be left behind to provide a general but practical guide to how problem loans should be handled: not the aggregate portfolio, but specific problem loans as they surface. This may be as simple as a two or three page flow chart or identification of steps.

Please call if you have any questions. Hope to come out the visit the project at the end of October or early November. Again, it was a great job.

Yours truly,

Lawrence Camp

cc: Prosser
Rogers, Frinta

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

TECHNICAL ASSISTANCE PROGRAMME

TO

CESKOSLOVENSKA OBCHODNI BANKA A.S.

WORKPLAN

FOR THE STRENGTHENING OF

THE PROBLEM LOAN DEPARTMENT

UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

CONTRACT NUMBER EUR-0014-I-00-1056-00.

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1 Introduction

This work is carried out under the USAID contract number EUR-0014-1-00-1056-00 in accordance with the TOR contained therein. The project covers the Problem Loans/Workout department.

Work commenced on this module on the 7th September 1994. The first task under the TOR is for the consultant to understand the Bank and the environment within which it operates and to prepare a project plan. As at the date of writing, many of the dates are estimates and it is believed that target dates and time frame may require adjustment once the full facts are to hand.

The role of the Bank's workout function is currently being defined and restructured. Consequently, the workplan is intended to be flexible so that effort may be directed to those areas which are identified by the Bank as being of the highest priority.

The requirements of the TOR have been adhered to closely in the construction of this plan. However, the sequential arrangement has been restructured so that this now follows the logical format of first assisting with the establishment of the workout function and the defining of functional responsibilities, together with the development of appropriate policies, procedures and the necessary early warning systems.

This module is essentially the planning stage, at the end of which, the range of deliverables required by USAID, will be provided in the format of a single comprehensive workout guide. This guide will include policy recommendations, suggested reporting formats, sample covenants, etc. Since the Bank is currently in the process of producing a Credit Policies and Procedures Manual, it is worthwhile considering the possibility of the guide forming the Bad Loan and Workout section of this manual.

Once the planning stage is complete and deliverables have been provided, then the emphasis will switch to an analysis of the structure of the problem and non-performing loan portfolio, with a view to ascertaining whether all under performing exposures have been identified. The intention is to gather information, in order that the Bank may, over a period, produce an action plan for each classified exposure, leading to an overall design for portfolio resolution. This then leads into involvement with a more hands on role, with a view to assisting with the strengthening of the department.

This role continues directly into the final stage of the project where the consultant will be involved in the day to day operation of the department, assisting, training and explaining as required.

Although each phase of the work is independent and can stand alone as a separate work module, it is intended that phases should overlap and inter-relate with the module which follows.

This is intended to maximise the use of available time, in order to avoid the difficulties and delays in obtaining information which to date have characterised this project.

A section in respect of additional factors, which require consideration but do not fall clearly within the ambit of this contract, are appended at the end of this workplan, as is a list of meetings which it is requested be arranged as soon as is possible.

2 Workplan Summary

PHASE ONE

ASSIST WITH AND PROVIDE ADVICE REGARDING THE ESTABLISHMENT OF THE PROBLEM LOAN AND WORKOUT DEPARTMENT IN HEAD OFFICE AND THE WORKOUT FUNCTION IN THE BRANCHES.

To undertake this work, the following activities must be carried out:

a) Establish the Bank's requirements.

b) Provide advice on an information request to and a reporting format from the branches for information capture.

   - Select branch to test questionnaire.

   - Test quality of response by direct investigation.

c) Review relevant legislation and the legislative environment.

d) Visit branches.

e) Help with the establishment of departmental and functional responsibilities and authority.

   - Define and agree departmental role.

   - Define and agree structure of the workout effort in Head Office and elsewhere as appropriate.

   - Define and agree staffing and operating requirements.

   - Prepare and agree job descriptions and functional reporting lines.

   - Consideration as to training requirements.

   - Discretionary authorities in the workout function.

f) Assist the bank with the development of policies and procedures, to include monitoring systems, loan review procedures, covenants, design of forms, etc.

   - Agree classification criteria.

   - Accruing/Non-accruing interest.

   - Authority for provisions and write-offs.

   - Review of existing analysis system.

- Consideration of the concept of value.
- Review of the decision making process.
- Recovery techniques.
- Debt/Equity swaps.

g) Assist with the development of an early warning system for identification of under performing credits.

DELIVERABLES:

i) Policy recommendation for the Problem Loan Department.

ii) Policy recommendation for the early detection of problem loans.

iii) Copies of recommended forms - Action Plans, Approval Memos, Status Reports, etc.

These will be provided in the format of a single comprehensive guide which will eventually form or can be adapted to form, a section of the Bank's Credit Manual. Where appropriate and time permits, guidelines and pointers will be provided.

PHASE TWO

ASSIST WITH THE DEVELOPMENT AND RUNNING OF THE WORKOUT FUNCTION IN THE BANK.

This function will assist with the following sectors:

a) Analysis of the information provided by the branches.

b) Identification of under performing credits.

- Decision as to where the exposure will be managed and the degree of discretion permitted.
- Review of classifications and provisions in conjunction with Credit Policy Department and the team that is working on developing the Bank's credit manuals.

c) Development of an action plan for portfolio management and an overall plan for portfolio resolution.

d) Hands on assistance in order to:

- Strengthen department.
- Restructure loans.
- Address third world bank credits with a view to ascertaining the Bank's requirements.

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PHASE THREE

WORKING AND TRAINING ON THE JOB.

a) Train by example/explanation. A hands on role, analysing and working out problem credits.

b) Seminars if necessary /appropriate.

c) Outside training if required.

ADDITIONAL CONSIDERATIONS

Where time and costs permit, effort will be allocated to:

. Input re' frauds.

. Considerations re' a Loan Review function.

. Conflict of Interest.

. Relationship with the State.

. Loss of "good" business by the Bank.

3 Phase One

ASSIST WITH AND PROVIDE ADVICE REGARDING THE ESTABLISHMENT OF THE PROBLEM LOAN AND WORKOUT DEPARTMENT IN HEAD OFFICE AND THE WORKOUT FUNCTION IN THE BRANCHES.

In the initial stage it is imperative to establish what the Bank requires from the workout process so that the necessary advice may be prepared. This phase is critical to the success of the project, since it is at this stage that all planning and preparation will be undertaken in order to establish the structure of the workout process.

A task of primary importance, which will take time to implement, is the capture of information in respect of the Bank's portfolio of loans and other exposures. A detailed questionnaire will be drawn up and circulated to all branches of the Bank, in order that the workout function may set up a database of all classified exposures. Prior to being to distributed to the branch network the questionnaire will be tested on a single branch and the responses checked by direct inspection. Enquiry will be made in order to ascertain whether information requirements can be derived from the books of the Bank, maintained on the IBIS computer system, or whether regular (monthly?) reporting will be required, in order that the database may be kept up to date.

Subsequently, all relevant legislation will be reviewed, including but not limited to, the Commercial Code, Civil Code, Banking Act, Bankruptcy Act and other relevant financial legislation, directives and decrees.

Meetings will be scheduled with the Bank's lawyers, together with outside counsel where appropriate, in order to discuss the legal and regulatory environment as regards the current position in the Czech Republic and Slovakia, and also to obtain input on any legislation currently before either Parliament or otherwise in the pipeline, which might impact on the financial environment in general and the banking system in particular.

Visits will be scheduled to several key branches for minimum periods of at least two days each, with a view to understanding both the credit approval process and the quality of staff in the credit process in the branches. Prague Branch is a key branch with which to meet, since it represents over 50% of the Bank's loan portfolio and a similar period should be spent with the branch in Bratislava given the different legal and regulatory environment in Slovakia. A period of at least one day should be spent with one or two other branches and it is suggested that these should be those branches identified by the Bank as having respectively, the best performing and worst performing loan portfolios.

The exact structure and role of the Bad Debt and Workout Department must also be defined. For example, is the department to be responsible for only those exposures classified "doubtful" or "loss", or is it also to accept control of those exposures

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which with intensive care may either recover or at the least be subject to an orderly liquidation. Consideration will also be given to whether this department should accept responsibility for only the distressed loan portfolio, or whether responsibility for either distressed investments or distressed banking relationships, should fall under the department's aegis. Decisions will be required as to the point at which a classified relationship is transferred to the workout department.

Agreement must be reached as to whether the department will be centralised wholly at Head Office or whether it will be possible to adopt a more decentralised approach with for instance a subordinate workout department responsible for Slovakia, situate either in Bratislava, or at the least as a sub-section within the Head Office department. Additionally, decisions will be required as to whether there will be a workout officer or workout department in each branch and if so the method of appointment of the staff member(s) and their direct and functional responsibilities and reporting lines. Once these decisions have been made, consideration can then be given to the structure and staffing requirements of the department.

Consideration will also be given as to the Bank's policy regarding use of legal counsel and whether the workout function should have its own lawyers in situ or if it should have the general use of the Bank's legal department or priority use of a few specific or specialised lawyers within that department. Alternatively, should outside counsel be used on either a general or case by case basis.

The workout department as structured at this moment consists of five staff members. The director, secretary and one new hire will remain but of the two others, one is being transferred to another department, whilst the other will soon commence a training course within the Bank. It is clear therefore, that there will need to be a substantial number of new hires or internal appointments, within the course of the next few months and in any event prior to year end. Close consideration must be given as to the educational qualifications and professional requirements sought from those, who will fill these critical and visible positions.

Job descriptions will be prepared and functional reporting lines thought through and established and the issue of training considered, both for those members situate in Head Office and if officers are to be situated in the branches, then for those throughout the network who may need this assistance. Additionally, decisions will be required as to whether the training should be of a specialised workout nature or a more general credit analysis course.

The matter of job descriptions and functional reporting, will be handled in close consultation and liaison with the project team headed by Mr Rejzek, which involves the human resources specialist seconded to the Bank from the UK based KnowHow Fund.

Approval authorities and discretionary limits for all those involved with problem loans, will require close consideration. Particularly, as to whether Branch Managers are to be permitted any discretion in respect of classified relationships or whether all decisions are to be taken from the centre? Will the director in charge of workouts be granted discretionary approval authorities and if so at what level within the Bank's hierarchy? The issue of authority for the granting of excesses over limits and approving restructuring and new facilities on classified accounts requires careful consideration. Input and advice will be provided.

Policies for managing the workout process will be required. Assistance will be provided with the development of policies and procedures, to include monitoring systems, loan and collateral review procedures, covenants, design of forms and any other areas in which the Bank identifies a requirement within the context of the Terms of Reference.

The Czech National Bank system of classification and provisioning requirements has been implemented. It is understood that a tougher classification system is presently under consideration by the Bank although as yet a final decision has not been taken.

Allied to the issue of classification is that of authority to make provisions and authorise the write-off of irrecoverable debts. In the same context is the issue as to when interest should stop accruing. Any interest which is accrued, must under Czech (and Slovak?) law, be taken to profit but may not be debited to suspense. This artificially inflates the Bank's profits with these "profits" being taxable. Consideration should be given to the freezing of interest in cases where facilities are classified doubtful or loss.

The Bank uses a computer analysis system known as HARMON. From information presently to hand it appears that the system is only of limited use in producing ratio and cash flow analysis. Some ratios produced by this system are wholly meaningless and the trend and common size reports are deficient. More importantly, HARMON is unable to produce any form of projection or "what if" analysis. There is a requirement to review further the HARMON system, understand its abilities and ascertain whether the system as it stands is sufficient for the type of analysis which will be required.

Specific considerations towards which particular attention will be targeted are:

- An understanding of the basis of valuation of the Bank's collateral. Does land valuation assume existing use, zoning requirements, change of use, blight, income production, comparable sales, replacement cost etc?

- The bases on which a company can be valued (going/gone concern basis) and discussion of breakup values.

- Consideration of the core lending decision making process. Can it be improved?

- When the bank decides to save a company, what methods and measures can be used? Should the bank use its own staff in the restructuring process or bring in outside experts and advisers as required?

- The validity and viability of debt to equity swaps in the current environment?

Assist with the establishment of controls and procedures to identify promptly problem loans, leading to the development of an early warning system for identification of under performing credits. Establish procedures and systems so that these can be dealt with in a timely manner.

4 Deliverables

The contract with USAID calls for the following deliverables:

i) Policy recommendation for the Problem Loan Department.

ii) Policy recommendation for the early detection of problem loans.

iii) Copies of recommended forms - Action Plans, Approval Memos, Status Reports, etc.

It is intended to provide these in the format of a single comprehensive guide which will eventually form a section of the Bank's Credit Manual.

Advice on the structure of credit/loan workout files, will be provided to the Bank at this stage.

5 Phase Two

The information requested by way of the questionnaire designed in conjunction with the Bank at the beginning of phase one, should by now be at least partially available. The input will be reviewed and entered onto a database in order to permit a detailed analysis of the Bank's problem loan and classified portfolio.

It is important that this exercise is performed diligently as the information from the branches will lay the foundation for decisions as to:

- Whether the exposure will be managed by:

  a) The ongoing business unit in the branch;

  b) The workout unit in the branch (if this is set up), or

  c) Head Office Workout Department.

- Where discretion for excesses will be allocated.

- Whether the current classifications have been awarded correctly or whether adjustment is required in the light of recent information and/or developments.

- If the Bank's provisioning policy should be adjusted in the light of information provided.

- If the loan grading system needs changing.

The detailed information now available should enable the Bank to identify under performing exposures and to develop an action plan for each classified or problem exposure with a view to establishing an overall plan for portfolio resolution.

With the earlier portions of this module underway it will be possible to commence a more hands on role in order to strengthen the department by way of direct involvement with restructuring loans and if required, addressing third world bank credits.

6 Phase Three

The final phase of this contract is a fully hands on role assisting in the day to day work of the department, helping with and advising on the analysing and working out of problem credits.

In the current environment it is probable that this form of on the job training will have a more beneficial effect, than any number of theoretical workout seminars. However, if the Bank deems seminars to be appropriate, assistance will be given in their preparation.

Advice will be provided as to the range of outside training available so that the Bank may follow up with this should it so wish.

At the end of this final phase, the Bank should have a fully operational workout department, possess appropriate policies and procedures, have made a good start on specific recoveries and be on the way to the development of a plan for overall portfolio resolution. However, it should be recognised that there is no substitute for experience, although the necessary building blocks will be in place.

7 Additional Considerations

The following issues require consideration, but do not fall clearly into any one of the planned phases. However, these need to be resolved, either as part of the current project or future projects.

1) Input with regard to some of the frauds currently extant.

2) In order for the bad debt and workout function to be fully effective, consideration must be given to a range of areas which should be considered in this context. Is a Loan Review Function being set up and if so where is it to be located. For the sake of clarity a Loan Review function is separate from and distinct from Audit, although there may be an overlap of responsibilities. In essence a Loan Review Function provides an independent evaluation of the loan portfolio and other extensions of credit and assists in maintaining future credit quality through an ongoing evaluation of the credit process, monitoring of corrective action and ensuring that all approvals are in conformity with the credit policy of the Bank. The main responsibility is to monitor the thoroughness and propriety of credit procedures together with the quality of credit decisions.

3) Consideration must be given to the independence of the views of Bank officers who sit on the Supervisory Boards of FTO's. There is a potential conflict of interest where such an officer is also responsible for both the financial and business analysis of the customer and recommends the transaction to the approval process.

4) The Bank clearly has a very close relationship with the State which should continue and be leveraged to maximum effect wherever possible. However, the Bank is not an instrument of social welfare and to be effective the workout function and the Board of the Bank must be prepared to take highly visible and on occasion unpopular actions, which may in the absence of State funds or other assistance, result in increasing levels of unemployment in the Czech Republic and Slovakia.

5) There appears to be a degree of concern that some "good" clients of the Bank are moving their banking relationships to other competitor banks of CSOB. How should the bank behave towards such clients? Some competitors are more flexible both in their information requirements and in the speed of their response, interest rates, fees, collateral requirements, etc.

8 Meetings Requested

In order to progress the project it would be helpful if the following meetings could be scheduled:

Within CSOB

Mr Kavanek	
Mr Stanura	
Credit Department	Mr Knapp
Branch Credit	Mrs Richterova
Interstate Agreements	Mr David
Credit Policy Department	Mr Navratil
Bad Debt Department	Mr Petersky
Mr Vojacek	
Mr Tauber	
Project Finance Department	Mr Snopek
Investments Department	Mrs Hadrova
Accounts Department	
IBIS	

Branches

Prague main branch

Bratislava

Jablonec

Branch with the "best" performing portfolio

Branch with the "worst" performing portfolio

External

Consolidation Bank	Workout Department
Bankers Association	
Banking Training Institute	

This is intended only as an initial list. As the project develops a broader scope of meetings will be required in order that the project may be implemented.

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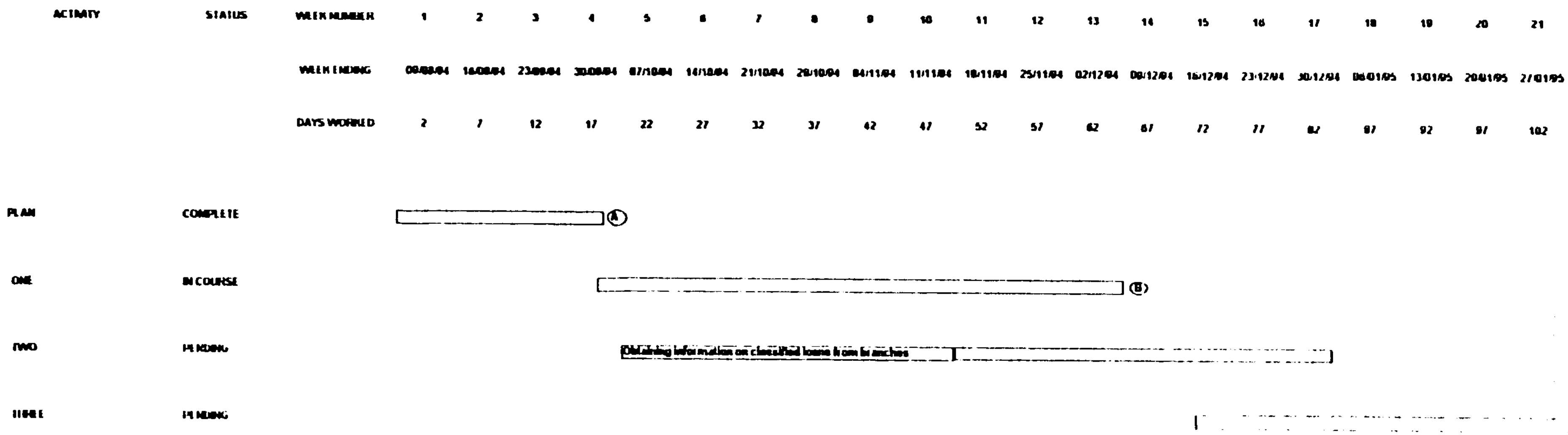
rkflow Bar Chart



(A) Handover of Workplan

(B) Handover of Deliverables

Draft

PROBLEM LOANS POLICIES AND PROCEDURES MANUAL

ČESKOSLOVENSKÁ OBCHODNÍ BANKA, A.S.

January 1995

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NOTICE

It must be recognised that members of Problem Loans and Bad Debts Department work under difficult circumstances, which could on occasion render them open to pressures and hazards which are not normally encountered within a banking environment.

The Bank recognises this problem and will use all reasonable means at its disposal to provide support and protection to those involved.

EXECUTIVE SUMMARY

PURPOSE OF THE MANUAL

This Problem Loan Policies and Procedures Manual ("the Manual") is provided by Deloitte & Touche to Ceskoslovenska Obchodni Banka A.S. ("the Bank") under the terms of Deloitte & Touche's engagement by the United States Agency for International Development under its contract number EUR-0014-1-00-1056-00.

The Manual, which is provided in draft form is intended to provide the Bank with suggested guidelines for establishing formal workout policies and procedures. Recommendations are provided with regard to the setting up and implementation of the Problem Loans and Bad Debts Department, together with guidance as to a range of workout methodologies which could be of assistance to the Bank in restructuring and recovering problem loans.

Provision of the Manual in draft form is necessary, since finalisation of the Manual and determination of Approval Authorities and workout policies and procedures is the prerogative and responsibility of the Board of Directors of the Bank.

The economic and legal environment in the Czech and Slovak Republics is in a state of change and development and the Manual will need to be reviewed and, if appropriate, modified on a regular basis. The Manual does not purport to provide legal advice.

Policies and procedures contained within the Manual, are in accordance with "best practice" and attempt to apply standard international banking practices. It has been necessary to modify these in certain respects to take account of the constraints imposed by the Czech and Slovak legal framework, particularly in relation to difficulties in the bankruptcy process and the taking and enforcing of collateral.

It is important to recognise that, whilst adherence to the policies and procedures set out in the Manual may help the Bank to formalise its workout policies, it will not ensure that the Bank makes full recovery on doubtful loans or prevent against loss.

INTRODUCTION

This section provides an introduction as to the background and purpose of the Manual.

DEPARTMENTAL STRUCTURE, RESPONSIBILITIES AND COMMUNICATION

This section recommends a structure for the Problem Loans and Bad Debts Department in Head Office and the appointment of Problem Loan Officers at branch level. It also provides a view of the responsibilities and powers of the department, emphasises the need for clear and continuous communication between the department and branch network and suggests that branches be set individual, clear and achievable targets for debt recovery.

PERSONAL RESPONSIBILITY

This section emphasises the requirement, that members of the problem loans function, are personally responsible and liable for their actions and decisions.

LOAN CLASSIFICATIONS AND CLASSIFICATION PROCEDURES

This section establishes classification procedures and requirements, which are more stringent than those proposed by the Czech National Bank and are based on international standards. The procedure requires that all classifications are reported to senior management, both at the time of classification and on an on-going basis.

AGGREGATE EXPOSURE AND CONNECTED AND ASSOCIATED ACCOUNTS

This section defines the basis of aggregate exposure and introduces and explains the concept of connected and associated accounts.

EARLY WARNING SIGNALS AND INDICATORS

This section introduces the concept of monitoring early warning signals and indicators on an ongoing basis, and provides details of a wide range of possible considerations in order to obtain advance warning of possible problems, so that remedial action may be taken.

Users are cautioned against an over-reliance on indicators and are advised that the most critical factor is to "Know Your Client".

REPORTING AND ACCOUNT RESPONSIBILITY

This section formalises internal classified account reporting requirements, provides details of the various reports, explains their content and the methodology for completion.

Recommendation is provided as to the basis on which limits and excesses for classified accounts are approved and suggestion provided as to the basis of accounting for "past due" amounts.

PROBLEM LOAN WORKOUT ADVICE, METHODOLOGY AND RECOMMENDATIONS

This section includes a range of methodologies available for use in analysing the credit, understanding the problem and available options, and negotiating a final settlement or initiating litigation, liquidation or bankruptcy proceedings.

Emphasis is placed on the aspect that each borrower's situation is unique and that there is no standard solution.

Recommendation is provided on a range of subjects of which the taking of secure and realisable collateral is probably the most critical.

TREATMENT OF INTEREST AND PAYMENTS RECEIVED ON PAST DUE ACCOUNTS

This section provides advice as to "best practice" and the rationale thereof. It is recognised that progress is unlikely until such time as Czech and Slovak law is changed in respect of this matter.

AUTHORITY FOR LITIGATION

This section sets out the responsibilities and authorities for litigation.

RECORD KEEPING

This section contains recommendations as to the basis on which records should be maintained for the purposes of information retention, communication and the giving of instructions.

CLAIM RECORD AND FINAL WRITE-OFF

This section places specific emphasis on the need to maintain clear records in order to establish an undoubted basis of claim.

Advice as to the basis on which write-offs should be authorised is included.

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A. PROBLEM LOANS AND BAD DEBTS DEPARTMENTAL STRUCTURE

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Instructions for Completion

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G. ACTION PLAN

H. OFFERING TICKET

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The Sales Comparison Approach

The Income Approach

1. INTRODUCTION

This Manual is provided to CSOB under the contract granted by the United States Agency for International Development, to assist the Bank in the setting up and implementation of the Problem Loans and Bad Debts Department and the policies and procedures relating thereto.

It is intended that this Manual should either form, or be adapted to form, a section of the Bank's Credit Policies and Procedures Manual.

The procedures described in this Manual are designed to assist and provide protection to the Bank in circumstances where there has been a deterioration in credit quality. It is not required that this deterioration should of itself threaten the possibility of loss to the Bank, it is enough that a deterioration has occurred, which is sufficient to imply that the exposure is any grade other than "Standard". Accordingly, this Manual is intended to cover the process to be followed for all exposures classified "Watch" or lower.

When an exposure is downgraded from "Standard" to "Watch" or lower, then the whole group relationship (the exposure itself and all connected and related accounts), must be managed in accordance with the terms of this Manual.

All members of Problem Loans Department and all Problem Loans Officers, whether in the Head Office or the branch network shall receive a copy of this Manual and should familiarise themselves with its directives. All credit staff must be aware of the contents of this Manual, especially the "monitoring" aspects, specifically when they are involved in the continuing management of problem loans. In circumstances where the procedures and policies detailed in this Manual do not cover specific situations, clarification, guidance and authority should be sought from the Manager Problem Loans Department.

This Manual has been approved by the Board of Directors of the Bank. Any material changes or amendments shall also be approved by the Board of Directors, although the Board shall take into consideration the views and recommendations of the General Director Banking, the Head of Credit, the Manager Problem Loans and the Credit Policy Committee. Matters which are solely procedural in nature may be changed or amended with the approval of the Head of Credit Policy Department. Any changes so approved, must be reviewed and approved post-fact, on a quarterly basis by the Board of Directors. Approved amendments shall be distributed by the Operations Department.

THE CONTENTS OF THIS MANUAL ARE STRICTLY CONFIDENTIAL AND SHOULD NOT BE DISCLOSED OR DISCUSSED WITH PERSONS OUTSIDE THE BANK.

2. DEPARTMENTAL STRUCTURE, RESPONSIBILITIES AND COMMUNICATION

2.1 HEAD OFFICE DEPARTMENTAL STRUCTURE

Problem Loans and Bad Debts Department shall be situate in the Bank's Head Office. The department shall be managed by the Problem Loans and Bad Debts Department Manager who reports to the Head of Credit.

In any circumstance concerning problem loans, all departments of the Bank shall as a matter of priority, co-operate and act under the instruction of the Manager of Problem Loans Department. In case of dispute, the matter shall be referred to the Head of Credit.

The Manager shall have direct responsibility for a team of Senior Problem Loans Officers (currently three are proposed). Two of these Senior Officers shall be responsible for exposures in the Czech Republic whilst the third shall be responsible for all Slovak exposures. Each Senior Officer shall be allocated responsibility for one or more Main Branches.

Departmental structure shall be as set out in Appendix A.

All Officers shall be physically located in Prague, although the Senior Officer with responsibility for the Slovak Republic, will in the initial stages, be expected to spend between two and three days a week in the Slovak Republic. Support will be provided to the Senior Officer by a Problem Loans Officer based in the Bratislava Head Office. If possible both Officers should be Slovak nationals.

Once the Senior Officer has gained sufficient expertise, it is conceivable that a Slovakian sub-unit of the department may be set up in the Bratislava Head Office. This is unlikely to occur in less than one year.

Each Senior Officer shall be responsible for a team of up to two Junior Problem Loans Officers who will work with the Senior Officers preparing reports and analysis, and accepting responsibility for managing the less complex cases.

2.2 PROBLEM LOANS AT BRANCH LEVEL

Each Main Branch shall have a Branch Problem Loan Officer appointed, who, although sitting in the branch credit department and having a strong working relationship with the Branch Credit Manager, shall report only to the Senior Problem Loan Officer in Head Office Problem Loans Department, who is responsible for that branch.

Although responsibility for larger and more important problem loans shall be allocated to Head Office, the volume of these loans is such that a proportion shall continue to be handled at branch level. In these instances the branch which made the loan shall remain an integral part of the recovery process but shall operate under the instruction of Head Office.

2.3 APPOINTMENT OF STAFF

The Problem Loans Department Manager has responsibility for the appointment of all Head Office located department staff. Wherever possible, efforts will be made to hire from within the Bank but it is recognised that new outside appointments are likely to be necessary.

In the case of department staff located in the branches, the Branch Problem Loan Officer shall be appointed from among the existing staff of the respective branches' credit department. If possible, the appointment shall be made by agreement between the Branch Manager and the Problem Loans Department Manager. The Branch Manager shall have the right of veto over the first choice of the Problem Loans Department Manager. However, if agreement is not possible within one month of commencing discussions, then the Problem Loans Department Manager has, in respect of any subsequent choice, the authority of sole appointment. The branch shall not have the right to replace the individual so appointed without the prior written consent of the Bank's Head of Credit.

It should be noted, that given there will be a need for close communication with international agencies, consultancies and investors, senior staff whether head office or branch located, will require to be fluent in one or more major foreign languages, such as English or German.

2.4 RESPONSIBILITIES AND POWERS

Primary responsibility of the department is to manage the Bank's problem loan and bad debt portfolio. The definition of a problem loan is a client designated "Doubtful" or "Loss".

Additionally, Problem Loans Department shall receive detailed reports on all "Watch" and "Substandard" exposures. The Manager of the department has the power to downgrade any exposure or relationship and to take or require action to be taken on any of these cases. He shall liaise with the Head of Credit in order to reach agreement as to whether the "Watch" or "Substandard" exposures shall continue to be managed by the branch or whether the department shall take over responsibility for the relationship.

A problem loan is classified by way of completion of a Problem Loan Report if it is thirty days past due (see 7.4). However, the department shall also receive reports in respect of any amount or instalment which has been outstanding for five working days and shall, after consultation with the Head of Credit, have the power and authority to take action or require action to be taken.

It shall be the department's responsibility to prepare and implement detailed action plans for each loan or relationship of Kc5mm or greater with a view to:

- Improving the strength of the borrower and hence the quality of the loan; and
- Achieving loan performance and recovery.

These tasks will require active participation in the borrower's restructuring and should include:

- Close liaison with branch management and staff;
- Close liaison with the borrower;
- Close liaison with government entities and departments at all levels which are involved with aspects of the State industries privatisation process;
- Introduction of investors from both inside the Czech and Slovak Republics and fr^m abroad; and
- A knowledge of the various consulting firms and aid projects which are in a position to channel funds towards the regeneration of industry in the Czech and Slovak Republics.

All credit proposals recommended for approval or review by the Branch Problem Loans Officer, shall be copied to Credit Audit for review, classification and comment. The presentation together with Credit Audit's comments shall be provided to Problem Loans Department within five working days of receipt.

In addition to handling designated loans, Problem Loans Department shall in conjunction with Branch Credit Department and Credit Audit, maintain up tc date information and analysis with regard to the composition of the Bank's bad debt portfolio. The intention is to assist executive management in negotiations with the Government of the Czech and Slovak Republics towards achieving a resolution of bad debts and exposures, outstanding to State Industry.

See 7.6 with regard to responsibilities when drawing up action plans to work out bad debts and problem loans.

Job statements for all members of the department's staff, outlining their key roles and responsibilities, are attached at Appendix B.

Authorities to approve or write-off problem loans are attached at Appendix C.

The Manager of Problem Loans Department shall at his sole discretion, have the power and authority to appoint and negotiate the remuneration of outside legal counsel and tax advisers.

2.5 COMMUNICATION

Problem Loans Department, in addition to liaison and discussion in respect of specific loans, must communicate with the network on a general basis.

Communication should include:

- Explanation of successful recovery techniques which have been used not only within the Czech and Slovak Republics but elsewhere;

- Regular circulation of names of bad or doubtful debtors (both individual and corporate). This should be arranged in co-operation with Audit Department who are developing a fraud register; and

- Details of the various forms of fraud prevalent in the Czech and Slovak Republics or elsewhere. eg: Prime bank guarantees, etc.

In the context of the leadership role to be undertaken by Problem Loans Department, consideration should be given to the establishment of a forum whereby the senior work-out officials from the main banks in the Czech and Slovak Republics can meet together on a regular basis to exchange views and information, as well as more specifically, the names of bad borrowers and any new frauds or dubious practices, extant within the republics.

Given that the Chairman of the Bank is a member of the Bankers Association, it is possible, despite the fact members will on occasion have conflicting aims, that the Association could provide a useful basis for this proposed forum.

2.6 TARGETS AND INCENTIVES

Each branch should be set a specific and realistic target for recoveries, having due cognisance as to the structure of that branch's portfolio. Cash incentives should be provided for exceeding target.

3. PERSONAL RESPONSIBILITY

The purpose of this section of the Manual is to emphasise the importance of the doctrine of personal responsibility.

Personal responsibility, in the context of the Problem Loans and Bad Debts Department, means that members of the department are personally responsible, within the bounds of the authority delegated to them, for any action, advice, recommendation or decision that they take. Decisions, which with the benefit of hindsight, are seen to be wrong on a consistent basis, will have a material and adverse effect on career progression within the Bank. Conversely, clarity of mind, (together with a degree of luck), present opportunities for both career progression and financial reward. Decisions are taken by people and as such accountability, is an integral part of responsibility.

In order to be effective:

- Get to grips with the transaction, gain adequate knowledge and understand the borrower;
- Develop an ability to gauge risk;
- Exercise common sense, good judgement and be astute;
- Act responsibly in evaluating risks, negotiating terms, conditions, competitive position, and in follow-up;
- Grasp thoroughly the qualitative and quantitative details of each transaction, analyse future variables, and make adequate allowance for their impact;
- Exercise independent judgement on each transaction and do not be influenced unduly by the decisions of associates;
- Anticipate rather than react;
- Be perceptive, forward looking and well informed;
- Be sound and creative; and
- Maintain an ongoing review of credit exposures.

When in doubt ask questions.

4. LOAN CLASSIFICATIONS AND CLASSIFICATION PROCEDURES

4.1 INTRODUCTION

The Bank presently uses a loan grading system integrating the requirements of the Czech National Bank. A further more complex system is under development which it is anticipated will be implemented in early 1995. Both these systems are based primarily on historic data and miss the subjectivity required that is needed in order to pre-empt future deterioration.

Given the current level of credit analysis skills in the Bank, a mechanistic approach is probably right at the present time. However, the Bank should strive to move to a new and more subjective system within the next two years. The following classification system is based on American Bankers Association guidelines.

The system and procedures are recommended strongly.

4.2 CLASSIFICATION PROCEDURES

Client Relationship Managers and Credit Officers should assign classifications to the loans and other facilities which they recommend for approval or review, or on the occurrence of any event which downgrades the quality of the exposure to any grade lower than "Standard". Due cognisance shall be given to the comments of credit analysts. This will assist those involved in the approval process in their assessment both of the facility and also of the Client Relationship Manager's and Credit Officer's judgement as regards assigning both rating and pricing.

Although it is required that a full report be filed at the point at which an amount payable in respect of an exposure of Kc5mm or greater, is thirty days past due, this does not absolve the branch or department responsible for the relationship, from following up on a daily basis within forty-eight hours of non-receipt of funds.

Clients shall be classified on an aggregate basis (as defined in 5.1) rather than on the basis of individual loans or portions of loans. Consequently, if a client has a facility which is classified "Substandard" and also possesses other facilities which are operating satisfactorily then all outstandings should be classified "Substandard" until the problem has been rectified.

When amount, whether of principal or interest, which relates to an exposure of Kc5mm or greater is five working days past due, the Client Relationship Manager and Credit Officer responsible for the client relationship, shall provide a short notification to Problem Loans Department, by completing Part A of an Initial Report (see Appendix D), advising of the existence of the problem and confirming that the Problem Loan Report will be filed at thirty days past due. The manager of the Problem Loans Department, may at his discretion, subject only to the prior consent of the Head of Credit, then take or require immediate action to be taken, if he believes this to be justified and in the interest of the Bank.

Should the past due amount be received prior to the date for the filing of the Problem Loan Report, the Client Relationship Manager and Credit Officer responsible for the client relationship, shall complete Part B, on a copy of the Initial Report, advising Problem Loans Department of the successful conclusion of the matter.

In case of doubt, any defalcation should be reported in a timely manner, so that a decision may be made as to classification. In case of non-reporting of a matter, which later proves to have been material in the light of the development of the relationship, then the Client Relationship Manager together with the Credit Officer allocated responsibility for the relationship, shall be held personally responsible for action or lack of action, in accordance with criteria established at section 3.

4.3 CLASSIFICATIONS

Exposures whether on or off-balance sheet, must be classified on an ongoing basis by Credit Officers, Problem Loans Department and Credit Audit in accordance with Czech National Bank directives and guidelines and the following definitions:

STANDARD

These are credits which are performing in accordance with contractual conditions as laid down in the loan agreement between the Bank and the borrower. There is no reason to believe that the borrower's financial position or collateral adequacy has been prejudiced in any way, neither has there been any problem with or delay in debt service.

The Bank is likely, subject to any internal or legal restrictions, to look favourably upon any request from the client for further or additional facilities.

WATCH

This category is used as an early warning for deteriorating credits which could result potentially in more serious problems. It includes outstandings or portions of outstandings which are superior in quality to those classified "Substandard" but, which warrant more than usual management attention.

Assets which fall into this category should include those where an adverse trend in the borrower's operation or financial condition is apparent, or where there is reason to suspect that the collateral or its value is impaired in any way. Any asset with which a Credit Officer is uncomfortable should be classified "Watch". Note that "uncomfortable" can be very subjective. If in doubt, classify.

Any delay in the payment of principal or interest for a period of thirty days would result in a relationship being classified at least "Watch".

SUBSTANDARD

This category includes credit exposures or portions thereof not classified "Doubtful" or "Loss", but which involve more than normal risk due to the poor financial condition or unfavourable record of the borrower, lack of sufficient security, or other factors noted by the Credit Officer. These outstandings should receive special corrective attention such as obtaining additional security, more complete financial information, reduction in outstandings, or other action as required by the specific circumstances.

Assets which fall into this category are characterised by the possibility that the Bank will sustain some loss if deficiencies are not rectified.

Any delay in the payment of principal or interest for a period of sixty days would result in a relationship being classified at least "Substandard".

DOUBTFUL

This category includes those accounts which exhibit all the characteristics of a "Substandard" credit but with the additional characteristic that there is a high possibility of loss. Such loss need not yet be definitely ascertainable.

This classification is used for assets where there are important and specific opportunities open to the Bank and the borrower which could avoid loss. Examples include capital injection, merger or acquisition, additional collateral, etc'.

Any delay in the payment of principal or interest for a period of ninety days would result in a relationship being classified at least "Doubtful".

LOSS

Outstandings or portions thereof which are considered uncollectible or worthless. This classification would usually be applicable when the borrower has been or is about to be, taken to court for recovery of a debt.

This should not mean that the asset does not have some residual recovery value but rather there is no rationale for spending more management time on the asset and that all outstandings should be written-off even though it is possible that some recovery may be made in the future.

Any delay in the payment of principal or interest for a period of one hundred and twenty days, would result in a relationship being classified "Loss".

4.4 CLASSIFICATION REPORTS

Classification reports and responsibilities for their completion shall be as set out in section 7 of this Manual.

NOTE:

The Bank should ultimately work towards adoption of classification criteria by which "Watch" becomes solely a warning indicator and all non-earning exposures are classified at least "Substandard" at thirty days. This would then result in classifications of "Doubtful" at sixty days and "Loss" at ninety days.

5. AGGREGATE EXPOSURE AND CONNECTED AND ASSOCIATED ACCOUNTS

5.1 AGGREGATE EXPOSURE

Aggregate exposure is defined as the sum in Kc equivalent, of all loans, overdrafts and other on-balance sheet exposure (Crowns plus Foreign Currency) together with all off-balance sheet exposure (Guarantee's, Letters of Credit, etc') granted to ıy single borrower or group of borrowers. In order to calculate the level of aggregate exposure, all loans and other facilities to the borrower, its shareholders, partners, owners, subsidiaries and affiliates must be added together.

For the avoidance of doubt, exposure is the full face value of all on or off-balance sheet items, irrespective of any Czech National Bank risk weighting directives.

Exposure must be aggregated in circumstances where:

- Any affiliate or related party is owned 50% or more by a borrower;
- Shareholders, partners, owners, subsidiaries or affiliates own a direct or indirect interest in the borrower of 50% or more;
- Any shareholders, partners, owners, subsidiaries or affiliates guarantee the debt of the borrower;
- The borrower guarantees the debt of shareholders, partners, owners, subsidiaries or affiliates;
- The borrowers are related, regardless of ownership through "significant" inter-connected business relationships; or
- Any shareholders, partners, owners, subsidiaries or affiliates take a significant management role in any entity which borrows from the Bank.

The Branch Workout Officer is responsible for ensuring that all classified clients have been allocated an individual client number on the IBIS system ("IBIS No") which has been entered into the computer. In order to monitor and control group aggregate exposures (as above defined), customers shall where warranted, be allocated a group number on the IBIS system ("Group IBIS No") so that their accounts are automatically grouped on the computer. It is the responsibility of the Branch Workout Officer to ensure that exposures are grouped correctly on IBIS, in accordance with the above rules.

5.2 CONNECTED AND ASSOCIATED ACCOUNTS

In the context of assessing the Bank's aggregate exposure it is appropriate to consider connected and associated accounts which may not necessarily be revealed as a result of applying the formulae at 5.1 above. It is required to consider these aspects in order to practice effective risk management.

Only those criteria which do not duplicate those at 5.1 above have been included in this section:

5.2.1 CONNECTED ACCOUNTS

The Bank should be aware of any connected accounts:

- A connected account may be defined as any account which is under the effective control of the first account holder. Effective control is deemed to occur when there is a significant shareholder or controller in a company or entity.

- Significant in this context depends on the level of shareholding required in order to control the company. It will be necessary to review the register of shareholders so as to ascertain both direct and indirect holdings and any shares that are being held by nominees, or any parties acting in concert with the relevant shareholder.

Members of the same family whether linked by blood or marriage should also be noted, since it is possible for people to arrange their affairs in such a way that it is otherwise not possible for the Bank to be fully informed.

5.2.2 ASSOCIATED ACCOUNTS

The Bank should also be aware of any associated accounts.

An associated account may be defined as any account which is associated in any way with the first account holder without being under that account holder's control.

An account may be deemed to be associated where:

- A company has a shareholding of less than 50% in another company or entity;

- A significant shareholder has a major investment in another entity. (Major in this context is a subjective measure and should be considered on a case by case basis. Remember the doctrine of Personal Responsibility and if in doubt, ask); or

- Board Members of an entity have significant outside interests without having effective control.

5.3 CLASSIFICATION CRITERIA FOR CONNECTED AND ASSOCIATED ACCOUNTS

Judgement and common sense must be used in classifying accounts. At one extreme it would clearly be wrong to classify the accounts of all members of a family solely because one member was a bankrupt. However, the Bank should be on notice that it is possible for family members to receive or wash funds for the bankrupt and as such a higher degree of vigilance is necessary.

At the other extreme it is clear that if a Holding Company is classified, then the accounts of all subsidiaries should be classified similarly as set out in the loan grading section of the Credit Manual.

6. EARLY WARNING SIGNALS AND INDICATORS

6.1 INTRODUCTION

This section deals primarily with early warning signals and indicators. However, it is appropriate to commence with a summary of the duties of the Client Relationship Manager and Credit Officers, which are relevant to bad and doubtful debts.

It is a truism that all facilities are considered "good" at the time they are first placed on the books of the Bank. A Client Relationship Manager is responsible for the relationship and since he is the representative of the Bank who is closest to the borrower it is his duty to "KNOW HIS CLIENT". In order to fulfil this duty the Client Relationship Manager shall maintain close contact with his clients and shall be expected to visit the client's business and office premises at least once per quarter to understand fully the client's business and evaluate the ability to service and repay the debt. In respect of the private sector, the Client Relationship Manager should if possible, try to get to know his client socially, to gain an insight into the client's lifestyle and an impression as to how much is being taken out of the business.

6.2 WARNING INDICATORS

It is the responsibility of the Client Relationship Manager and all Credit Officers to be alert for potential problems which could impact on the client's ability to service the debt and repay the Bank in a timely manner.

Client Relationship Managers and Credit Officers should monitor their clients on an ongoing basis in order to anticipate problems before they occur and if possible to take remedial action or even close out the relationship so as to avoid loss to the Bank. Potential difficulties may be specific to the client, specific to the industry, or economic or political in nature.

It is the duty of all Client Relationship Managers and Credit Officers to ascertain in a timely manner, all negative trends and problems in the relationships for which they are responsible, which with the lapse of time could cause the relationship to be classified. The financial condition of such clients may not justify their immediate classification but their potential weakness requires early identification.

Each Branch Manager shall report, on a quarterly basis to Problem Loans Department and Credit Audit, the status of such borrowers where weakness is apparent, together with details of any action taken to reduce risk to the Bank. Credit Audit will report to the Board of Directors specifically on the sufficiency of action taken to protect the Bank. Until such time as Credit Audit is established and operational this function shall be the responsibility of Problem Loans Department.

The purpose of identifying weak borrowers is to provide an early warning system of potential weaknesses so that action may be taken to protect the interests of the Bank.

The most obvious signs of difficulty are:

- Non-availability of funds in advance of payment falling due; and
- Non-payment of principal or interest.

However, by the time of non-payment, the problem is likely to be well advanced. - The skill lies in detecting potential problems and difficulties, before matters deteriorate to the extent of non-payment.

It is not possible to provide a definitive list of all eventualities but the following generic points, should be considered warning signs:

- Reported profitability not commensurate with industry norm;
- Lifestyle not commensurate with reported business profitability;
- Difficulty in answering questions re business projections such as sales, margins, profitability etc';
- Difficulty or inability in providing financial reports or future projections, or evasiveness in replying to questions about business performance;
- Sudden or unexplained changes in the structure of the borrower's balance sheet (e.g. a jump in inventory - is it stale? or a jump in creditors or debtors - are they being delayed or are they uncollectible?);
- Sudden or unexplained changes in the trading account(e.g. a major change in purchases, sales, administrative expenses, interest charge etc');
- Sudden or unexplained changes in ownership, management, auditors, key employees or relationships;
- Sudden or inexplicable changes in ratios resulting from analysis of the balance sheet; and
- Adverse market intelligence.

When it is discovered that a client is suffering from one or a selection of adverse factors, immediate consideration shall be given to classification of the relationship as per section 4. Bear in mind the early warning indicators described below and at the least be prepared to award a "Watch" classification as per 4.3

6.3 EARLY WARNING SIGNALS

THE BEST DEFENCE THAT THE BANK CAN HAVE AGAINST DEFALCATION IS A HIGH QUALITY CREDIT FUNCTION AND CONSISTENT MONITORING AND FOLLOW UP.

6.3.1 CARE IN THE USE OF INDICATORS

Early warning indicators, must be used with the greatest caution and even further care must be taken in their interpretation. Remember that the purpose of using these indicators is to provide the Bank with a timely warning of a possible deterioration in credit quality. However, the use of indicators should not be intended as an end in itself and results should be used intelligently. Consideration must be given as to what has caused the indicator to be activated and the true meaning of the result.

Examples of indicators with dual meanings are:

- Declining liquidity; this could mean either:

    - More effective use of working capital, i.e. cash balances reduce due to investment in production capacity whilst inventory is run down, due to just in time delivery methods. Receivables decline as debtors pay more rapidly in order to take advantage of discounts for early payment and payables increase as creditors are stretched; or

    - Inefficiencies in the business lead to cumulative losses and decline in cash. Inventory is run down since the business can no longer afford to buy or hold stock. Receivables decline in line with lower production capacity and payables increase as creditors are stretched due to the business's inability to pay.

- Increased profitability; this could mean either:

    - A strong business with a good product, genuinely gaining market share and being successful; or

    - A change in accounting practice from LIFO to FIFO and inventory valuation basis from market value to cost. Depreciation and/or amortisation periods being extended.

The purpose of these examples is to emphasise, that indicators should not be seen as an end in themselves. The most critical factor is to "Know your Client and your Client's Business", keep in close touch, monitor the relationship on an ongoing and consistent basis, understand the political, economic and industrial environment and how changes in these factors impact on the general business environment and the client's business.

Having provided a warning against over-reliance on early warning systems, the following indicators should be considered as a matter of course. These are detailed under the following headings:

- Management/Operational Factors
- Income Statement/Profitability
- Balance Sheet/Leverage and Financial Factors
- External Factors

6.3.2 MANAGEMENT/OPERATIONAL FACTORS

- Change of key executive, director or auditor.
- Illness or death of key personnel.
- Change of ownership.
- Lack of clear senior management succession.
- Labour problems.
- Litigation against the client.
- Negative publicity.
- Evasive answers to direct questions concerning recent or projected performance.
- Any major acquisition.
- Unavailability of internal information, or poor records of the same.
- Change in the nature of the borrower's business or objectives.
- Imaginative accounting or changes in accounting methods or accountants.
- Expressions of dissatisfaction with treatment by another bank or with present auditors.
- Refusal of permission to talk with the company's auditors.
- Crganisational transitions, for example, moving from an entrepreneurial management style to a more formal decentralised environment.
- Late submission of financial statements.

- Poor financial controls.
- Arrogance in place of borrower co-operation.
- High-style personal and corporate living habits by the principals of young enterprises.
- Failure to perform personal obligations.
- Recurrence of problems advised previously as having been solved.
- Loans to officers, shareholders or affiliates or any increase in the same.
- Qualified audit or adverse accountants opinion.
- Refusal or inability to provide audited financial statements.
- Inability to provide projections or projections provided which are clearly unrealistic.
- Major differences between projections and result achieved.
- Loss of one or more key or major clients, suppliers, product lines or franchises.
- Excessively large contracts which either can not be achieved on existing production capacity or would strain existing capacity excessively.
- Poor maintenance of plant, machinery and equipment and failure to build up a reserve to replace the same.
- Insufficient expenditure on R and D.
- Difficulty in arranging meetings with management or visits to plants and other production capacity and/or outlets.
- Delay in reacting to declining markets.

6.3.3 INCOME STATEMENT/PROFITABILITY

- Losses; particularly if these occur at the operating level.
- Diminishing margins of profitability regardless of how they are computed.
- Decline in net income or unseemly growth in profits that may result from such changes as the purchase of another company or the opening of new sales outlets.
- Over-concentration of sales.
- Decline in sales or a too rapid rise in sales.

- Increasing sales and expenses coupled with a decline in margins.
- Decline in profitability ratios.
- Increase in the bad debt ratio.
- Disproportionate increase in overheads/sales.
- Disproportionate increase in total assets/sales.
- Disproportionate increase in total assets/profits.
- Adverse changes and trends in relation to key industry statistics - for example, sales per square foot of retail store space.
- Deviation from normal seasonal borrowing pattern.
- Changes in the market value of equity in relation to book equity.

6.3.4 BALANCE SHEET/LEVERAGE AND FINANCIAL FACTORS

- Decrease in cash or near cash.
- Hardcore borrowings or overdraft used as a permanent or evergreen facility.
- Major sale of assets.
- Sharp changes in inventory
- Overstocked, damaged or stale inventory
- Decline in inventory turnover.
- Sharp build up in receivables.
- Build-up in the ratio of receivables to sales. (Slowdown in receivables collection period).
- Extended average age of receivables.
- Disproportionate exposure to past due receivables.
- Extended terms granted.
- Excessive amounts due from subsidiaries and affiliates.
- Unfunded cash requirements, including large current or near-term debt maturities.

- High leverage, not only financial, but operational (for example, high fixed costs).
- Stretching payables.
- Decline in net working capital.
- Delays in seasonal clean-ups.
- Concentration of long term assets other than fixed assets.
- High level of intangible assets.
- Disproportionate increase in current debt or decline in liquidity.
- Substantial and unexplained increase in long-term debt.
- Increase in leverage.
- Increase in gearing.
- Significant changes in balance sheet structure.
- Inability to finance outside the banking market.
- For non-financial borrowers, the inability to clean up simultaneously at all banks.
- Financing by other banks on terms less onerous than those required by the Bank.
- Slowness in trade.
- Violation of covenants of agreements (ours and others).
- Credit refusals by other lenders.
- Request for refinancing or an extension of term-loan payments or revolver maturities.
- Delays in stock offerings or expected financing by long term lenders.
- Any public offerings at unusually high rates.
- Unusual increase in overdrafts.
- Unusual payments to shareholders, directors or management.
- Downtrend in the ratio of retained earnings to total assets.

6.3.5 EXTERNAL FACTORS

- Any adverse industry information, including regulatory.
- Changes in ratings.
- Adverse national or international developments.
- Cresting markets, industries, or borrowers.
- Unusual increase in trade enquiries.
- Changes reflected in bank and trade checkings.

This list although long, is far from comprehensive. Remember the warning at the beginning of this section and ensure that the results achieved from using the early warning indicators are used intelligently. A "knee jerk" over-reaction on the part of a bank can precipitate the very situation that the bank wishes to avoid. Remember also that the earlier a problem or potential problem is noted, the easier it is for the Bank to take action in a timely manner, either to close out or restructure the relationship.

Ensure that the account is classified in accordance with section 4 and that the necessary reports are filed in accordance with section 7.

7. REPORTING AND ACCOUNT RESPONSIBILITY

7.1 INTRODUCTION

This section deals with the reporting process which is required at both branch and head office level.

Exposures graded "Watch" or lower must be reported to management by the branch or unit where account responsibility lies. Other than the Initial Report, there is no difference in reporting forms and requirements as between the exposure remaining with the branch or alternatively being transferred to the Problem Loans Officer located in the branch or to Head Office Problem Loans Department.

Problem Loans Department shall instruct where and by whom the exposure or relationship shall be managed. The individual so designated shall have full responsibility for the exposure.

IBIS is currently being enhanced. It is recommended that any enhancement should provide for inclusion of a field, to show where account responsibility is allocated.

7.2 REPORTING REQUIREMENTS

Exposures and relationships may be classified by the responsible Client Relationship Manager or by a Credit Officer. Additionally, exposures and relationships may be classified by Credit Audit either in the course of the regular post-fact review process for all credits of Kc 5 million or greater, or at the time of the annual inspection of a branch or unit by a Credit Auditor from Credit Audit.

When an exposure is downgraded to "Watch" or lower, the Credit Officer must complete a Problem Loan Report which is sent to Problem Loans Department. Problem Loans Department may then accept the classification which should be prepared in accordance with criteria at Section 4. Alternatively, Problem Loans Department may require an amended classification. The classification required by Problem Loans Department shall take precedence.

Where a relationship is classified by a Credit Auditor, a Problem Loan Report shall be prepared by the Credit Auditor, setting out the reasons for the classification. Branch management may comment on this report before downgrading occurs. However, if the comments are not accepted or insufficiently convincing, the classification shall stand. In such instances, the Problem Loan Report shall be signed by the classifying Credit Auditor.

When a classification of "Watch" or lower, is awarded to a loan, the whole relationship is classified. This includes all credit and debit balances together with all off-balance sheet contingencies such as letters of credit, guarantees, etc. When classifying a relationship the Bank must utilise the criteria relating to aggregate exposure and connected and associated accounts as set out in Section 5.

For any classification of "Watch" or lower, all credit balances must be marked both on the computer and manual records, so that withdrawal of funds is permitted only with the express written consent of a Credit Officer. This consent shall be evidenced by the completion of an Offering Ticket which must be signed-off at the required level of authority.

Classified accounts are to be reported to Problem Loans Department, by the officer responsible, as at the close of business each month, using the Classified Exposure Report. This monthly report is mandatory until such time as the account is again awarded a "Standard" grade. The report is to be completed by the officer allocated account responsibility, which is likely to be either the Credit Officer or the Problem Loans Officer. The report requires detailed information as to month-end outstandings which are to be appended by Loan Administration prior to the officer responsible making his comments.

Prior to the reports being sent to Problem Loans Department the amounts must be balanced to the General Ledger. By signing the form, the officer responsible for the exposure or relationship is confirming the accuracy of the numbers and information contained therein.

The range of reports and consents required are as follows:

- Initial Report
- Problem Loan Report and attachments
    - PLR 1
    - PLR 2
    - PLR 3
- Classified Exposure Report
- Action Plan
- Offering Ticket
- Problem Loan Summary Report

These are explained in outline below and shown in detail in the relevant appendices.

7.3 INITIAL REPORT (Appendix D)

- To be filed in respect of any exposure of Kc5mm or greater, when a payment, whether or principal or interest is five working days past due.
- The Credit Officer assisted by the Client Relationship Manager responsible for the relationship is accountable for accurate and timely completion.

- Sent by the branch to Problem Loans Department.

- A two part form.

    - Part A provides outline details of outstandings, collateral, the past due amount and the reason for the delay.

    - Part B confirms that the past due amount has been received. If this amount is not received, then, on reaching thirty days past due, the branch must complete the Problem Loan Report (see 7.4 below) and supporting forms.

- The purpose of the report is to warn Problem Loans Department that there is a potential problem with a relationship. Problem Loans Department has the power and authority, after consultation with the Head of Credit, to take action or require action to be taken.

7.4 PROBLEM LOAN REPORT (Appendix E)

- To be completed:

    - When an exposure or relationship is downgraded to "Watch" or lower; and

    - Thereafter on at least a six monthly basis measured from the date of the original Problem Loan Report, until such time as the exposure or relationship is upgraded to "Standard".

- Any exposure which reaches thirty days past due is automatically to be classified "Watch" or lower if appropriate. However, it is not necessary for an exposure to reach thirty days past due in order for this report to be submitted.

- A Problem Loan Report must be submitted immediately the Credit Officer or Client Relationship Manager believes either:

    - That a significant deterioration has occurred or is occurring in a credit; or

    - In compliance with criteria laid down in Section 4.

  This must be sent to Problem Loans Department within five working days of the recognition of quality deterioration.

- The Credit Officer assisted by the Client Relationship Manager, together with the Branch Credit Manager, are responsible for the accurate completion of this report, although approval by the Branch Manager is required.

- On initial classification the Problem Loan Report must be sent by the branch to Problem Loans Department. The subsequent six monthly reports must be sent by the branch to Problem Loans Department if responsibility is retained by the Branch or produced internally by Problem Loans Department if the department has accepted responsibility for the exposure or relationship.

- The Problem Loan Report should provide:

  - Full details as to the background to the relationship;
  - A summary of the client's history;
  - Details of the Bank's exposure;
  - The reason for classification;
  - Remedial action taken by the Bank; and
  - Remedial action taken by the Borrower.

  The Report should also include an assessment of the potential loss and confirm that documentation and collateral is complete and up to date. Any potential or actual failures or shortcomings, should be noted on the report.

- Financial statements for the borrower should be attached.

- The purpose of a Problem Loan Report is to give the Bank's management timely notification of a problem in order that action may be taken.

The Credit Officer assisted by the Client Relationship Manager is responsible for using the Problem Loan Report to report events of default, including but not limited to non-payment of principal or interest, together with violations of covenants as well as other potentially serious credit problems.

The attachments PLR 1, PLR 2 and PLR 3 are completed by the officers responsible for completion of the Problem Loan Report and are integral to the report. The Problem Loan Report is the verbal description and analysis of the exposure and situation whilst the attachments provide detailed account information and numerical analysis of the position.

7.4.1 PLR 1

Contains details of:

- When the account was opened;
- Gross debit and credit balances;
- All contingencies and off-balance sheet items;
- Limits;

- Names and levels of approvers;
- Past due amounts;
- Provisions and reserves;
- Interest basis: charged/reduced/stopped;
- Gross collateral value; and
- Estimated market value.

The purpose of the form is to provide an overview of the Bank's position in a concise format.

7.4.2 PLR 2

- A detailed analysis of the borrower's credit exposures both on and off-balance sheet.
- To be produced for each entity or borrower in a group, with all exposures totalled to a single consolidation report.

7.4.3 PLR 3

- A detailed analysis of the collateral position.
- Explanation as to the basis of valuation used and an estimate of current market value.
- To be produced for each entity or provider of collateral in a group, with all collateral totalled to a single consolidation report.

7.5 CLASSIFIED EXPOSURE REPORT (Appendix F)

- To be completed on a monthly basis, as at the closing date of the month, in conjunction with the Action Plan.
- Sent by the branch to Problem Loans Department if responsibility retained by the Branch or produced internally by Problem Loans Department if the department has accepted responsibility for the exposure or relationship.
- The Problem Loans Officer assisted by the Client Relationship Manager, together with the Branch Credit Manager and the Branch Manager are responsible for the completion of this report.
- Reports must arrive at Problem Loans Department by the 12th of the subsequent month. in order that the Bank's problem loans may be properly quantified and administered.

- The report:

  - Summarises any activity on the account during the course of the previous month.

  - Details reserves and provisions.

  - Indicates value of collateral.

  - Shows potential additional write-offs.

  - Contains details of current month developments, action taken and planned, projections and recommendations.

- The purpose of the report is to ensure that a close watch is kept on all classified exposures as an aid to monitoring the Bank's position.

7.6 ACTION PLAN (Appendix G)

- The first Action Plan to be submitted shall contain not only short term or tactical actions but also the longer term strategic plan or goals. All future plans shall report on both performance against target and amendments to strategy.

- To be completed on a monthly basis, as at the closing date of the month, in conjunction with the Classified Exposure Report.

- The Problem Loans Officer assisted by the Client Relationship Manager, together with the Branch Credit Manager and the Branch Manager are responsible for the completion of this report.

- Sent by the branch to Problem Loans Department if responsibility retained by the Branch or produced internally by Problem Loans Department if the department has accepted responsibility for the relationship.

- Reports must arrive at Problem Loans Department by the 12th of the subsequent month. in order that the Bank's problem loans may be properly quantified and administered.

- The Report:

  - Details current exposure;

  - Projects exposure as at year end;

  - Lists recent developments; and

  - Provides list of detailed action steps and target dates for implementation.

- All reports after the original Action Plan are to include a detailed explanation as to performance of action steps against original target dates. Any slippage is to be explained and revised targets provided.

7.7 OFFERING TICKET (Appendix H)

- To be completed in respect of any transaction over a classified account which will increase the Bank's exposure. Required even in respect of interest or other charges.

- The individual with account responsibility (probably a Problem Loans Officer), is responsible for completing this application. Counter-signature by the Branch Manager or his delegated alternate is mandatory.

- Sent from the branch to Problem Loans Department.

- The application:

    - Provides details of approval date, limit and expiry;

    - Lists current risk exposure;

    - Provides transaction details;

    - Shows the aggregate position post the transaction.

    - Confirms that all documentation and collateral is complete and that there is full compliance with the terms and conditions of the approval; and

    - Requests approval for the transaction.

It is mandatory that no transaction may be passed across a classified account without completion of an Offering Ticket, signed-off at the required level of authority.

7.8 PROBLEM LOAN SUMMARY REPORT (Appendix I)

- To be completed at the 15th of each month;

- The report shall contain specific details in respect of all facilities and gross exposures of Kc 20mm, graded "Watch" or lower. All exposures of lesser value but graded on the same basis, shall be reported in consolidated format;

- The Manager of Problem Loans Department is responsible for ensuring that this report is produced in a timely manner;

- Sent from Problem Loans Department to the Credit Sanctioning Committee.

- The report:
  - Shows prior month and current month classifications;
  - Provides the name of the borrower/obligor;
  - Details gross outstandings;
  - Lists interest and principal provisions; and
  - Recommends additional provisions if required.
- The purpose of the report is to provide the Bank's executive management with an overview of classified exposure and provisioning requirements.

7.9 APPROVAL OF LIMITS FOR PROBLEM LOANS

As soon as a credit is classified "Watch" or lower, the existing credit limit automatically expires. The Problem Loan Report and Action Plan, with supporting attachments and a recommendation as to the proposed level of classification together with a Fact Sheet and Credit Proposal shall be completed and sent to Problem Loans Department with a copy to Head Office Branch Credit Department. Problem Loans Department shall either accept the classification or require a different level of classification as they see fit. A complete Fact Sheet, Credit Proposal, Problem Loan Report and Action Plan shall be submitted every six months or more often if warranted. If the classification is "Substandard", "Doubtful" or "Loss", Credit Audit shall receive copies of the reports.

Extensions and renewal of limits in respect of problem loans shall not be "blanket approved" for periods of twelve months. The maximum period of approval for an exposure classified "Doubtful" or "Loss" is six months. Regular follow up reporting to Problem Loans Department and/or Credit Committee is required.

Authorities to approve or write-off problem loans are attached at Appendix C.

7.10 APPROVAL AUTHORITIES FOR EXCESSES

As a matter of Bank policy, excesses over limit must not be permitted on any non-performing loan or exposure. However, occasions will arise, when in the interest of commercial reality, the Bank will wish to grant authority for such excess.

In such cases, an Offering Ticket (see 7.7) must be completed and sent to Problem Loans Department for approval. It is the responsibility of the Manager of Problem Loans Department to obtain the necessary level of approval, in accordance with the authorities contained in Appendix C.

7.11 PAST DUE LOANS

This is the primary responsibility of Accounting Department.

A "Past Due" account shall be opened in respect of any unpaid amount. Any amount unpaid at the due date is transferred to this account until settled or until a new repayment schedule is authorised by the competent approval authority.

Loan Administration has secondary responsibility for monitoring all unpaid amounts and ensuring that the relevant Client Relationship Manager and Credit Officer are notified in writing within two working days of discovery. Copies of the notification are to be provided to the Branch Manager.

A monthly report of all items in past due accounts should be provided to the Branch Manager, Head Office Branch Credit Department, Problem Loans Department, Head of Credit and Credit Audit. The report shall be annotated by the Branch Credit Manager, with an explanation as to the current position.

8. PROBLEM LOAN WORKOUT ADVICE, METHODOLOGY AND RECOMMENDATIONS

8.1 INTRODUCTION

This section deals with the methodology to be used in analysing the exposure, understanding the problem and available options, negotiating a final settlement or initiating litigation or bankruptcy proceedings.

The aim in any work-out is to maximise the return to the Bank, in order to protect depositor's funds All other considerations are secondary and subservient to this primary requirement.

EACH BORROWER'S SITUATION IS UNIQUE AND THE DEGREE OF SEVERITY OF THE UNDERLYING PROBLEM IS VARIABLE, AS SUCH, ACTION STEPS MUST BE PREPARED ON A CASE BY CASE BASIS. THERE IS NEVER A RIGHT ANSWER, ONLY A LEAST BAD OPTION.

8.2 ACTION TO BE TAKEN WHEN SYMPTOMS OF WEAKNESS APPEAR

This guide as to action steps is not exhaustive nor necessarily in order of priority. However, so as to protect the Bank's position, it is required that action be taken at the first hard evidence of a deteriorating loan. Deterioration should be considered in the context of early warning signals and indicators as specified in section 6.

Exercise extreme care in all dealings with a financially troubled borrower. Problem Loans Department must consult with Legal Department and/or outside attorneys, whenever analysis and recommendations have the potential to lead to legal action.

As part of the remedial action plan an immediate assessment of the possibility of a successful work-out should be undertaken. This should include the following considerations and actions:

8.2.1 REVIEW CONDITION/INTERNAL REVIEW

- **Exposure.**

  Check exposure both on and off-balance sheet.

  Ascertain if there are relationships or connected or associated accounts (see 5.2) at other branches and subsidiaries.

  Include any loans outstanding to executives of the borrower or obligor.

  Cancel any Credit Proposals in course of being considered.

- **Consultation**

Consult with Problem Loans Department who will as necessary consult with the Head of Credit, the General Director Banking, the Credit Sanctioning Committee and the Board of Directors.

- **Classification**

Consider the appropriate level of classification. (see section 4).

- **Legal Review**

Physically check and ensure that all necessary loan and collateral documentation has been received.

Examine all documentation and collateral for adequacy and completeness. Obtain a full view of the legal strength of documentation either from Legal Department and/or outside attorneys. Maintenance of proper documentation is an ongoing function but an extra review when problems arise is mandatory.

Physically inspect collateral and if possible secure and/or store.

In instances of a mortgage on real estate, search the real estate registry and obtain a certified copy of the mortgage registration.

Determine prior and/or subsequent mortgages and pledges.

Obtain Valuation: The Bank must obtain and pay for a valuation (cost must be proportionate to exposure). The valuation shall be prepared on two bases:

- Value in Use. - Going concern; and
- Alternative Basis. - Gone concern/Open Market Value.

The State basis of valuation shall <u>not</u> be used.

Debit costs of valuation to the client's account. This shall then form part of the debt.

Look for any way to improve the Bank's position and consider the rights and remedies of the Bank.

Consider the relative impact of reorganisation, liquidation or bankruptcy.

- **Operating Review**

Monitor account activity on a daily basis. Watch for warning signals such as cross-firing and hardcore borrowings.

Cross-firing involves the circulation of the borrower's own cheques between a range of bank accounts, in order to maintain exposure within limits and give an impression of account activity.

- **Additional Collateral**

Consider and analyse the possibility of taking additional collateral. Give careful consideration to the impact the action would have on the company's other creditors, particularly suppliers.

Examine the effect that legal proceedings may have on the borrower's business.

- **Special Expertise**

Assess need for special expertise (internal or external) e.g. legal advisers, surveyors, valuers and appraisers, bailiffs etc.

8.2.2 ANALYSE THE PROBLEM/EXTERNAL REVIEW

- **Financial and Business Analysis**

Consider the company's business and ask "what must the company do well to be successful?". Look beyond the financial statements to determine if the borrower is a viable economic entity. **Asking the right questions is the key to good decision-making.**

Review in depth the information held on the Bank's files. Obtain up to date audited financial information from the borrower. Management accounts and projections should be obtained and reviewed.

Be certain that:

- Cash-flow projections bear a reasonable and consistent relationship to historical performance;
- Projected debt maturities and other future cash requirements are covered by historical, rather than projected cash flow;
- Beware of income accounts and balance sheets that are not consistent with earlier projections. Insist on a sound explanation of the circumstances;

- Beware of a decline in earnings when the explanation of the drop is too vague or too simplistic;

- Consider all warning indicators. For instance an increase in receivables and inventory combined with a slowdown in income or payables;

- Watch profit trends and leverage; and

- Remember that the Bank will never be shown projections that do not support the proposal.

Analyse the financial information on both a break-up and going concern basis. Focus primarily on asset liquidation or reduction in order to achieve cash generation and liquidity.

- **Meet With Management Of The Borrower**

Appraise the borrower's management and management team, with a view to ascertaining the quality thereof.

Investigate and be satisfied with the borrower's financial controls such as:

- Check all assets by reviewing market value against the figures carried in the balance sheet.

- Measure inventory, payables and receivables periods to turnover. Are these within industry norms?

- Review liabilities. Are all sums properly due? Are creditors paid on time? Specifically, is tax paid when due?

- Is financial progress monitored on a regular and ongoing basis?

- Are monthly cash flows produced?

- Can profitability be measured on a product by product basis?

- Have partners/owners/managers taken significant amounts of cash out of the business within the past twelve months?

- Have other banks or creditors been preferred?

This does not purport to be a definitive list but rather should be considered as a guide to the areas which require consideration.

Obtain consolidating as well as consolidated statements. Track carefully the performance of each subsidiary to be certain that the profits of one do not cover up the losses of another.

Review the exposure with the borrower in order to fulfil two objectives:

1. To obtain the best projections that can be provided. These should be prepared or at least confirmed by the borrower's external auditors; and

2. To ensure that the borrower's management has a full understanding of the problems and their impact on the financial alternatives.

- **Meet With Board Members And/Or Owners**

Ensure that Supervisory and Management Boards are fully aware of the financial difficulties, have been informed by management and/or auditors and understand the implications and consequences of the corrective action required by the Bank.

Examine the personal situation of owners, management and guarantors in particular.

- **Additional Collateral**

Three factors must be considered in evaluating collateral; control, marketability, and margin.

Do not wait too long to take collateral, and do not wait too long to sell it.

Do not regard collateral as a substitute for repayment, loans must normally be repaid from the flow of funds. However, collateral can provide incremental protection since it prevents other lenders from controlling the borrower's assets and places the Bank in a stronger negotiating position because the assets may be necessary to operate the business.

- **Explore Alternatives**

Meet again with executive management. Explore the range of alternatives and operate on a consultative basis. Time is of the essence since the quality of collateral generally deteriorates, at least in line with the condition of the business.

Discuss and consider the possibility of the borrower retaining an outside consultant. Alternatively, an introduction to Consilium s.r.o. ("Consilium") in an advisory capacity, might be of assistance with restructuring or flotation. The Bank may introduce the consultant or Consilium but this introduction must be on an arms length basis.

Convince management and Board Members that the Bank's continued co-operation is aimed towards, and dependant on, the attainment of certain specific goals required by the Bank. Management should set certain objectives (e.g. inventory reduction, plant shutdown, asset disposal) to be accomplished by specific dates. Steps towards achieving these goals should be monitored on an ongoing basis.

Meet With Auditors

Review the borrower's current and projected financial position.

- Review in detail the structure of assets and liabilities together with the operational and cost structure of the business.
- Review ageing schedule of receivables. - Are these all current and collectible? Are there any concentrations of risk?
- Review ageing schedule of payables. - Are these all current? Could demand by a major creditor have the ability to collapse the borrower?
- Obtain schedule of inventory. - Is this current or are any stale or fictitious items carried?

It is probable that many businesses will need to undergo an operational and financial restructuring. These processes will need to be complementary if the businesses are to secure their future. On an operational level it is probable that there will be a high level of operating costs which could inhibit the ability to generate adequate internal cashflow. On the financial level it will be necessary to match future cashflows with debt service ability.

The following broad aspects should be considered:

- Does the borrower export? Are there hard currency earnings?
- What is the situation between the borrower and other creditors?
- Is Government support available?
- Would the borrower be more viable if slimmed down to a smaller unit?

- **Other Lenders**

In instances where the Bank is one of several banks attempting to obtain recovery against the same borrower. Legal proceedings can become combative and confused.

Consider the potential preferred position of other banks and lenders, including the National Property Fund and attempt to assess their reaction to the Bank's proposed plans for the borrower.

Meet with all other lenders to the borrower to form a banking group. One member of the group should be appointed to the role of lead bank in negotiations, so as to present a common front in order to assist recovery.

Co-ordinate all activities with this group. Incremental loans or new money requirements must be pro-rata as must be any rights, or benefits.

Utilise senior bank management contacts with other banks to convey the necessity of co-ordination and sharing between lenders.

Meet with the borrower and other participants, including all other lenders. Consider involving all creditors of the borrower in order to review the possibility of a support package.

8.3 ASSUMPTIONS, FORECASTING AND PROJECTIONS

In order to ascertain the future viability or otherwise of the business, it is necessary to attempt to project forward, the possible results and cash generative ability of the borrower. Cash generation is the key, since this is the fundamental condition on which debt repayment is predicated.

Forecasts and projections are derived from a combination of historic trends and future projections. These projections are of necessity based on a range of assumptions with regard to the future economic and operational environment.

8.3.1 ASSUMPTIONS

- Test the validity of all assumptions. False assumptions lead to wrong decisions.

- Query all assumptions especially those which show an abrupt end or reversal of previous trends or sudden or explosive growth or improvement. **Never accept information at face value.** Wherever possible information should be checked with independent sources.

- Consider future cash needs and requirements and the continuing ability to satisfy future obligations on an ongoing basis.

- Forecasts should include all income and expenditure so as to establish cumulative cash flow over the period of the projection.

- Always double check calculations even substantial businesses can miscalculate simple factors.

- Do not take information on trust. If in doubt seek clarification and/or independent verification.

- Identify the basis upon which the forecast is structured and obtain details of assumptions utilised. Check the assumptions, are they reasonable, realistic and achievable?

  - Discuss with the branch which may have local/industry knowledge.

  - Use own knowledge of the industry, market, pricing etc.

  - Compare views of management to those of others in the industry. Any variance or divergence of views provides an opportunity to obtain a basis for comparison with industry norms.

  - Produce a range of forecasts on a "What if" basis so as to allow assumptions to be tested. Beware of the danger of creating uncertainty as a result of producing a wide range of forecasts.

- Test variances to management's assumptions, to allow for market trends and the businesses' historic performance.

- Strong evidence is required in order to accept assumptions which do not appear reasonable.

- All forecasts must be tested.

- Financial views change. Forecasts need to be updated regularly to reflect changes in market conditions and plans of management.

- The principles of check, verify and test apply as much to updating a forecast as to a new risk proposal.

8.3.2 FORECASTING AND PROJECTIONS

- Any forecast or projection is only as good as the assumptions upon which it is based.

- Use test of "reasonableness". Are the assumptions reasonable in the context of the market and market conditions?

- Obtain clarification from management but do not necessarily accept all you are told.

- Forecasting is never 100% accurate even over the short term. Forecasts provide a "most likely view" only when assumptions have been tested.

- The mechanism of producing projections.

  - Start with position at balance sheet date and performance in earlier periods.

- Look at latest balance sheet and build assumptions re' changes that may be planned or may occur in the future.

- Ensure all relevant components are included within the assumptions. Consider the ramifications of all actions such as proposed purchases of capital equipment. How would it be financed, over what period, repayments, interest rate - fixed or floating? Consider disposals (e.g. plant & machinery) which would bring cash into the projection.

- Over time there will be trends: assumptions should reflect historic performance, i.e. collection and payable periods should bear some resemblance to historic performance. Levels of sales growth to gross margins, and operating expenses to turnover are to be considered under the "reasonableness" test.

- To build a cashflow projection either build trading, profit & loss accounts and balance sheets for the future and then extract all data related to cash transactions. Alternatively, build cashflow forecasts using spreadsheets that encompass all the data that would be in the profit and loss account and balance sheet year by year.

8.4 CONSIDER OPTIONS: AN OVERVIEW

The consideration of options is the most critical part of the Bank's decision making process. It has been mentioned previously that asset quality declines, at least in line with the condition of the business, so that time is of the essence. However, the Bank must not be stampeded into a decision, solely to move matters forward.

Having completed the financial analysis the Bank must at this stage consider its position. Information will now be to hand which should reveal whether the borrower is viable or potentially viable and worth saving, or whether the borrower will never be viable under any circumstances. In this last situation, the decision is easier.

There should now be a good understanding of the structure of the borrower's business and future prospects. Most fundamental to this analysis is whether the borrower is profitable, or given certain assumptions, potentially profitable at the operating level. If the borrower as a single entity is not viable, consider whether there is any part of the business which would, if the business were restructured, be viable on a stand alone basis or whether alternatives must be considered.

Options should not be considered on an individual or single solution basis. The resolution of problem loans often requires a flexible approach so that for instance, a debt to equity swap can be structured in conjunction with obtaining additional collateral, selling assets and/or writing-down or writing-off residual debt. However, in simple terms, options can be divided into the following broad categories

- Improving the Bank's position;

  Obtaining additional collateral.

  - Government and other support.
  - Additional financial support from interested parties.

- Restructuring and/or new money;
  - Renegotiation of terms and conditions with close adherence to budgets and forecasts.
  - New money to generate cashflow to service/repay both new and existing debt.
  - Sale or flotation of parts of the business.
  - Debt conversion.
- Sales of assets or collateral, or calling guarantees;
- Sales of debt; or
- Take out by another bank.

The Bank's interest shall be paramount at all times and all efforts are to be directed to this end. If the action plan does not appear to be achieving the desired results, consideration must be given to other alternatives.

These could include :

- Compromise settlement with the borrower; or
- Foreclosure, litigation, liquidation or bankruptcy.

Since the objective is to recover funds owing to the Bank, due consideration should be given to any other forms of legal action which could protect or advance the Bank's position.

8.5 WORKOUT AND RECOVERY OPTIONS

8.5.1 IMPROVING THE BANK'S POSITION

In circumstances where the borrower's situation is not terminal, it may be possible to take action to improve the Bank's position. This action should be targeted either at obtaining additional collateral or additional financial support.

- **Obtain Additional Collateral:**

  There should be a sustained effort to obtain additional asset security, not so much because the assets have immediate value or are saleable forthwith, but rather as a long term insurance policy which should provide the Bank with incremental recoveries and value when the Bankruptcy Law is more effective.

Review the assets of the borrower and meet with management and owners to ascertain what assets are available to be mortgaged or pledged. Ensure that the collateral is obtained rather than obtaining a right to receive the collateral in the future. Other creditors could prevent that right from being exercised.

Establishment of an Asset Register

The volume of asset security held by the Bank is enormous and this condition is likely to be duplicated throughout the branches of most banks within the banking system.

Collateral consists of buildings, machinery and a diversified range of other equipment and production lines. These all have some value if marketed systematically either within the Czech and Slovak Republics or where appropriate, on an international basis.

Once the Bankruptcy Law has been adopted in workable form, it is probable that all branches/banks will attempt to sell broadly similar asset security within a finite time frame. This will only exacerbate what is already a weak marketplace, adding to the diminution of value that will occur as these items enter the commercial environment in an ever increasing volume. In other words, oversupply will lead to a drop in prices.

Problem Loans Department should maintain a central register of assets which are available to the Bank either by way of the Bank having swapped debt for assets or debt for equity, or alternatively which could be obtained by the Bank were it to foreclose on a debt.

These assets could then be marketed both nationally and internationally.

The development of such a data base, connections and skills will enable the Bank to be in a position to service its clients if they have any requirement for plant, machinery, etc.

This structure will permit the Bank to benefit from a price better than that available if branches are to market similar assets on a competitive basis; and

In this context it would be appropriate for the Bank to make contact with specialist valuers and auctioneers both within and outside the Czech and Slovak Republics such as Henry Butcher and Co in the UK, who could assist with valuing and selling plant and machinery on an international basis.

Government Support

All sources of potential funding must be considered, in order to obtain whatever support might be available.

It is probable that State support will be limited to sensitive industries, such as defence, heavy industry and major employers.

Wherever possible State support should be sought by way of guarantee or more usefully through the provision of subsidies or grant aid. Consolidation Bank can on occasion assist by providing direct loans.

The Bank should review on an ongoing basis the possibility of transfer of exposure to Consolidation Bank, Ceska Inkasni, Slovenska Inkasni or the Ministries of Finance.

- **Other External Support**

The Bank should maintain a close relationship with the Privatisation Agency as well as establishing contact with the offices of all aid donors in the Czech and Slovak Republics and where appropriate with the headquarters units in the donor's country of origin. Although there are many such organisations, ECPhare, EBRD, EIB and USAID are of particular relevance.

It is important that the Bank should ascertain the donor's general and specific investment criteria.

Any grants available for feasibility studies leading to the general restructuring of companies or the setting up of joint ventures should be considered. The EC Joint Operations Phare Programme ("JOPP") is of particular relevance for the pre-funding of joint-venture feasibility studies.

The rationale behind this advice is to enable the Bank to link in to restructuring schemes, loans and investments, which may not only assist the work-out process but may also produce profit opportunities.

- **Financial Support from Interested Parties**

If facilities are or are to be restructured then always attempt to obtain additional support in addition to anything that may be available within the company. Consider that owners, managers and workers all have their livelihoods at stake and that most will prefer to contribute to the restructuring process rather than lose future earning capacity. This contribution can range from owners and investors providing additional injections of equity, to the workforce being required to accept a wage reduction or as a minimum a wages freeze for an agreed period.

Owners and managers of a borrower should be the people who know that business best. They should also be aware of their markets and competitors.

Always consider whether any competitors or investors would be interested in buying into or taking over the borrower. Their reasons for so doing might range from the wish to shut down a source of competition, to a need for additional production capacity or an investment opportunity. Consider also that end users of the product might be interested in obtaining a downstream tied source of supply and could be prepared to invest, in order to achieve this end.

Review the possibility of the borrower working on a sub-contract basis.

8.5.2 RESTRUCTURING AND/OR NEW MONEY

Under more critical circumstances, stronger and more innovative action is required. A range of options are available:

- **Renegotiation and New Money**

  The renegotiation of facilities requires careful deliberation. The questions to be considered are:

  - What went wrong originally?
  - What has changed?
  - Why should this revised structure produce a more successful result?

  Any renegotiation must be based on the results of analysis of the original problem as explained at 8.2.2 together with an examination of the business plan incorporating the underlying assumptions and the projections derived therefrom, as instructed in section 8.3.

  Renegotiation should include as tight a collateral package as can be negotiated, together with closely structured covenants and events of default. Progress of results, measured against budget and forecasts, should be monitored on an ongoing basis, with a view to declaring default in case of non-performance.

  If there is a "new money" requirement this should be provided only if it can be demonstrated to the Bank's complete satisfaction, that provision of these new facilities will enable the generation of sufficient cashflow, to service and repay both new and existing debt. "Demonstrated" in this context means the Bank's complete acceptance of underlying assumptions and forward projections. The "hope factor" is an insufficient basis on which to provide additional funding. **Do not be tempted to throw good money after bad.**

- **Debt Conversion and Exit Strategies**

  The Bank should only become involved in debt conversion when it is perceived that value will be added to the borrower by following this route, i.e. the ability to recover because the debt service burden has been reduced or removed.

The route of debt conversion should not be used as a soft option in order that the Bank does not have to recognise a loss. The simple exchange of a bad loan for a debt instrument of dubious value, a bad investment or an overvalued asset is not an acceptable option.

Debt conversion shall be undertaken only when the Bank considers that there is:

- A reasonable chance of success;
- Believes the option to be "fair" given due cognisance of the circumstances; and
- Perceives a clear exit strategy.

Debt conversions could assist with ensuring the involvement of other parties to the restructuring (employees, key directors, suppliers as well as other banks), who without this comfort, might withdraw support or leave the company.

In instances of debt conversion, it is not the Bank's intention to be a long term investor and the Bank must at all times consider its exit strategy.

Considerations must be:

- Timing; when will the borrower recover to a degree that disinvestment is possible;
- What methods of disinvestment are possible:
  - Flotation.
  - Placement.
  - Sale to investment institutions such as pension funds, etc.
  - Sale to existing investors, management or the workforce and employees.
  - Trade sale.
  - Purchase of own shares. (This must be in accordance with section 161 of the Commercial Code).
- Possibilities of a staged disinvestment.

Various forms of debt conversion are available for consideration.

These are:

- Conversion of bank debt into Long Term Redeemable Convertible Secured Debentures;
- Debt to Equity and Debt to Asset swaps; and
- Debt forgiveness.

- **Conversion of Bank Debt into Long Term Redeemable Convertible Secured Debentures**

Covenants, Events of Default and restrictions can be built in and collateral obtained, in the same way as for a secured bank loan. Debentures can be interest free or at a below market rate of interest or provide a grace period so that interest is payable, possibly on a graduated or rising basis over a period of time. A right to convert can be attached either at any time or only after a period of time has elapsed.

Conversions of this nature are only worthwhile where projections show that the entity is viable or potentially viable in the future and that the business could be floated or placed, so that the debentures can be converted into quoted shares and then sold. In this context, attention should be paid to assumptions in respect of projections as set out in section 8.3.1 and consideration of exit strategies as above specified.

The Commercial Code permits a company to issue debentures up to half the value of its capital stock. The issuance of such instruments must be authorised by the shareholders in general meeting. Unless otherwise specified in the Articles of Association, a two thirds majority is required. The minutes of the meeting must be notarised.

Care must be taken with this route, since a transaction of this nature could in certain circumstances, result in the Bank being required to make a general offer to all shareholders. This would clearly be to the disadvantage of small or inexperienced shareholders. As a consequence the Bank must liaise with lawyers in order to ensure that a structure is adopted to protect the rights of inexperienced investors. i.e. **Protecting the Bank's interests must also include protection of the Bank's good name.**

- **Debt to Equity and Debt to Asset Swaps**

The Bank should give consideration to the possibility of debt for equity and debt for asset swaps.

The proviso that conversions of this nature are only worthwhile where projections show that the entity is viable or potentially viable in the future, continues to apply.

Where debt is exchanged for equity, this may be achieved by one of two methods. Existing shareholders may either agree to sell their shares to the Bank or the basic capital of the borrower may be increased. In the second instance the Commercial Code requires that the borrower's shareholders in general meeting give their consent to the arrangement. There is no legal limit on the percentage or size of the ownership interest acquired by the Bank via this route. However, the Czech National Bank ("CNB") must grant specific consent if that ownership interest continues at a level in excess of ten percent of the equity, for a period of greater than two years.

It is recommended that, if at the time of structuring the swap, it is considered possible that the Bank might continue to own in excess of ten percent of the equity upon the expiry of the two year period, then the Bank would be prudent to obtain CNB consent before entering into the swap.

An alternative route for consideration is that of the debt for asset swap. The "asset" can range from fixed assets such as real estate in the form of land and buildings to current assets such as inventory or receivables or in appropriate circumstances, intangible assets such as patents, copyright or brand names.

These assets may then be:

- Held in portfolio;
- Sold or leased on the open market; or
- Leased back to the borrower.

The most viable strategy can be determined only on a case by case basis and having due regard to the circumstances pertaining at the time.

- **Debt Forgiveness**

Debt forgiveness is the equivalent of providing an injection of equity finance into a business.

As an effective "holder" of equity the Bank should attempt to obtain an equity return This can be achieved through a variety of routes:

The provision by the borrower of shares, without any additional payment on the part of the Bank to an agreed value or agreed percentage of equity. As and when a dividend is paid, then the Bank benefits from an incremental return.

It may be necessary for the Bank to commit to hold the shares for either a minimum or maximum period of time, dependant upon the circumstance of the particular borrower. Instances will arise where the management of the borrower will require the right of first refusal on the eventual sale of the shares.

Given that the Banking Act restricts the equity holdings of Banks to a 10% interest, it would appear reasonable to set 10% as being the target towards which to aim.

- **Earn Out**

  - **Open ended by amount but closed period:** The debt is written-off but it is agreed that the Bank will receive a proportion of profits for a pre-agreed period or number of years.

  - **Open ended by period but closed amount:** The debt is written-off but it is agreed that the Bank will receive a proportion of profits up to the level of the debt written-off.

  It is important to ensure that the definition of profit is approved in advance by all parties, that the basis of accounting is agreed and that there are proper controls to guard against excessive costs or transfer pricing It is recommended that the basis of accounting and controls should be to International Accounting Standards.

- **Conversion of Receivables**

Where receivables or client receivables are due from a "difficult" country, investigation should be made to ascertain if it is possible for these to be paid in an appropriate local currency. These funds could then be used to capitalise a local business entity.

This method is only to be considered where there is a real business to be undertaken and this structure should not be considered as a solution or end in itself.

Consider also:

- Who will manage and run the company;
- Anticipated profitability;
- How if at all profits will be repatriated; and
- The ultimate exit strategy.

8.5.3 THE NATIONAL PROPERTY FUND ("NPF")

The NPF is likely to be a major creditor of many entities to which the Bank grants credit facilities.

With effect from December 1994, the NPF is a preferred creditor in bankruptcy This has the potential to impact negatively on the Bank to a major degree, which arises through the respective exposures no longer being on an equal basis of priority.

It is probable the NPF will be a major creditor in many instances where the Bank wishes to restructure a borrower's exposure. Accordingly, there will be a need for the Bank to work in close co-operation with and alongside the borrower, in order to make a joint presentation to the NPF with the intention of gaining their support for the project.

As a matter of policy the Bank shall not restructure facilities or provide new money, in order that the NPF or other creditors may be paid out to the disadvantage of the Bank. In a restructuring the pain/cost must be spread as widely as possible.

8.5.4 ASSET SALES

At this stage, asset sales shall wherever possible, be undertaken in co-operation with the Borrower. Sale proceeds shall be mandated to or controlled by the Bank. These should be placed in reduction of the borrower's indebtedness to the Bank.

Consideration should be given to calling guarantees. Bear in mind that although guarantees are provided quite easily, it will be extremely difficult to recover in the current environment. Only call guarantees if the Bank is prepared to undertake legal action to enforce recovery.

8.5.5 TAKE OUT BY ANOTHER BANK

These instances are likely to be rare. However, on occasion another bank or lender may either possess a differing view of the borrower or may have a vested interest in the borrower's survival.

8.5.6 SALE OF DEBT AT A DISCOUNT

It is believed that one of the few instances (other than bankruptcy) in which banks are permitted to obtain tax relief on a debt, is when that debt is sold at a discount to face value to a third party. The Bank creates general reserves throughout the year. On sale of a debt at a discount, a loss is crystallised and the general reserve is then allocated to the specific loss which may then be written-off against the reserve.

On this basis the Bank should give consideration to the possibility of setting-up a subsidiary "Bad Bank" to which impaired debt could be sold at a discount. The sale would provide the Bank with tax shelter on the written down value of the debt and recovery efforts could continue under the control of the Bank. CNB consent would be required for the setting-up of a 100% subsidiary of this nature. It is recommended that attorneys be instructed to investigate this matter in depth.

An alternative to this approach is that the Bank use all efforts to seek out or locate lenders, investors or other parties, whom might wish to buy debt at a discount to face value. The rationale behind this purchase might range from a differing perception of the borrower, to special circumstances in which there is an ability to recover the debt more effectively, or an ability to leverage the exposure either to obtain access to the assets of the borrower or alternatively for investment, recovery or other purposes.

A further alternative is (and again legal advice must be sought as to the validity of this approach), that the Bank locates a third party who is prepared to purchase the asset from the Bank in return for a fee together with an attached repurchase agreement, effective after (say) three months. If this can be structured so as to comply with the law then the benefits are:

- The Bank obtains a tax deduction in respect of the discount to face value incurred on the sale of the exposure;
- The third party receives a fee;
- The Bank receives back its credit exposure at the written down value, which must be covered fully by collateral, to which ownership rights have been obtained in accordance with section 8.7.1.

With the proviso that legal counsel provide their consent to this method, this provides the Bank with a route by which valid tax deductions may be obtained, in respect of doubtful exposures.

8.5.7 DEBT SECURITISATION

The concept of securitisation of a package of loans and supporting asset security should be explored.

Securitisation in this context involves the Bank "packaging" a portfolio of poor quality debt and related asset security into a special purpose vehicle, set up for the sole purpose of the transaction. Shares in the special purpose vehicle are then offered for sale at a discount to face value of the underlying loans, the discount being proportionate to the perceived risk and recoverability of the portfolio. It is necessary that the portfolio should contain as wide a range of assets as is possible, in order to provide investors with a diversified spread of risk.

There are three pre-conditions in order for this route to prove effective:

- The Bank's legal advisers must confirm that the transfer and/or sale of debt at a discount, permits the Bank to qualify for a tax write-down;
- Ownership of collateral must be vested in the special purpose vehicle in accordance with criteria at section 8.7.1; and
- The further development of market liquidity and investor's sophistication and appetite for an investment of this nature.

It is likely that, at the present time this scheme is too advanced for the market and local investors. However, change will continue and it is possible that this concept might be of use within the next few years.

8.5.8 LITIGATION, LIQUIDATION AND BANKRUPTCY

This is the final stage when all else has failed. Approval for litigation must be obtained in accordance with section 10.2. The process must be handled under the instruction and control of the manager of Problem Loans Department. Attorneys shall be appointed at the manager's sole discretion.

The law is in course of development and this Manual does not purport to provide legal advice. However, the potential costs of the litigation must be proportionate to the exposure and chances of eventual full or partial recovery.

The following aspects are worthy of consideration:

- Prior to 1990 there was no right of pledge and arrangements were regulated by the Civil Code, which restricted the ability to transfer real assets. The Bank should not rely on pre-1990 documentation.

  The period of 1990 to 1991 is unusual in that a hybrid law existed, which permitted the taking of a pledge on real estate. Provided the pledge was registered, a degree of protection was provided to a lender.

  The current law came into being during 1991 and provides lenders with the ability to take mortgages and pledges of real assets. However, the law is deficient in terms of providing lenders with an ability to foreclose and realise collateral. Documentation if drawn properly under current laws provides an adequate level of protection although the ability to realise collateral remains in doubt.

  It is important that pledge documentation should specify that the pledge "may be disposed of in other ways" and to specify in the agreement the ways in which the pledge may be realised.

- When the Bank takes a pledge on real estate, it is usual practice to take a Full Power or appointment as agent, in order that, in case of default, the Bank can control or realise the property. However, the weakness is that a Full Power is revocable irrespective of whatever is written in the contract. The law is rigid with regard to the revocability of a Full Power. The route of requiring a period of time before revocation takes effect will not work since this is considered an infringement of basic rights.

- Under present legislation and where the Bank represents 80% + of the debt, there may occasionally be a case for buying out smaller debtors at a discount, on an individually negotiated case by case basis, in order to keep the borrower outside the bankruptcy process in order that the Bank may exercise control.

- In a liquidation, it is pre-supposed that creditors will be satisfied at full value. However, if during the course of a liquidation, conditions for bankruptcy are fulfilled, then the bankruptcy process should be implemented. Action is the personal responsibility of the liquidator.

  Given that liquidation is more controllable and advantageous to the Bank than the bankruptcy approach, the Bank should wherever possible, use all efforts to retain matters within the liquidation process.

  In cases of liquidation, a liquidator is appointed by either:

  - The general meeting of shareholders;
  - The courts; or
  - As set out in the Articles of Association.

  It is suggested that in the future, when either a new facility is granted or an exposure restructured, the Bank should, in order to maintain control of any eventual liquidation process, require that the borrower's Articles of Association be amended to state that in instances of liquidation, a representative of the Bank shall be the liquidator.

  Whilst it is open to the courts to recall a liquidator, such recall can be only for a good reason. "Good" in this context could mean illegal actions or the breaking of obligations on the part of the liquidator, i.e. sale of assets at an undervalue; preference of creditors; unclear arrangements etc. If the Bank behaves fairly and prudentially, it is unlikely that a challenge to its appointment would succeed.

- During the course of liquidation or bankruptcy, the individual or entity which is the subject of this action is debarred from the ability to undertake actions or enter into contractual relationships. The ability to undertake acts of this nature is then vested respectively in the liquidator or receiver. In instances of liquidation, the liquidator may only conclude new contracts, to the extent that they relate to the conclusion of unfinished business transactions.

  If during the course of liquidation or bankruptcy proceedings, assets of a borrower are sold by a person other than the Liquidator or Receiver, then this act would not be effective in law and the creditors could recover the goods. The courts may overturn any action and declare the action to be invalid. However, there is room for dispute in court if the new owner of the asset purchased in good faith.

Whenever possible the Bank should work in close conjunction and co-operation with the liquidator or receiver which is likely to be more effective than a combative approach.

8.6 FOREIGN TRADE ORGANISATIONS ("FTOs")

Exposure to FTOs represents approximately 46% of all credit facilities granted by the Bank. Whilst recognising that this situation has arisen as a result of historic factors, the Bank must now move rapidly to resolve this over-concentration of risk.

Four years ago almost one hundred percent of foreign trade of Czechoslovakia was channelled through the FTOs. It is believed that this figure has now reduced to about 40%. FTOs although still important, are no longer integral to the structure of the Czech and Slovak economies and do not appear to be a government priority. It is projected that their market share of foreign trade will be further reduced over the years ahead.

Consideration must be given as to what value FTOs now add to the economic process. Previously they were an integral part of the system. Is this now really the case? Consider, which of the FTO's earlier clients have stuck with the FTO. Is there a broad cross section or do bigger and better quality producers and buyers now sell or buy direct, leaving the FTO with only smaller or less profitable transactions?

As the economy and business awareness continues to develop, there would appear to be a reducing requirement for entities of this nature. Unless FTOs are able to adapt to a wholly new business environment, it would seem probable that they are likely to decline into a minor trade finance or accepting house role.

Consider the short, medium and long term viability of the FTO structure:

- What and where are the businesses, suppliers and customers?
- Is the overall business growing, static or declining? Why?
- Are there different aspects or sectors of the business? Respectively, are they growing, static or shrinking? Why?
- Is the business profitable at the operating level?
- Consider the cost structure both of the business overall and of its related parts.
- Interest?
- Bottom line?
- Market value of assets: Possible collateral or asset sales?
- Review shareholding and investment portfolios for assets which might be saleable on the stock

market or by private placement with investors either direct or through Consilium.

- Purchase of both overseas and domestic receivables?

- Barter transactions?

Instances have occurred where the Bank has entered into a credit exposure on the strength of the relationship with an FTO, which persuaded the Bank to provide finance to a joint venture or affiliate (sometimes essentially of an equity nature). The exposure is now in default and the FTO wishes to keep the debt at arms length. It is wrong fundamentally, that having persuaded the bank to back a venture, to an extent often many times greater than the investor's injection of equity, the bank should be asked to accept the loss.

The Bank should point out to the FTO its moral commitment, with the intention of obtaining a contribution to the loss. The Bank should review its relationship with those organisations which refuse to provide support to their troubled subsidiaries and affiliates.

It is recommended that if the Bank is to take action against FTO exposure, then this should commence in the immediate future, with the aim of obtaining further government assistance. Support is more likely at this stage rather than in five years time, when the importance of FTOs to the economy and the country is reduced further.

8.7 ADDITIONAL CONSIDERATIONS

8.7.1 THE TAKING OF REALISABLE COLLATERAL

Given the current phase of the law's development, the ability to realise collateral is fraught with difficultly, open to dispute and often in doubt.

Section 299 of the Commercial Code permits the realisation of a pledge by a pledge creditor. In instances of a pledge on inventory, receivables or other movables, it is believed that effective control can be achieved. However, in the case of real estate a critical dilemma in interpreting the law, is the belief that an owner of property should not be deprived of his ownership rights, by virtue of the realisation of a security interest. **Consequently, ownership of property is the basis of secure lending.**

In the context of problem loans and workouts, the Bank should consider the strategy of renegotiating credit facilities with borrowers, in order to obtain better quality documentation, with the simultaneous intention of gaining direct ownership of collateral security.

If collateral is transferred into the Bank's name, the primary problem is that a risk weighting for capital adequacy purposes, of up to two times the original credit exposure, is generated.

The resolution of this dilemma requires a two pronged approach, in order that the Bank remain within BIS and CNB guidelines.

- The Bank should, subject to legal advice, consider the setting up of a subsidiary nominee company, into which the ownership of all asset security should be registered.

Ownership of this subsidiary should be structured, so that the Bank and each of its subsidiaries, own approximately an equal stake in the company. On a consolidated basis, the Bank will own therefore, one hundred percent of the nominee company.

The Bank completes capital adequacy returns to the CNB on a single company rather than consolidated basis. As a consequence, the use of this corporate structure, will provide the Bank with secure and realisable collateral, whilst at the same time ensuring the maintenance within guidelines of capital adequacy, so far as it is impacted by the adoption of this solution.

Any property transferred into the Bank's name, with the objective of the Bank obtaining a good security interest in that property, shall be subject to a repurchase agreement between the borrower and the Bank. The agreement shall specify that the property will be repurchased by the borrower, at such time as the debt has been extinguished. This repurchase shall be for a nominal consideration of Kc 1.

In the event of any material default, the repurchase agreement shall lapse and shall (other than with the Bank's consent) not be of any further force or effect. In such instance the property will be wholly available for disposal at the discretion of the Bank.

It is important that any agreement of this nature, specifies that the borrower accepts responsibility for the ongoing maintenance of the property, until such time as the debt is repaid and the property is returned, or otherwise until default is declared. This also provides protection to the Bank as regards capital adequacy.

The secondary (and comparatively minor) problem, arises from the requirement to pay a five percent tax upon the transfer of real estate. However, this should be viewed in the context of the possibility of bankruptcy proceedings, which can generally be called by any two or more creditors, the resolution of which, could involve a period of time in excess of three years. Current interest rates are higher than fifteen percent per annum. On this basis the solution is self-evident.

8.7.2 ENVIRONMENTAL POLLUTION

In the Czech and Slovak Republics, there does not appear, at the present time. to be liability for banks lending to industries or businesses which pollute the environment. This is potentially a risk area and it is possible that developments in the law, could result in banks being required to accept liability for the results of environmental pollution.

In Western Europe and the United States, environmental pollution is almost the only area, where banks have the potential to lose sums greater than the aggregate of principal and interest.

If a borrower or the Bank seek an outside investor as a route to resolving a problem loan, then due cognisance must be paid to the following aspects of Resolution 123, which resolution relates to environmental pollution.

1. The government must give its prior consent in order for the resolution to apply;

2. Reimbursement of costs is limited to the purchase price of either assets or equity. This is a maximum indemnity.

3. Sanction fees are excluded. These are penalties imposed by the government. Any purchaser should ascertain the potential amount or alternatively obtain prior waiver of such fees.

This is relevant to the work-out process since a restructured company could subsequently flounder under the weight of environmental claims.

8.7.3 NON-ACCRUING INTEREST

There is a problem in "switching off" interest or placing a loan or exposure onto a non-accruing basis. Banks are limited in their ability to "switch-off" interest unless the client is in course of bankruptcy proceedings.

In deciding to "switch-off" interest, account must be taken of the following considerations:

1. If interest is not passed through an income account (on which tax is paid), then in case of bankruptcy or liquidation, the size of the potential claim is reduced;

2. If all creditors do not act in concert, then a lender "switching-off" interest, could in case of bankruptcy or liquidation, be disadvantaged vis-a-vis other creditors; and

3. The Commercial Code, sections 41 to 55, places banks at risk of legal action since such behaviour could be deemed to be "unfair competition". However, if banks behave prudentially it is unlikely that there would be material risk.

Discussions are presently in course at government level, which could allow unpaid interest to be a deductible expense for tax purposes. If approved, this would ease the adoption of a pragmatic approach to "switching-off" interest.

8.7.4 CONVERSION OF LOCAL CURRENCY EXPOSURE INTO FOREIGN EXCHANGE

The interest rate structure for facilities denominated in Kc is such, that customers of the Bank are likely to request their Kc denominated facilities be converted into foreign currency, in order to take advantage of the interest rate differential. In the short term there may be a benefit to the client in terms of saving interest costs but the long term cost to the client, if there is a major and adverse currency movement, is likely to wipe out an amount greater than all savings achieved. The only proviso to this situation arises when there is an ability and willingness to hedge the exposure forward on the client's behalf.

In the specific context of problem loans and work-outs, foreign exchange facilities add an additional element of risk to the process, namely that of the cross currency exposure.

The collateral for a facility of this nature is likely to be a Kc denominated asset. Any adverse currency movement might well therefore, leave the Bank in an unsecured position.

The Bank should not accept the conversion of Kc facilities into foreign currency solely in order to enable the client to benefit from a lower interest rate structure. Conversion should be permitted only in instances where there are foreign currency cashflows of sufficient size, stability and regularity to permit full debt service in a timely manner.

8.7.5 STATUTE OF LIMITATIONS

Care must be exercised by the Bank that claims and exposures do not become time barred through inaction.

Irrespective of having made formal demand upon non-payment or the original event of default, the Bank must ensure that formal demand is again made on the borrower, at least six months prior to the claim becoming time barred. The borrower must acknowledge his obligation in writing in order that a new period of limitation may commence.

If no acknowledgement is received then the Bank must commence legal action in order to protect its position.

8.7.6 DEBTS TO ENTITIES IN THE FORMER SOVIET UNION

It is probable that at least some of the Bank's problem clients, possess debts due from entities in the former Soviet Union.

Whilst these debts are likely to be almost impossible to collect and probably will have to await inter-governmental initiatives, the Bank should, in conjunction with its customers, explore all possibilities for debt collection/reduction including debt swaps and swap, barter and countertrade opportunities.

8.7.7 SLOVAKIA

The legal environment within Slovakia, differs from that in the Czech Republic. Consequently, the following aspects require consideration:

- Within Slovakia the Bank operates as a branch of a foreign bank. As such, in instances of liquidation or bankruptcy, the Bank is not represented on the committee of creditors.

- The Bank should set up a Slovak subsidiary to which debts of all clients involved in the bankruptcy process could be sold. The subsidiary would then be a Slovak entity which could sit and vote on creditor's committees.

8.7.8 MISCELLANEOUS

The following are a series of matters, which do not fit naturally within the body of the Manual. However, these points are worthy of consideration and are included on a "for what worth" basis.

- It is now possible to obtain a form of summary judgement or rapid hearing in order to block a sale, transfer or removal of an asset. This is through the issuance of preliminary measures in order to freeze the action complained of. If necessary this can be obtained in days or even hours.

- If management or key directors are valuable or critical to the future of a business or the turnaround or profitability of an enterprise, then these can be incentivised by cash payments, golden handcuffs, profit share, bonuses, equity options etc.

- With smaller clients it is possible, although unlikely, that the bank can assist with finding new markets for their goods. This should be only on a small scale basis and does not require the setting up of specialist departments to handle this matter.

- CNB is setting up an Interbank Credit Information system known as FIBOK. Contains details of clients, banks, types of accounts etc. - Could be useful to the work-out process in respect of information on non-clients.

9. TREATMENT OF INTEREST AND PAYMENTS RECEIVED ON PAST DUE ACCOUNTS

9.1 CAVEAT

It is recognised that under the existing tax, accounting and legislative environment, this section is unworkable. However, the Bank should be aware of "Best Practice" and use all means available to influence the government, in order that due allowance be permitted in respect of non-accruing or unpaid interest or principal. A specific recommendation is that the Bank should work with all other banks in the Czech Republic, in order to transform the existing Banking Association into a viable and influential banking lobby.

9.2 INTRODUCTION

In the absence of agreement to the contrary, Czech and Slovak laws presently require payments into an account to be allocated to settle first interest and subsequently principal. This problem is exacerbated by the Bank's decision, as set out in its standard terms and conditions, that customers must accept the Bank's requirement, that payments are allocated first to penalty interest, subsequently to interest and fees and only lastly in reduction of principal. In the instance of problem loans, consideration will be given by the Bank to flexibility in this matter.

The allocation of payments on this basis is a self-inflicted wound by the Bank, on itself and exacerbates the difficulties for problem borrowers both in terms of interest and debt service and also, ultimate repayment. The rationale behind this view is that any successful business, even in a stable operating environment would have great difficulty in servicing interest, at rates approaching thirty percent per annum. If interest is charged at this level as a means of short term punishment, then damage, although painful is limited. However, the Bank has client relationships where debt has not been serviced for three years or more, and where interest at thirty percent per annum now amounts to a multiple of the original debt.

The problem exists both for the borrower and the Bank. For the borrower, because there is now in some cases a total inability to pay and for the Bank in that it has taken interest to profits on which tax has been paid. Unless the borrower is placed into bankruptcy, the Bank is unable to obtain any tax relief in respect of either principal or interest.

9.3 TREATMENT OF INTEREST

A loan shall be considered non-earning if Principal or Interest are past due more than 30 days.

All past due interest shall be reserved and not taken into income. Any interest taken to income but not received must be reversed.

A non-earning loan must be awarded a classification of "Watch"* or lower as designated in Section 4.

9.4 PAYMENTS RECEIVED ON PAST DUE ACCOUNTS

Interest payments received for "Substandard " and "Doubtful" loans shall be applied first as a reduction of principal, second as a recovery to the write-off, and finally as interest income.

For loans which have been written-off in full, payments shall be applied first to recovery of principal written-off and only then, to interest income.

* Note that although the recommendation is for a classification of "Watch", the Bank should work towards adoption of classification criteria by which non-earning exposures are classified "Substandard" at thirty days.

10. AUTHORITY FOR LITIGATION

10.1 INTRODUCTION

In most cases it will be Problem Loans Department which initiates legal action. However, in low value cases, the exposure may still be managed at branch level and in such instances litigation will be handled by the relevant branch.

10.2 AUTHORITY

Authority for litigation rests with the Credit Sanctioning Committee which must be advised of claims in respect of credit exposures, both against and by the Bank as soon as they are known or to be instigated. Where the litigation is managed at branch level then Problem Loans Department should be informed and where necessary requested to assist. Where litigation is handled by Problem Loans Department, then application may be made direct to the Credit Sanctioning Committee.

The Manager of Problem Loans Department shall have absolute responsibility and authority for the appointment of outside lawyers.

Prior to initiating any legal action the following information should be provided by the unit in the Bank which is initiating or has responsibility for the litigation process:

- Comments and recommendation of Problem Loans Department;
- The name of the lawyer or law firm to be used and the reason for using them;
- Comments of local lawyers if appropriate;
- Estimated expense to be incurred (e.g. lawyers fees, bailiffs, surveyors, valuers etc);
- The objectives of the action and the expected result (i.e. foreclosure, lien, attachment);
- Total debt which is the subject of the claim, including principal, interest and expenses incurred to date and future expenses as above estimated; and
- The chances of recovery expressed in percentage terms.

Instances will arise when a Branch Manager may be aware that a borrower is about to leave the Czech or Slovak Republics with the object of defeating his creditors, or a borrower is concealing or dissipating his assets with the same objective in mind. In such cases the Branch Manager may, if urgent action is required, take necessary steps on his own responsibility, although he should use best efforts to obtain at the least a verbal agreement from one of the Board Members of the Bank. A formal advice in writing shall be provided through Problem Loans Department to the Credit Sanctioning Committee within 5 business days of such action being taken. This action shall be formally noted and recorded in the minutes of such meeting.

Litigation always involves risk and the outcome is frequently in question. As a consequence it is forbidden and against Bank policy to instigate litigation proceedings without the prior written approval of the Credit Sanctioning Committee, against:

- Another bank.
- A government or quasi-government entity or institution.
- A charitable institution.

11. RECORD KEEPING

The problem loan and workout function is critical to the future success of the Bank. As a consequence it is crucial that proper records are maintained, in order to track the progress of a relationship. These are required for record purposes but also to serve as evidence should it be necessary to produce records at court.

Clear records are required in order to chart the progress of a situation, negotiations, agreements, debt forgiveness, suspension or reduction of interest, provision of information and other details critical to the Bank's relationship with the debtor.

It is mandatory that written records shall be kept of all conversations, agreements etc. These shall be maintained in the format of a note to the file, setting out the essence of the discussions or agreement.

Copies shall be distributed as follows:

1. Original to the client's credit file maintained in Problem Loans Department.

2. Copy to the Branch Credit File.

   - A recommended structure for a credit file is set out at Appendix N.

3. Copy to the Day File of the individual recording the information.

   A day file is a chronological record of all correspondence, memoranda, presentations etc. produced by that individual. A separate day file is to be maintained by the departmental secretary on behalf of each member of the department. This file should be retained for a minimum of three years.

4. If action is required, whether on the part of the client, Bank or other third party, then a copy shall be placed in the recall/diary system that shall be maintained by the departmental secretary. This copy shall be returned to the officer responsible, on the due date for the necessary follow up or so that action may be taken.

5. If the information impacts on or requires action by another department, then a copy sent to that department, annotated to the effect that action or follow up is required, is an effective and efficient method of advice or instruction.

6. A copy shall also be placed in the departmental circulation file.

   The circulation file shall contain copies of all written material produced by any member of the department during the course of a week. This includes all, memoranda, file notes, letters, applications, presentations, agreements etc.

The purpose of a circulation file is as an aid to communication between the members of the department. It assists in the transmission of information and forms part of the learning and training process.

Clarity of communication is important to success. This sharing and pooling of information will contribute to the development of all parties concerned.

12. CLAIM RECORD AND FINAL WRITE-OFF

12.1 CLAIM RECORD

Maintenance of clear client records is important for the Bank, not only as a catalogue of events, performance and agreements but also in order to ascertain accurately the outstanding amount, which may not necessarily be the amount carried on the Bank's accounting records. Discrepancies between amounts due or unpaid and amounts reflected on the books usually arise as a result of management decisions (e.g. placing on a non-accrual basis, partial or full write-offs, etc.).

The claim record should enable management to ascertain at all times:

- The nature of the exposure;
- The gross principal amount due (including write-offs or allocated reserves);
- The amount of any write-offs or reserves which have been made;
- The net book value;
- The amount of interest earned and not collected (which may or may not be accrued and, if accrued, may have been reversed); and
- The amount of expenses (legal or otherwise) incurred in taking remedial action and considered collectible in case of a full payout. These expenses may or may not have been already charged-off on the Bank's books.

12.2 FINAL WRITE-OFF

After a period, a point will be reached when further time and effort to obtain recovery will prove uneconomic. Authority to write-off bad debts shall be in accordance with the authorities specified in Appendix C. The consent of the appropriate level of authority, together with the agreement of the Credit Sanctioning Committee should then be obtained in order to cease legal action.

The rationale as to the decision to abandon action should be documented fully in the client's credit file.

Draft

PROBLEM LOANS POLICIES AND PROCEDURES MANUAL APPENDICES

ČESKOSLOVENSKÁ OBCHODNÍ BANKA, A.S.

January 1995

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NOTE

These appendices, which should be read in conjunction with the earlier sections of the Problem Loans Policies and Procedures Manual, contain suggested forms for use by the Bank in the monitoring and recovery of problem loans.

Whilst the format and content of these forms have been designed to apply to the Bank's requirements as envisaged, the length of each form will need to be expanded or reduced in accordance with the specific needs of the presentation or report.

APPENDICES

APPENDIX A.

PROBLEM LOANS AND BAD DEBTS DEPARTMENTAL STRUCTURE

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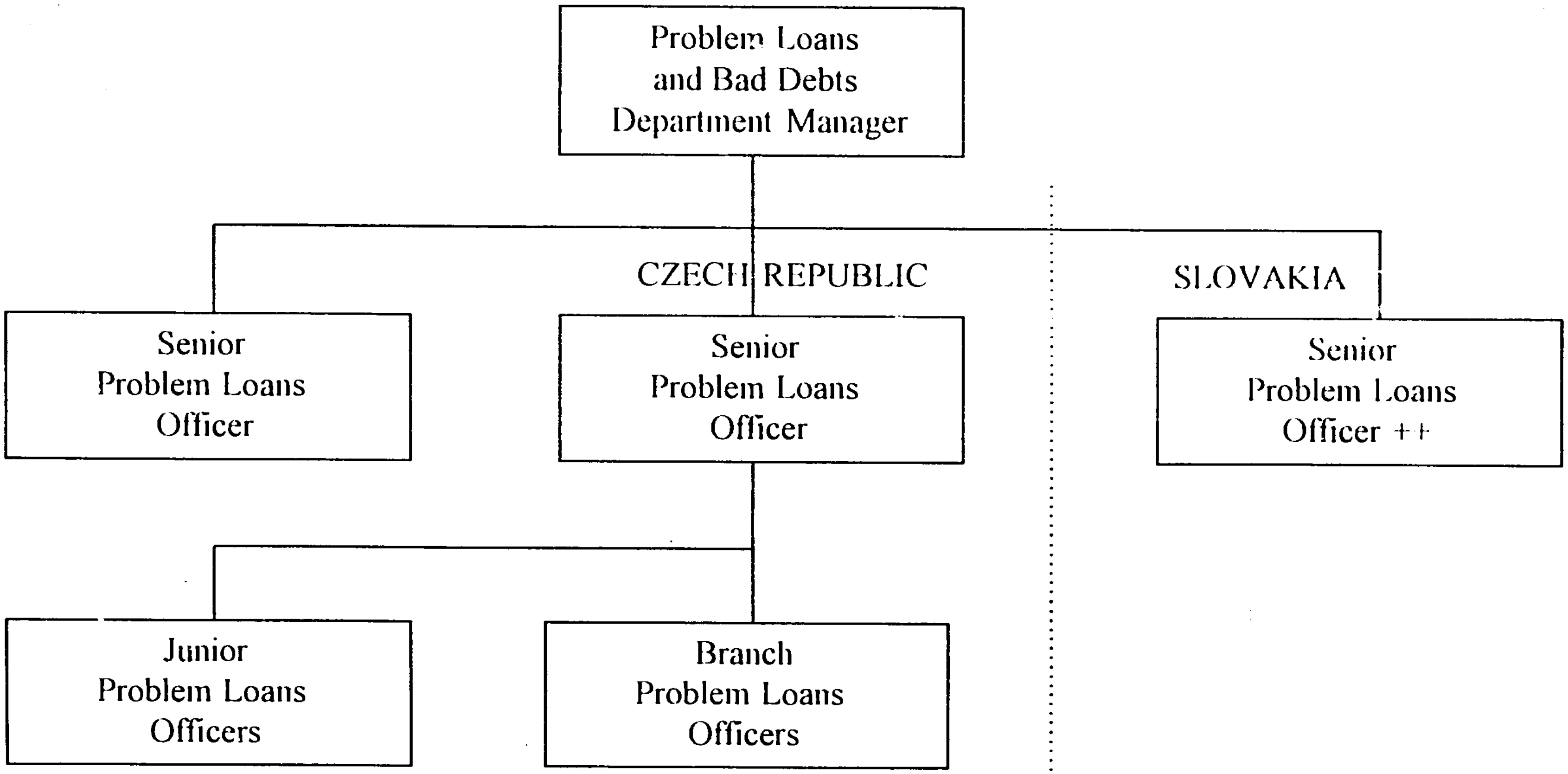
PROBLEM LOANS AND BAD DEBTS DEPARTMENTAL STRUCTURE



** Structure repeated below all three Senior Officers.

One Branch Problem Loans Officer per Main Branch.

++ Based in Prague but travelling regularly to Bratislava as and when required

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APPENDIX B.

JOB STATEMENTS

JOB STATEMENTS

Job Title: Problem Loans and Bad Debts Department Manager

Reporting to: Credit Department Manager

Job Purpose

To manage and organise the work of the Problem Loans and Bad Debts Department including the management of underperforming credits. To advise and instruct Problem Loan Officers and branch staff in determining the action to be taken to improve the quality of the Bank's assets and client credit quality, and in managing the conversion/recuperation of impaired assets. To deal personally with complex cases. To monitor and control the bad debt portfolio and maximise recovery

Duties and Tasks

- manage the Department and its work, allocating tasks to Bad Debt Officers, giving them training, advice and instruction and monitoring their work
- receive and review the files of underperforming clients and ensure the Bank is protected against loss
- monitor the Bank's exposure to problem loans, liaising with Credit Policy Department regarding industry trends and reporting to the Credit Sanctioning Committee on findings and provision and write-off recommendations
- report regularly to the Credit Sanctioning Committee on progress and problems encountered in managing bad debt cases
- liaise with heavily indebted clients to negotiate agreements regarding repayment of debts, e.g. by rescheduling, debt forgiveness or debt-to-equity swaps
- discuss details of client files and advise branch staff on the management of problem loan cases
- manage personally the files of significant high risk credit clients
- liaise with Legal Department and external Legal Advisers where litigation is required to secure debt repayment
- foreclose on security held by the Bank and manage liquidation of assets (may involve liaison with third parties, external specialists and/or official liquidators, directing their work in the Bank's best interests): finding/negotiating with potential investors who may take on debts or sell them on the secondary market: arranging recuperation of debt at local level or convert into local currency or commodities

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- liaise with Branches and other departments where appropriate regarding the management of heavily indebted clients not yet in liquidation, and new cases to be dealt with

- instruct Operations Department concerning procedures regarding the identification and management of bad debts

Main Responsibilities

- to manage and organise the work of the Department

- ensure effective monitoring and work out of the Bank's portfolio of bad debts

- develop and implement procedures and actions to recover underperforming credits and minimise loss to the Bank in case of bad debts

- monitor the Bank's bad debt portfolio effectively, identify potential problems as soon as possible and maximise recovery on underperforming and bad debts

- monitor the Bank's bad debt exposure thoroughly and recommend appropriate provisions and write-offs to recommend prudential provisioning policies and requirements

- give consistent advice concerning the management of credit risk

Main Authorities

- direct staff throughout the Bank to improve the credit position of problem clients

- take action to recover bad debt (e.g. debt conversion, asset sale)

- manage personally the files of a number of key clients and negotiate with third parties regarding the sale of debts

- require information concerning specific bad debt cases and industrial or economic trends

- appoint external specialists where appropriate

- prepare Department budgets and approve expenditure within budget

- approve restructuring of credit limits up to Kc 400 million (up to Kc 200 million where there is a new money requirement) and authorise write-off of irrecoverable amounts to Kc 20 million

Qualifications and Experience Required:

Academic & Professional Qualifications appropriate to the Job

Degree level education preferable

Experience needed to perform Job

At least two to three years' experience of debt recovery work (five years' experience desirable). Further experience of credit risk assessment. Some management experience.

Skills Requirements

Banking and Technical Skills	Professional, Managerial and Professional Skills
Thorough knowledge of bad debt management and the disposal of bad debts Good knowledge of credit and risk assessment Knowledge of industry and economic trends	Negotiating skills Staff management Good verbal and written communications skills Fluent in English and knowledge of other major foreign languages useful

Job Title: Senior Problem Loans Officer

Reporting to: Problem Loans and Bad Debts Department Manager

Job Purpose

To manage, in the best interests of the Bank, the files of underperforming credit clients and the conversion/recuperation of the assets of creditors in liquidation or bankruptcy.

Duties and Tasks

- receive and review the files of underperforming clients and ensure the Bank is protected against loss
- liaise with heavily indebted clients to negotiate agreements regarding repayment of debts, e.g. by rescheduling, debt forgiveness or debt-to-equity swaps
- discuss the details of client files with Branch staff and advise on action to be taken
- prepare reports and recommendations for the administration of underperforming client files for consideration by the Department Manager and the Credit Committee
- liaise with Legal Department and external Legal Advisers where litigation is required to secure debt repayment
- foreclose on security held by the Bank and manage liquidation of assets (may involve liaison with third parties, external specialists and/or official liquidators and directing their work in the best interests of the Bank: finding and negotiating with potential investors who may take on debts or sell them on the secondary market: arranging recuperation of debt at local level and/or convert into local currency or commodities
- liaise with Branch staff and other Departments where appropriate to monitor files on a continuous basis and prepare further recommendations for action as the situation develops
- manage personally the files of significant high risk credit clients
- assist in the preparation of procedures concerning debt management and give Branch and Department staff advice concerning these
- supervise work of Branch and Junior Problem Loans Officers

Main Responsibilities

- to monitor and work out a portfolio of bad loans
- to improve the position of the Bank's underperforming credits and reduce the Bank's losses arising from bad credits
- to give consistent advice concerning the management of credit risk
- to manage liquidation/asset recuperation in the Bank's best interests

Main Authorities

- to direct Branch and Junior Problem Loans Officers in measures to improve the credit position of problem clients
- to manage personally the files of a number of key clients
- to instruct heavily indebted clients in actions required by the Bank
- to negotiate with third parties concerning the liquidation process and recuperation of assets

Key Objectives (List below up to six performance objectives relevant to job)

TO BE AGREED

Qualifications and Experience Required:

Academic & Professional Qualifications appropriate to the Job

Secondary school level education

Experience needed to perform Job

At least one to two years experience of debt recovery work (three years' experience preferable). At least one further year's experience of credit risk assessment.

Skills Requirements

Banking and Technical Skills	Professional, Managerial and Personal Skills
Thorough knowledge of bad debt management and the disposal of bad debts Good knowledge of credit and risk assessment	Negotiating skills Knowledge of a major foreign language useful

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Job Title: Junior Problem Loans Officer

Reporting to: Senior Problem Loans Officer

Job Purpose

To manage the conversion/recuperation of the assets of creditors in liquidation or bankruptcy in the best interests of the bank (dealing with smaller and less complex cases than those handled by Senior Problem Loans Officers)

Duties and Tasks

AS SENIOR PROBLEM LOAN OFFICER BUT DEALING WITH SMALLER AND LESS COMPLEX CASES

Main Responsibilities

- to monitor and work out a portfolio of bad loans
- to manage the liquidation/asset recuperation process in the best interests of the Bank

Main Authorities

- to instruct heavily indebted clients in actions required by the bank
- to negotiate with third parties concerning the liquidation process and recuperation of assets

Key Objectives (List below up to six performance objectives relevant to job)

TO BE AGREED

Qualifications and Experience Required:

Academic & Professional Qualifications appropriate to the Job

Secondary school level education

Experience needed to perform Job

Up to one year's experience of debt recovery work. At least one further year's experience of credit risk assessment.

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Skills Requirements

Banking and Technical Skills	Professional, Managerial and Personal Skills
Good general knowledge of bad debt management and the disposal of bad debts Good knowledge of credit and risk assessment	Negotiating skills

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Job Title: Branch Problem Loans Officer

Reporting To: Senior Problem Loans Officer at Head Office.

The primary reporting line is to the Senior Problem Loans Officer in the Head Office Problem Loans Department. The Branch Problem Loans Officer sits in the Branch Credit Department and has a strong working relationship with the Branch Credit Manager.

Job Purpose

To monitor and manage impaired assets and bad loans at the branch level under the direct instruction of Head Office Problem Loans and Bad Debts Department. To act as a focus for customer contact at the local level. To manage on a day to day basis, small or less serious classified exposures and to report to Head Office as instructed. To inspect and value collateral and to realise that collateral when instructed.

Duties and Tasks

- To obtain details from and complete in conjunction with, the relationship manager and approving Credit Officers, a full report summarising the background to the problem together with the steps taken to date in order to effect recovery.
- To examine documentation to ensure that it has been completed correctly and to confirm that the bank is protected fully.
- To recommend the appropriate level of classification and provisioning together with an explanation as to the basis of recommendation if any subjective judgement has been made.
- To prepare an action plan as to how the account is to be managed in the future together with recommendations as to whether litigation is appropriate so that recovery may be maximised.
- To copy full details of all items to Problem Loans and Bad Debts Department and the Credit Audit section in Internal Audit Department.
- To negotiate with the customer, under the instruction of the Senior Problem Loans Officer, an agreement as to how repayment is to be effected either by way of rescheduling, debt forgiveness or debt to equity swaps.
- To liaise, in conjunction with the Senior Problem Loan Officer, with the Legal Department as to how, (in the event that rescheduled payments are not maintained), litigation is to be implemented. To work closely with Legal Department to ensure that the case is progressed in a timely manner.
- To foreclose on any security held by the Bank and to collect and liquidate all available assets of the borrower.
- To report to the Senior Problem Loan Officer on a monthly basis any developments or action taken with regard to classified accounts.
- In addition to the monthly follow up reports, to report every six months providing full details as to progress and updating classifications and future action plans.

- To serve as the local contact point with the borrower where bad and problem loans are handled by Head Office.

Main Responsibilities

- To report to Head Office all classified exposures in accordance with the bank's requirements.
- To recommend classification and provisioning requirements.
- To liaise with local classified client relationships.
- To monitor and work out a portfolio of impaired exposures.

Main Authorities

- To require details of any exposure where payments of Principal, Interest or Fees are 30 days or more past due.
- To manage personally the files of a number of classified clients.
- To instruct clients in actions required by the Bank.
- To instigate legal action and where necessary foreclose on security.

Key Objectives (List below up to six performance objectives relevant to the job)

TO BE AGREED

Qualifications and Experience Required:

Academic & Professional Qualifications appropriate to the Job

Secondary school level education

Experience needed to perform Job

Up to one year's experience of debt recovery work. At least one further year's experience of credit risk assessment.

Skills Requirements

Banking and Technical Skills	Professional, Managerial and Personal Skills
Good general knowledge of bad debt management and the disposal of bad debts Good knowledge of credit and risk assessment	Negotiating skills

APPENDIX C.

APPROVAL AUTHORITIES

APPROVAL AUTHORITIES

Approval authorities should be as follows:

Kc MM omitted

	Provision or Write Off	Total Exposure	Initial Associated Costs **
Manager Department 45	20	200/400*	1
Manager Credit Dept	30	500	2
Director Banking	40	750	3
Credit Sanctioning Committee	50	1000	5
Board of Directors	50+	1000+	5+

A Main Branch Manager can write-off up to Kc 1mm per annum, subject to no single amount exceeding Kc 0.2mm. All write-offs at branch level shall be routed through one account which shall be reported through Problem Loans Department, to the Credit Sanctioning Committee and the Board of Directors on a six monthly basis.

* The split level approval authority for the Manager of Department 45, means that the Manager can approve up to Kc 400mm where the exposure is restructured without a new money requirement. Kc 200mm is the maximum which can be approved if <u>any</u> new money or additional risk exposure is involved.

** Initial Associated Costs shall be defined as those costs to be incurred in order to ascertain the Bank's position and the recoverability of the exposure. For example, it includes the cost of valuing collateral or <u>initial</u> legal expenses. It does not include costs required in order to proceed to litigation.

APPENDIX D.

INITIAL REPORT

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INITIAL REPORT

TO: PROBLEM LOANS DEPARTMENT

CC: Branch Problem Loans Officer
Branch Credit Department
Client Credit File

BORROWER: BORROWER IBIS NO:

GROUP: GROUP IBIS NO:

DATE: BRANCH:

PART A

Gross Aggregate Outstandings: Kc ______

Aggregate Facility Limit: Kc ______

Limit Expiry: ______

Collateral Value: Kc ______

Amount Past Due: Kc ______

Reason for Delay: ______

______

______

Action Taken to Ensure Payment: ______

______

______

Signed By:

Client Relationship Manager: ______

Credit Officer: ______

PART B

We certify that funds have been received, the amount past due above mentioned has been paid in full. A further report will be filed in case of any subsequent delay.

Signed By: Date: ______

Client Relationship Manager: ______

Credit Officer: ______

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APPENDIX E.

PROBLEM LOAN REPORT

PROBLEM LOAN REPORT

TO: PROBLEM LOANS DEPARTMENT

CC: Branch Credit Department
Branch Problem Loan Officer
Client Credit File

BORROWER: BORROWER IBIS NO:

GROUP: GROUP IBIS NO:

DATE: BRANCH:

---

1. **BORROWER.**

2. **BACKGROUND, OUTSTANDINGS AND LOAN HISTORY.**

3. **CLASSIFICATION AND REASON FOR CLASSIFICATION.**

4. **REMEDIAL ACTION TAKEN BY THE BORROWER.**

5. **REMEDIAL ACTION TAKEN BY THE BANK.**

6. **ACTION PLAN.**

7. **ASSESSMENT AND PROSPECTS OF RECOVERY.**

8. **STATUS OF DOCUMENTATION.**

9. **FINANCIAL SUMMARY.**

Signed By:

Client Relationship Manager:______________________________

Credit Officer:______________________________

Branch Credit Manager:______________________________

Branch Manager:______________________________

The Problem Loan Report should be completed using the following methodology:

1. **BORROWER.**

- Provide background details as to the client, business background and history, ownership, management and other relevant customer details.
- List all owners with a holding of 10% or greater in the business. List names and background of senior executives.
- Include all group issues.
- Summarise the relationship with the Bank.

2. **BACKGROUND, OUTSTANDINGS AND LOAN HISTORY.**

- Provide details in Kc of the Bank's exposure as at the date of the report. Append a detailed analysis of all exposure at attachment PLR 2.
- When was the facility approved originally and who were the approving officers and approving authority at the date of approval and/or review.
- Document the Bank's exposure including outstandings and undrawn commitments on an individual basis. Show each facility separately and include tangible and intangible collateral. Append a detailed analysis of all collateral at attachment PLR 3.
- Provide details of write offs (if any), specific provisions, general reserves and net book value.
- Describe the loan history and status including date classified, bankruptcy proceedings, liquidation plans, etc.

3. **CLASSIFICATION AND REASONS FOR CLASSIFICATION.**

- Recommend an appropriate level of classification and justify the recommendation by reference as to the reasons leading to the present difficulties. eg: fraud, losses, speculation, miscalculation, etc'.

4. **REMEDIAL ACTION TAKEN BY THE BORROWER.**

- Describe what action the client has taken to correct the situation.

5. **REMEDIAL ACTION TAKEN BY THE BANK.**

- Describe action taken by the Bank to improve its position including obtaining repayment or additional collateral.

6. ACTION PLAN.

- Describe what action is proposed to protect the Bank's position. Provide details together with target dates for implementation.

7. ASSESSMENT AND PROSPECTS OF RECOVERY.

- Summarise and evaluate honestly, the present position. Estimate the size of any write-off that may be required and the timing of any proceeds or income that could be achieved through a realisation process or legal action.

8. STATUS OF DOCUMENTATION.

- Confirmation that documentation is complete and as described in the last approved Credit Proposal.

- Date of the last documentation review and the names of the reviewing officers.

9. FINANCIAL SUMMARY.

- Attach three years financials, together with spread sheets and analysis.

- Provide details in respect of financial structure which might not be apparent immediately from the figures. i.e. hidden reserves, overvalued property, uncollectible or long term receivables, stale inventory or other.

Complete attachment forms PLR 1, PLR 2 and PLR 3 in accordance with instructions appended.

PLR 1

CUSTOMER NAME: ____________________

DATE RELATIONSHIP COMMENCED/KIND OF RELATIONSHIP: ____________

DATE LIMIT APPROVED: ____________ ORIGINAL MATURITY: ____________

ORIGINAL LIMIT: ____________________

NAMES & LEVELS OF APPROVERS: ____________________

____

CURRENT CLASSIFICATION & DATE AWARDED: ____________________

TOTAL GROUP AGGREGATE OUTSTANDING: Kc ____________________
(Provide detailed analysis at PLR 2 attached)

Specific Provisions: ____________ Date Provided: ____________

General Provisions: ____________ Date Provided: ____________

Amount Written-Off: ____________ Date Written-Off: ____________

Interest Accrued but not yet due: ____________________

Past Due Principal: ____________________

Past Due Interest: ____________________

Amount & Date of last significant receipt: ____________________

Interest Basis, Margin & Inclusive Rate: ____________________

Date Interest Charge Stopped/Reduced: ____________________

Free Credit Balances with CSOB

	Kc	F/X(1)	Kc Equiv(2)
Current Account			
Deposit Account			
Money Market Placement			
Total:			

Shares, Securities and Other Assets held by CSOB on Client's behalf: (Type and Valuation) ____________________

____

(1) Provide breakdown by currency.

(2) Specify F/X conversion rate.

TOTAL COLLATERAL VALUE: Kc ____________________
(Provide detailed analysis at PLR 3 attached)

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Date of last communication with the client: ____________________

Date of receipt of latest financial information: _______________

Reputation of company locally (attach press cuttings): _________

Completed by: _______________________ Date: ______________________

PLR 2

NAME: ______________________________

FACILITY	OUTSTANDINGS				LIMIT			
	Kc	F/X(1)	Kc Equiv(2)	Total O/S	Kc	F/X(1)	Kc Equiv(2)	Total Limit
Overdraft								
Enforced Debit								
Loan								
Letter of Credit								
Guarantee								
Aval								
Foreign Exchange								
Other (Specify)								
TOTAL								

Unless otherwise specified, provide all figures in Kc '000 omitted.

(1) Provide breakdown by currency.

(2) Specify F/X conversion rates.

A SEPARATE SHEET IS TO BE COMPLETED FOR EACH SUBSIDIARY AND/OR AFFILIATE OR RELATED PARTY TO WHICH THE BANK HAS A CREDIT EXPOSURE. THESE SEPARATE EXPOSURES SHALL THEN BE COMBINED ON TO A SINGLE CONSOLIDATION SHEET. THE EXACT BORROWER MUST BE CLEARLY STATED AND THE CONSOLIDATION SHEET MARKED ACCORDINGLY.

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NAME: ______________________

Collateral

	Total Value (Kc)	Bank Value (Kc)	Basis of Valuation	Date of Valuation	Estimated Market Value (Kc)
Real Estate					
Machinery					
Other Equipment (Specify)					
Vehicles					
Receivables					
Inventory					
Guarantees from non-banks					
Bank Guarantees					
Bills of Exchange/Avals					
Insurance Companies					
Cash					
Other (Specify)					
Total:					

- If you are unable to fit all details on this page, continue on another sheet.
- Provide the name and qualifications of the valuers on another sheet.
- Estimated Market Value is to be taken as a realistic selling price in the current environment, if a sale were to be achieved within a three month period. - In providing this estimate you should consider, who could both afford the asset in question and who would wish to acquire it. - IT IS MANDATORY THAT YOU COMPLETE THIS SECTION.

A SEPARATE SHEET IS TO BE COMPLETED FOR EACH SUBSIDIARY AND/OR AFFILIATE OR RELATED PARTY TO WHICH THE BANK HAS A CREDIT EXPOSURE. THESE SEPARATE ITEMS OF COLLATERAL SHALL THEN BE COMBINED ON TO A SINGLE CONSOLIDATION SHEET. THE EXACT BORROWER MUST BE CLEARLY STATED AND THE CONSOLIDATION SHEET MARKED ACCORDINGLY.

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COMPLETION INSTRUCTIONS

Do not assume that any information is already held on this client. Fill in all possible sections even if completion seems to you to be irrelevant.

GENERAL INSTRUCTIONS

- Fill in all relevant sections.

  If an item is not applicable, state "N/A".

- If you decide to re-type the format for ease of completion, DO NOT leave ANY item off the format.

PLR 1

- Past Due Principal. This represents all amounts of principal that should have been paid but have not been paid as at the date of this report.
- Past Due Interest. This represents all amounts of Interest that should have been paid but have not been paid as at the date of this report.
- Money Market Placement. This represents money market placements solely through CSOB. Do NOT use balance sheet figures as to placements or any other investments.

PLR 2

- If an item is Kc denominated, place this in the Kc column, rather than in the Kc equivalent column.
- Items denominated in foreign exchange, require two entries. The first is the actual exposure in the relevant currency, the second is the Kc equivalent.
- Total Outstandings is the arithmetic total in Kc equivalent of all exposures of any given type.

PLR 3

- Total Value, means the gross amount of the valuation provided to the Bank.
- Bank Value, means the amount of the value as taken by the Bank for lending purposes.

- Basis of Valuation is the method that has been used to calculate the value. i.e. State Method, Book Value, Open Market Value etc.

- If open market value is used, always attach a copy of the valuation.

- Always provide your own estimate of Estimated Market Value.

- For all guarantees, state from whom these are from, especially in respect of cross-guarantees from non-banks. Note that some guarantees may have been given only for a specific exposure. i.e. A particular L/c or loan to a particular company in a group.

APPENDIX F.

CLASSIFIED EXPOSURE REPORT

CLASSIFIED EXPOSURE REPORT

TO: PROBLEM LOANS DEPARTMENT

CC: Branch Credit Department
Client Credit File

BORROWER:

BORROWER IBIS NO:

GROUP:

GROUP IBIS NO:

BRANCH:

MONTHLY REPORT FOR: (Month)

DATE:

CLASSIFICATION: (Watch/Substandard/Doubtful/Loss)

EARNING/NON-EARNING: (Specify)

REASONS FOR CLASSIFICATION: (List & Summarise)

SUMMARY OF MONTH'S ACCOUNT ACTIVITY

Kc (000)

Principal at Prior Month End:

Plus, Additional Disbursements:

Plus, Interest & Charges:

Less, Payments Received:

Outstandings as at Current Month End:

Less, Doubtful Interest Reserve:

Less, Specific Provisions:

NET RESIDUAL BANK RISK:

Collateral Held: (Value)

Potential Additional Write-Off:

Branch Report on Current Month Developments, Action Taken and Planned, Projections and Recommendations:

(Explain)

Signed By:

Client Relationship Manager: ______________________________

Branch Problem Loans Officer: ______________________________

Branch Credit Manager: ______________________________

Branch Manager: ______________________________

APPENDIX G.

ACTION PLAN

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ACTION PLAN

TO: PROBLEM LOANS DEPARTMENT

CC: Branch Credit Department
Client Credit File

BORROWER: BORROWER IBIS NO:

GROUP: GROUP IBIS NO:

BRANCH: DATE:

CLASSIFICATION: (Watch/Substandard/Doubtful/Loss)

EARNING/NON-EARNING: (Specify)

DATE PAYMENT LAST RECEIVED AND HOW APPLIED: (Principal/Interest)

OUTSTANDINGS: (Kc 000)	**CURRENT.**	**PROJECTED AS AT YEAR END.**
ORIGINAL VALUE:		
Less, Provisions:		
GROSS VALUE:		
Less, Doubtful Interest Reserve:		
NET:		

RECENT DEVELOPMENTS:

ACTION STEPS: **IMPLEMENTATION DATES.**

(Specify)

Signed By:

Client Relationship Manager:____________________

Branch Problem Loans Officer:____________________

Branch Credit Manager:____________________

Branch Manager:____________________

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APPENDIX H.

OFFERING TICKET

OFFERING TICKET
(Transaction Disbursement Request)

TO: PROBLEM LOANS DEPARTMENT

CC: Branch Credit Department
Client Credit File

BORROWER: BORROWER IBIS NO:

GROUP: GROUP IBIS NO:

BRANCH: DATE:

Kc

APPROVALS AS PER FACT SHEET/CREDIT PROPOSAL:

APPROVAL DATE:
AMOUNT:
EXPIRY DATE OF APPROVAL:

CURRENT POSITION:

OVERDRAFT/REVOLVING LINE:
LOANS:
LETTERS OF CREDIT:
GUARANTEES:
FOREIGN EXCHANGE:
OTHER LIABILITIES:
FREE CREDIT BALANCES:
PLEDGED CREDIT BALANCES:

TRANSACTION DETAILS:

AMOUNT:
TENOR:
MATURITY:
INTEREST RATE:
FEES:

POSITION POST TRANSACTION:

AGGREGATE DEBIT:
AGGREGATE CREDIT:

IT IS CONFIRMED THAT DOCUMENTATION AND COLLATERAL REQUIREMENTS AS PER THE TERMS OF THE CREDIT APPROVAL ARE COMPLETE, AND THAT THERE IS FULL COMPLIANCE WITH ALL TERMS AND CONDITIONS OF THE APPROVAL.

PLEASE AUTHORISE THE ABOVE TRANSACTION.

Branch Problem Loans Officer: ______________________________

Branch Manager: ____

APPROVED IN ACCORDANCE WITH THE CREDIT POLICIES AND PROCEDURES MANUAL SECTION 4.

APPROVING OFFICER: ________________________

NAME/POSITION: ____________________________

APPENDIX I.

CLASSIFIED ACCOUNT SUMMARY REPORT

TO: THE BOARD OF DIRECTORS

FROM: PROBLEM LOANS DEPARTMENT

DATE:

CLASSIFIED ACCOUNT SUMMARY REPORT
CLASSIFIED ACCOUNTS AS AT_____

CLASSIFICATION LAST MONTH / THIS MONTH	BORROWER	OUTSTANDINGS	INTEREST PROVISION	PRINCIPAL PROVISION	RECOMMENDED PROVISION

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APPENDIX J.

VALUATION CRITERIA FOR REAL ESTATE

VALUATION CRITERIA FOR REAL ESTATE

This explanation is provided, with the intention, not of turning the members of Problem Loans Department into expert valuers but rather, in order to provide an explanation as to the methodologies involved in this work.

An understanding of these methodologies is important, in order that meaningful discussions may be held with the Bank's valuers.

There are three main ways in which to approach the valuation of real estate, these can be summarised as:

1) The Cost Approach

   The current cost of replacing a property with another property of identical age and condition. This takes account of all depreciation and includes the value of the land;

2) The Sales Comparison Approach

   The value as indicated by recent sales of comparable properties in the area; and

3) The Income Approach

   Value as indicated by the capitalisation of income at an appropriate rate.

It is usual to produce a valuation on all three bases and then take an average, in order to arrive at an approximate realistic market value. Market value can be defined as "the price at which a property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or to sell, each being aware of the relevant facts and with equity to both". However, where it is known that the market for real estate is in decline, this figure should always be adjusted downwards to take account of the state of the market. The reverse does <u>not</u> apply in a rising market.

The three approaches are now considered in detail:

The Cost Approach

1. Estimate the value of the land or site as though vacant.

   (i) Ascertain details of recent sales and other vacant sites currently available for purchase or under offer.

   So far as is possible, sites should be comparable to the site in which the Bank is interested, specifically with respect to location, size and other physical characteristics;

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(ii) The comparable figures obtained should be analysed based on the price per square metre.

The valuer should make comparison with the subject site and adjust for any differences. The comparisons should be plotted on a chart or grid with the price of comparable land, adjusted downwards or upwards as necessary, to take account of whether the site is judged to be respectively, superior or inferior, as compared to the subject site.

The adjusted prices provide an approximate range of market value per square metre for the site, as though it were vacant; and

(iii) The valuer then reviews factors, placing greater emphasis upon those considered directly relevant. Once understood, a price per square metre is selected, which is then multiplied by the size of the subject site in order to obtain an estimate of the value of the land.

2. Estimate the remainder of cost (all improvements undertaken to the site).

(i) Consider the replacement cost of all improvements (buildings, landscaping, roads, sewage and all other infrastructure works). A local construction or engineering firm should be used to estimate what it would cost to build the improvements at today's prices.

(ii) Once the replacement cost has been estimated, calculate depreciation and deduct. Depreciation consists of three types:

- Physical Deterioration

  The deterioration or physical wearing of the property. Often calculated by comparing the property's estimated effective age to its estimated economic life. This provides a depreciation percentage;

- Functional Obsolescence

  The decrease in value arising from defects in design and the resulting lack of desirability in terms of layout and style. This is difficult to quantify and is often subjective; and

- Economic Obsolescence

  The loss of value from causes outside the property itself. Again this is difficult to quantify and is often subjective.

(iii) Deduct aggregate depreciation (as calculated), from the estimated replacement cost, to obtain the depreciated improvements value.

3. The estimate of the value of the land, obtained at (1), is added to the depreciated improvements value, obtained at (2). The result provides an indication of value through the Cost Approach method.

The Sales Comparison Approach

1. Research the market for recent sales, and available properties comparable to the subject property in terms of type, use, location, size, age and other relevant factors.

2. Consider the basis of comparison. This may be price per square metre, number of rooms or other relevant basis. The valuer should then analyse each of the comparable properties' most important attributes in relation to the subject property and make adjustments to account for any differences. These adjustments would typically be made by using an adjustment grid, whereby the comparables are listed on a chart and the adjustments shown. If the comparable is inferior to the subject in a respect, then an upward adjustment is made to the comparable, if superior, then a downward adjustment becomes appropriate.

   Once all adjustments have been made, the result will be a range of values on a per unit basis.

3. The valuer then analyses the individual comparables and places most emphasis on those most relevant to the subject, in order to obtain, a per unit value. This is then multiplied by the subject's size (square metres, rooms etc) to obtain the final valuation.

The Income Approach

1. Comparable buildings in the area are reviewed in order to determine a fair market rental. The result is used to estimate the market rent and potential gross income for the subject. This should be expressed as an amount per square metre per month or per year.

   Once a fair rental per square metre has been estimated this is then multiplied by the number of square metres of the subject.

2. Available market data is collected in order to estimate a proper allowance for vacancy and collection loss, forecast to occur during the period of projected ownership.

3. The forecast vacancy and collection loss is subtracted from the potential gross income in order to derive the effective gross income estimate.

4. Anticipated fixed and variable operating costs and expenses, viz. utilities (heating, electricity etc), repairs and maintenance, real estate taxes, insurance and other real estate operating expenses which are likely to be incurred during the period of operation and ownership are estimated and projected forward. Expenses are estimated by an analysis of the subject's actual operating expenses and from a comparison with similar properties.

5. Expenses are subtracted from the effective gross income to derive an estimate of net operating income.

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6. The resulting income stream is converted into an estimated current value, either by the direct capitalisation method or by using discounted cash flow techniques to obtain a net present value. The discounted cash flow calculation should include the reversion or sale of the property at the end of the projection period.

A capitalisation rate is obtained by reviewing comparable sales and dividing the net income, by the sale price, in order to obtain a rate of return.

In the current environment and due to illiquidity in the Czech and Slovak property markets, the discount rate is possibly a better guide. The discount rate shall be taken as the yield on long term government bonds with an increase or premium to allow for market illiquidity and country risk factors. Until such time as a market in long-term government bonds develops, the calculation should be based on the market yield of high quality corporate debt.

All cash flows are calculated on a pre-tax and pre-debt service basis, in order to avoid the effects of income taxes or mortgage debt service.

Value Reconciliation

Once all three methods of calculation have been performed, a range of values will have been obtained. The valuer would then consider each approach with a view to understanding both the quality and quantity of the data. The approach or approaches considered the most reliable, should be weighted the most heavily and a final valuation achieved.

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APPENDIX K.

VALUATION CRITERIA FOR PLANT AND MACHINERY

VALUATION CRITERIA FOR PLANT AND MACHINERY

As with the section relating to the valuation of property this explanation is provided. with the intention, not of turning the members of Problem Loans Department into expert valuers but rather, in order to provide an explanation as to the methodologies involved in this work.

Understanding the basis of value

There are two main bases on which plant and machinery may be valued. These are:

1) Going Concern or Value in Use

- This basis reflects the value of the assets as part of an ongoing and viable business and the extent to which those assets contribute to the profitability of that business.

2) Gone Concern or Value in Exchange

- This basis reflects the views of buyers, sellers and investors regarding individual assets and represents the value obtainable for the assets if sold on an individual or forced sale basis.

There is likely to be a significant variance between values obtained by these two different methods. The choice as to which basis is most realistic, depends on the ongoing viability or saleability of the business.

Assets which are specialised in nature may have little value if marketed individually on a gone concern basis, yet may be making a major contribution to the business. This value can be estimated and is termed "value in use" or "value as part of a going concern".

In instances of valuations on a going concern basis, the investor is less interested in the open market value of the assets but focuses on the contribution which these assets make to current and future cash flows.

Valuation Approaches

There are three conventional approaches to asset appraisal. The Market, Income and Cost approaches.

The Market Approach

- This approach indicates a fair market value.

  Review recent sales and listings of comparable assets, making adjustment and allowance to the values, so as to compensate for differences in location. time of sale and other relevant characteristics.

The Income Approach

- This approach measures the present value of projected future net income or cash flow.

  The relevant figure is forecast over an appropriate period which should approximate to the useful economic life of the asset. The net present value should then be obtained, using traditional discounted cashflow techniques.

  In the instance of machinery and equipment there it is a problem in using this approach, since it is difficult to segregate a specific stream of costs and revenues for each individual piece of equipment.

The Cost Approach

- This approach considers replacement cost to be an indicator of value.

  A prudent investor would pay no more for an asset than the amount for which he could replace the asset as new. The first step under this approach is to determine the replacement cost as new.

  The replacement cost as new, represents the amount of money in terms of current labour and materials, required to construct or acquire new property of equivalent utility.

  Once the appropriate replacement cost as new is determined, adjustments are made to represent losses in value resulting from physical deterioration and from functional, technical and economic obsolescence.

  These concepts are defined below:

  - Physical Deterioration

    The loss in value of the asset arising from wear and tear, use in service and all other physical factors that reduce life expectancy and serviceability.

    The concept of physical deterioration is easily understood. However, in order to quantify the loss due to physical deterioration, the "service life" and "serviceability" factors of the asset must be considered. As an asset is placed in service and begins to age, its service life is impaired or reduced. Thus, there is a reduction in value due to the fact that the asset has a reducing remaining life throughout its service.

  - Functional Obsolescence

    The loss in value of an asset caused by the inability of that asset to perform adequately, the function for which it was intended. Functional obsolescence is thus internal to the asset and is related to such factors as design or production inefficiencies, excessive operating costs, etc.

- Technical Obsolescence

This is a form of functional obsolescence which relates to the loss of value arising from changes in technology, which cause the asset to be less productive or more costly to operate than its competitors.

In quantifying functional and technological obsolescence, most obsolescence is eliminated by using a replacement cost as new approach. Further adjustments are made by quantifying excess operating costs and capitalising them over the remaining life of the asset, or alternatively, by estimating a reduction in that asset's remaining useful life.

- Economic Obsolescence

The loss in value of an asset caused by external forces such as changes in the economics of the operation, reduced demand for the product produced, increased competition, etc.

Since the loss in value is due to external forces it is difficult to assign an income stream to individual assets. Consequently, it is hard to quantify economic obsolescence on an individual asset basis. Thus, the quantification of economic obsolescence is best made on a collective basis, as in the case of a going concern.

APPENDIX L.

POLICY FOR RECEIVABLES FINANCING

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POLICY FOR RECEIVABLES FINANCING

L.1 POLICY

Receivables financing is a high risk area when compared to the greater certainty which can be achieved in lending against a mortgage of real estate, or lien or pledge on other acceptable assets. It is similar in risk profile to lending against inventory, with the added uncertainty arising from the fact that a direct risk is being taken on a third party who is not a client of the Bank.

In providing finance secured by receivables, the Bank must at all times consider the standing and creditworthiness of their client. This is critical in understanding the ability of the client to survive and/or trade out of a problem, arising from the default of a significant debtor.

This policy should be applied specifically in the case of all workouts. It should be noted that a strong policy of this nature, would also be of benefit to the Bank as standard policy.

The methodology for receivables financing is:

1. Provide finance against only an assignment of receivables.

   A suggested format for the assignment of receivables together with appropriate notification letters is attached at Appendix M.

2. Obtain an ageing schedule of receivables from the client and analyse both as to spread of the ultimate debtors (e.g. industry, market, country) and period of outstandings.

   The client must confirm that all receivables are current. If any items are past due these should be highlighted and explained.

3. Pay specific attention to any debtor which makes up 10% or greater by value of the exposure.

   Concentrations of risk arising from connected and associated exposures, or groups of exposures which aggregate 10% or greater by value, should receive similar scrutiny.

   For a definition of connected and associated exposures see section 5 of this Manual.

4. Review and understand the payment record of significant, important or frequent clients. - The definition of these terms is subjective and judgement must be exercised case by case. However, a client or group of clients which make up 10% of exposure by value, would qualify for investigation under this criteria.

5. Analyse in depth and understand fully any aggregations of risk of 10% or greater, specifically with regard to the debtor's historic track record with the client.

Note in particular any payment delays and ascertain the reasons therefore.

6. Where the debtor represents an exposure of 25% or greater by value, then that debtor's financial statements should be reviewed and analysed.

   Should any debtor make up 25% or greater of total receivables a limit should be allocated as to the maximum exposure that the Bank is prepared to accept against that debtor.

7. Consider the debtor's standing in their country of domicile. As a minimum, bank and trade checkings together with a Dun and Bradstreet report should be obtained.

8. Country risk and the acceptability thereof should be considered.

   A specific cross country limit allocation should be obtained from correspondent banking on either a committed line or transactional basis.

9. Ensure that the receivables actually exist, i.e. that they are not false receivables or pre-billings (invoices created before shipment actually takes place).

10. Ensure that the receivables have not been pledged to any other lender.

11. Consider the Bank's margin requirements and appraise how much should be granted both against individual debtors and the receivables as a whole. Remember that the criteria are maxima and not a target.

12. The client should provide the Bank with a written authority, for the Bank to send to the client's debtors.

    The authority should be irrevocable without the prior written consent of the Bank and mandate all monies due to the client, to that client's account with the Bank. Depending on the spread and quality of the receivables, notice should be served on all debtors which, as a minimum, represent 10% by value of the client's portfolio of receivables.

13. The client's letter of authority should be sent to the debtors by the Bank, requiring that they sign and return a copy of the letter to signify their agreement and acceptance of the instruction. This agreement then forms part of the Bank's collateral.

    If this methodology is followed then it is probable that if monies due are diverted without the Bank's prior knowledge or consent, then recovery could be made in the appropriate courts of the country concerned.

14. On at least a weekly basis, the schedule of monies due, should be checked and reconciled to the bank statement. Any item that can not be reconciled should be checked with the client. Any amount that is past due should be followed up.

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L.2 RISKS IN CERTAIN EXTERNAL JURISDICTIONS

In certain jurisdictions which practice British and/or Scottish Law, an assignment, unless registered at the Companies Registry, provides only an equitable rather than a legal interest and is invalid as against the crystallisation of an Floating Charge. Fortunately, the jurisdictions in which a Floating Charge exists are limited in number. However, the Bank must be aware of the potential for loss.

This possible risk, emphasises the requirement for the Bank to provide financing against overseas receivables, for clients of only the highest quality.

APPENDIX M.

DOCUMENTATION

DOCUMENTATION

M.1. INTRODUCTION

It is usual to structure an offer of facilities or amendments thereof, by way of an offer letter which is provided to the client for acceptance and return.

It is recognised that in the Czech and Slovak Republics, it is more usual to structure offers by use of a Loan Contract.

The following format is offered on the basis that although the wording may not suit local laws and conditions, the structure is capable of adjustment in order to comply with local needs.

M.2. CONTENTS OF AN OFFER LETTER

A typical offer letter would comply broadly, with the following layout:

The offer would be made by the bank, addressed to the client and contain an initial statement of offer, which would then lead into the body of the document;

1. **Facility:** Details of the amount of the facility or facilities and the methods by which the facilities may be utilised;

   Explanation that if facilities are to be used in any currency other than Czech or Slovak Crowns, then the Bank reserves the right to convert the debt into local currency at a time and at rates determined at the sole discretion of the Bank;

2. **Structure:** A typical structure which might be used for providing loans and/or acceptances and/or overdrafts etc. Includes details of interest and fees;

3. **Conditions Precedent:** Conditions which require completion prior to the facilities being available for utilisation;

4. **Representations and Warranties:** Undertakings by the borrower to the effect that the completion of the commitments specified in the offer letter are within the borrower's powers:

5. **Covenants:** Undertakings by the borrower that he will comply with a range of conditions and requirements during the life of the facilities;

   These may not be enforceable at the present time but are still worthwhile since it would give the Bank the right to break the contract. Additionally, the Bank by continually testing its rights in court will assist with the development of the law, which will contribute to greater stability and certainty in the banking system at the end of the day.

6. **Payments:** The basis and method by which payment will be made;

7. **Events of Default:** A range of conditions, which if breached would have the effect of terminating the facilities and the contractual relationship between the Bank and the borrower, and could lead to litigation;

8. **Judgement Currency:** Sets out the basis on which the Bank will, in the case of liquidation or other impairment to the customer's ability to pay, convert the debt from one currency to another;

9. **Miscellaneous:** A range of miscellaneous conditions which require precise clarification, in order to establish a formal basis for the relationship; and

Finally, the client is requested to sign and return a copy of the offer, in order to place the contractual relationship on a legal footing.

M.3. PURPOSE OF A SUBORDINATION AGREEMENT

The purpose of an agreement of this nature is to ensure, that, if the Bank restructures or forgives debt in order to assist the viability or survival of a borrower, other creditors of the borrower are not preferred at the expense or to the disadvantage of the Bank. If the Bank has forgiven debt, this is not so that repayment of debt to other creditors may be accelerated.

A subordination agreement is structured as a legally binding commitment, addressed by a creditor of the borrower, to the Bank, undertaking that all monies due to that creditor, by the borrower, will be subordinate to the interests of the Bank. The monies will not be repaid or collateral taken, until such time as the Bank has been repaid in full.

A copy of the agreement is provided to the borrower for signature, in order that the borrower is aware of all terms and conditions and evidences agreement to and compliance with, the terms thereof.

M.4. RECEIVABLES FINANCING

The Bank is involved heavily in the field of receivables finance. A format for assignment of receivables, together with service of notice on the ultimate debtor, is provided by way of an additional assistance.

M.5. USE OF DOCUMENTATION

The following wording is put forward in order to assist the Bank in structuring its own documentation in compliance with Czech and Slovak laws and requirements.

The documentation is set out using the subsequent conventions:

* - Insert an item in order to complete the full sense of the clause i.e. name, address, date, amount, currency, interest rate etc.

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[] - Where an optional phrase, clause etc, is suggested as being appropriate.

/ - Divider between two or more options or alternatives, which may, depending on the context, be either permissable in conjunction with each other or alternatively be mutually exclusive.

Documentation has been structured to cover loan, acceptance and overdraft facilities. If term loans, revolving credits, letters of credit, guarantees etc, are provided, then adjustment and modification will be required at relevant points. However, the structure and format of this offer letter and the range and requirements of sections such as Conditions Precedent, Events of Default, Representations and Warranties, Judgement Currency etc, remain unchanged.

M.6. THE OFFER LETTER

* A.S. *,19*

*

Gentlemen,

[Kc/£/US$] * Loan/Acceptance/Overdraft Facilities

On an initial offer

Pursuant to our recent discussions, we have pleasure in offering to you [loan/acceptance/overdraft] facilities ("the Facilities") on the terms and conditions of this letter agreement ("the Agreement").

On a revised, amended or extended offer or where the offer replaces an earlier offer or facility letter

This Agreement (when accepted by you) shall supersede and replace any existing agreements between us, which will thereupon be cancelled and of no further effect. All sums outstanding from you to us on the date of your acceptance hereof shall be deemed to have been incurred and to be outstanding hereunder.

1. The Facilities

(a) The Facilities will be available to you for utilisation by way of [short term loans ("Loans") and/or our acceptance of your drafts ("Acceptances") and/or an overdraft on current account [repayable on demand] ("Overdraft")] in an aggregate principal amount not exceeding at any time outstanding Kc/£/US$*/ or in the equivalent amount thereof of such other convertible currency ("Alternative Currency") as we may agree to provide hereunder.

(b) Notwithstanding the provisions of paragraph 2.1(a) and (b), you will repay all amounts outstanding hereunder or provide immediate cash cover in respect of Acceptances outstanding hereunder on demand made by us to you or, if no such demand is made, not later than *. Without prejudice to the foregoing, if no such demand is made on or before *, the Facilities may, at our sole discretion, continue to be available to you for utilisation, on the terms and conditions of this Agreement, or on such other terms and conditions as we may from time to time require.

[(c) Should any obligation hereunder be expressed at any time in an Alternative Currency, then any calculations for ascertaining the amount of the Facilities available for utilisation from time to time and any other conversions hereunder shall be made at the rates and times, conclusively determined by us, appropriate for such conversions.]

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2.1. Loans

(a) Loans shall be made in an amount/an amount or a whole multiple of Kc/£/US$ * for periods of 1, 2 or 3 months at your option, or in such other amounts or for such other periods as we may from time to time agree, and shall, subject to paragraph 1(b), be repaid at maturity thereof.

(b) Interest will be calculated on each Loan at the rate of *% per annum above the rate, conclusively determined by us, at which we are able to fund such Loan for the relevant period in the Prague Interbank Market, and will, subject to paragraph 1 (b), be paid at maturity thereof.

2.2. Acceptances

(a) You will draw drafts on us at 30, 60 or 90 days' sight in amounts of Kc/£/US$ *, or for such other periods or in such other amounts as we may from time to time agree. On presentation to us by you of such drafts, we shall accept them (then "the Acceptances") [and return them to you/and discount them]. [Immediately after such discount, we shall remit to you (or apply in accordance with your instructions) the net proceeds after deduction of discount charges and acceptance commission.]

(b) Acceptance commission will be calculated on the face value of each draft at the rate of *% per annum, and will be paid by you at the time of acceptance thereof.

(c) Remittances in cover of maturing Acceptances should be made so that we receive good value cash in Prague not later than the close of business on the respective dates on which the Acceptances fall due for payment.

(d) Should you wish to draw new drafts and apply the proceeds against maturing Acceptances, you will draw new drafts on us and present them to us at least two days before the respective dates on which the maturing Acceptances fall due for payment, and you will provide us with prompt cash cover in respect of any balance due (including acceptance commission [and discount charges]) in the amount notified by us to you.

2.3. Overdraft

Interest on the Overdraft will be calculated on the day to day cleared balance at the rate per annum of *% above the average of the rates, conclusively determined by us from time to time, at which seven day deposits in Kc/£/US$ are offered to us in the Prague Interbank Market, and will be debited to your account on the last day of every month.

2.4 [Arrangement/Commitment] fee

You will pay us [an arrangement/a commitment] fee at the rate of *% [per annum] on the [maximum/daily unused] amount of the [Facility/Facilities] during the period commencing on the date

of your acceptance of this Agreement and ending on *, such fee to be payable [annually/ quarterly] in [advance/arrears].

3. Conditions Precedent

USUAL

Our obligations hereunder are subject to our receipt, in form and substance satisfactory to us, of:

(a) the duplicate of this letter duly signed on your behalf;

(b) our General Terms and Conditions ("the Conditions") duly executed on your behalf [and complying with all registration formalities required by law];

(c) a certified true up-to-date copy of your Memorandum and Articles of Association/a certificate from your Secretary that there has been no change to your Memorandum and Articles of Association since *; [and]

(d) a certified copy of your Board of Directors' Resolution authorising the execution, delivery and performance of this Agreement and the Conditions and containing specimen signatures of your officials authorised to sign this Agreement and the Conditions and give instructions in connection therewith [./; and]

[(e) an unconditional demand guarantee ("the Guarantee") from * ("the Guarantor"); [and]

(f) a certified copy of the Guarantor's Board of Directors' Resolution authorising the execution, delivery and performance of the Guarantee and containing specimen signatures of its officials authorised to sign the Guarantee[./; and]

(g) an opinion of * counsel/certified copies of all necessary governmental and other consents and approvals (including exchange control consent) necessary for any utilisation of the Facilities).

ADDITIONAL

Where a fee is payable in advance

. [the first instalment of] the [arrangement/commitment] fee referred to in paragraph 2.4.

Legal Charge

. a legal charge in our favour ("the Charge") over the property known as * duly executed by you and complying with all registration formalities required by law, together with:

(i) a valuation of such property [prepared by our surveyors];

(ii) a [report on title/certificate of title] to such property [prepared by our solicitors]; and

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(iii) an insurance policy, from an insurance company acceptable to us, in form and substance acceptable to us, written in our favour/with our interest noted thereon, covering such property to a minimum amount of Kc * , together with the premium receipt evidencing that cover is current and that the policy is in full force and effect.

Legal Charge - Third Party

a legal charge in our favour ("the Charge") over the property known as * duly executed by * ("*") and complying with all registration formalities required by law, together with:

(i) a valuation of such property [prepared by our surveyors];

(ii) a [report on title/certificate of title] to such property [prepared by our solicitors]; and

(iii) an insurance policy, from an insurance company acceptable to us, in form and substance acceptable to us, written in our favour/with our interest noted thereon, covering such property to a minimum amount of Kc * , together with the premium receipt evidencing that cover is current and that the policy is in full force and effect.

Assignment

. an assignment in our favour ("the Assignment") duly executed by you and complying with all registration formalities required by law;

Assignment - EGAP Export Credit Guarantee

. an assignment in our favour ("the Assignment") of your Export Credit Guarantee [providing *] duly executed by you;

Cash Collateral

. a deposit of Kc/£/US$ * placed with us;

Cash Collateral - Third Party

. a deposit of Kc/£/US$ * placed with us by the Guarantor.

4. <u>Representations and Warranties</u>

You hereby represent and warrant to us that:

(a) the execution, delivery and performance of this Agreement, the Conditions [and the *] are within your powers, have been authorised by proper corporate proceedings and do not contravene any provision of law or of your Memorandum and Articles of Association or any agreement or other document binding on you;

(b) there has been no adverse change in your financial condition since the date of your last published financial statements; and

(c) none of the events specified in paragraph 7 below has occurred or is subsisting and no event has occurred which with the giving of notice or lapse of time or both would constitute such an event.

5. Covenants

(Covenants can be structured either as positive or negative undertakings. However, in some instances it is more effective for the Bank to structure its requirements in the form of an Event of Default).

You hereby undertake to us:

USUAL

Provision of Accounts and Information

. To supply us, within one week of their publication, copies of your Annual Report and Audited Accounts [and those of the Guarantor] and to supply such other information on your [and its] affairs and financial condition as we may from time to time reasonably require.

Pari Passu

. That any liabilities of yours hereunder shall not at any time rank postponed in point of security to any other obligations and liabilities of yours to other lending institutions.

Negative Pledge

. Not to create, or permit to subsist, any mortgage, charge, pledge, lien or other security interest (other than pledges of goods or documents of title and trust receipts in the ordinary course of your business) on any of your undertaking, property or assets, without our prior consent in writing.

FINANCIAL

Minimum Net Worth

. To ensure that at all times your [consolidated] Net Worth (represented by the aggregate of [your/your and your subsidiaries'] issued and paid up capital and reserves) is at least Kc *.

Minimum Tangible Net Worth

. To ensure that at all times your [consolidated] Tangible Net Worth (represented by the aggregate of [your/your and your subsidiaries'] issued and paid up capital and reserves less any intangible assets) is at least Kc *.

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Leverage

- To ensure that at all times your [consolidated] Total Liabilities do not exceed [* times] your [consolidated] Tangible Net Worth (represented by the aggregate of [your/your and your subsidiaries'] issued and paid up capital and reserves less any intangible assets).

Current Ratio

- To ensure that at all times your [consolidated] Current Assets are not less than [* times] your [consolidated] Current Liabilities.

Quick Ratio

- To ensure that at all times the aggregate of your [consolidated] cash and book debts is not less than [* times] your [consolidated] Current Liabilities.

Gearing

- To ensure that at all times your [consolidated] liabilities in respect of borrowed money do not exceed [* times] your [consolidated] Tangible Net Worth (represented by the aggregate of [your/your and your subsidiaries'] issued and paid up capital and reserves less any intangible assets).

Interest Cover (EBIT)

- To ensure that at the end of each financial year interest paid by you [and your subsidiaries] during that financial year does not exceed [*] % of your [consolidated] profit, before the deduction of tax and interest paid.

The above ratios are provided by way of example as to the structure of a financial covenant. Rather than provide detail on further financial covenants, there now follows a wide range of ratios which the Bank may consider relevant for inclusion in an offer on a case by case basis. In each instance the structure and layout of the covenant should be based on or related to the above formats.

. Gross Profit Margin	(Gross Profit/Net Sales)
. Return on Sales	(NPAT/Net Sales)
. Return on Investment	(NPAT/ABNW)
. Return on Investment	(NPAT/ATNW)
. Return on Assets	(NPAT/Total Assets)
. Annual Sales Growth	(Net Sales Yr2 - Net Sales Yr1/Net Sales Yr1)
. Annual Profit Growth	(Net Profit Yr2 - Net Profit Yr1/Net Profit Yr1)

.	Annual Total Assets Growth	(Total Assets Yr2 - Total Assets Yr1/Total Assets Yr1)
.	Working Capital Turnover	(Net Sales/Working Capital)
.	Fixed Charge Coverage (EBIRT)	(NPAT + Interest Payable + Rent/Interest Payable + Rent)
.	Cash Ratio	(Cash + Near Cash/Current Liabilities)
.	Inventory Reliance	(Current Liabilities - Quick Assets/Inventory)
.	Average Collection Period	(Receivables x 360/Net Sales) = Days
.	Average Payables Period	(Payables x 360/Net Sales) = Days

Abbreviations

NPAT - Net Profit After Tax

ABNW - Average Book Net Worth

ATNW - Average Tangible Net Worth

In order to provide a further element of control, covenants can be structured as absolute amounts. i.e:

- To ensure that at all times your [Consolidated] Total Liabilities do not exceed/shall not be less than Kc *

This can be applied to Total Assets, Shareholders Funds, Tangible Net Worth, Current Assets, Assets, Investments and/or due to/from Subsidiaries and Affiliates, Rates of Return, Cost Structure etc.

If the offer is based on projected cashflows then a relevant covenant would be:

- To ensure that for each * month/monthly period, your cash flow shall be not less than * times the total of debt service requirements over the same period.

GENERAL

Restriction on Dividends

- Not to declare, pay or make or agree to declare, pay or make any dividend or other distribution without our prior consent in writing.

Revaluation of Property

. If at any time the market value of the property referred to in paragraph [*] (as determined by a valuation or revaluation thereof prepared by our surveyors at your expense) is less than [*] % of the [amount outstanding hereunder/maximum amount of the Facility/Facilities]; you will, forthwith on our demand, provide cash cover or other security acceptable to us [or repay such amount of the Loan /Overdraft/Facility so that the amount outstanding hereunder (after such repayment) does not exceed [*] % of such valuation].

Sole Banker

. Not to open or maintain any bank accounts [in the Czech or Slovak Republics] except with you.

Restriction on Further Subsidiaries

. Not to acquire or subscribe for the whole or a substantial part of the share capital of any company [or make any investment therein] without our prior consent in writing.

Restriction on Disposal of Assets

. Not to sell, transfer or dispose of all or a substantial part of your undertaking, property, revenues and assets [without our prior consent in writing].

Restriction on Capital Expenditure

. Not to acquire or agree to acquire (whether by purchase, hire purchase, lease or otherwise) any asset for a total consideration exceeding Kc [*] without our prior consent in writing.

<u>NOTE:</u>

1) Once a definition has been provided it is no longer necessary to continue to provide that definition in every covenant. However, it would be advisable to insert as necessary "as above defined" at the relevant point.

2) If any of the financial covenants above are included in a Loan Contract or Offer Letter, then one or both of the following clauses must be inserted at the end of this section.

    (a) The expressions used in this paragraph shall be construed in accordance with generally accepted accounting principals in International Accounting Standards or alternatively in accordance with requirements as advised by the Bank from time to time; and

    (b) "Subsidiary" shall be defined in accordance with International Accounting Standards.

6. Payments

(a) All payments to be made to us hereunder [or under the *] shall be made in Kc/sterling/dollars/or the Alternative Currency in which the relevant payment obligation is denominated and in freely convertible and immediately available funds] on the due date to such account or accounts as we may from time to time notify to you. Should any payment happen to fall due on a day which is not a Bank Business Day (which, for the purposes of this Agreement, shall mean a day on which banks are open for business in Prague [the City of London/New York/, New York and in the principal financial centre of the relevant Alternative Currency]), it shall be paid on the following Bank Business Day and such additional time shall be included in the computation of interest.

(b) All payments hereunder [or under the *] shall be made in full and any withholding or other taxes or deductions to which such payments may be or may become subject shall be for your account.

(c) If as a result of any law, regulation or directive, enacted or issued by any governmental or other competent authority (or any variation in the same) the cost to us of maintaining the [Facility/Facilities] increases, we will notify you of the amount or percentage, conclusively determined by us, of such increase and you agree that you will on demand from time to time pay the amount so notified from the date of our notification.

(d) If you fail to pay any amount hereunder [or under the *] at the time it becomes due, we shall be entitled to charge you interest on such amount from the date of such failure up to the date of actual payment at the rate of *% per annum above the rate, conclusively determined by us, at which we are able to obtain a comparable amount in the Prague Interbank Market for such period or periods as we may from time to time select.

(e) You will indemnify us against any claim, cost, loss or expense (including funding costs) suffered or incurred by us in respect of the repayment of all or any part of the Loan otherwise than on the last day of an Interest Period.

7. Events of Default

USUAL

If:

(a) you fail to pay any sum hereunder [or under the *] when due [or you fail to provide the cash cover required by paragraph 1(b)] or you fail to comply with any of your other obligations hereunder [or thereunder] or any other indebtedness of yours [or the Guarantor] becomes prematurely payable or repayable following a default. or is not paid when due, or any security given by you [or the guarantor] becomes enforceable, or any statement, representation or warranty made by you pursuant to or in connection with this Agreement shall be or prove to have been or shall become incorrect in any material respect; or

(b) you cease or threaten to cease to carry on business, or you become insolvent or unable to meet your debts as they fall due, or you convene a meeting of or propose or enter into any arrangements or composition for the benefit of your creditors, or a petition is presented or an effective resolution is passed for your winding up, or an encumbrancer takes possession or a receiver is appointed of the whole or any part of your property, or a distress or execution is levied or enforced or sued out against any of your property and is not discharged within fourteen days [;/, or any of the foregoing occur in relation to the Guarantor]; or

(c) the Guarantee [or the *] cease[s] to be in full force and effect;]

then, in any such event the [Facility/Facilities] shall immediately cease to be available and we may, by written notice to you at any time thereafter[:

(i)] declare any sums or obligations outstanding hereunder to be immediately due and payable whereupon the same shall become forthwith due and payable without demand or other notice of any kind, all of which are hereby expressly waived by you[./; and]

(ii)] demand immediate cash cover in respect of any outstanding [Acceptance(s)/Bond(s)]. On receipt of such monies (but without prejudice to our rights thereto) we shall account to you for interest thereon until the respective [dates on which such Acceptances fall due for payment/expiry dates of such Bonds], at the rate per annum at which we are able to obtain deposits of an equivalent amount in the Prague Interbank Market for the periods from the date of our receipt thereof until such respective dates.]

ADDITIONAL

Change in Ownership

. [without our prior written consent] any change occurs in the ownership (legal or beneficial) of [a substantial part/more then *% of] your issued share capital;

Change in Management - General

. [without our prior written consent] any change occurs in your [senior] management;

Change in Management - Specific

. [without our prior written consent] * ceases to be your [full time] *;

Change in Ownership and Management

. [without our prior written consent] any change occurs in the ownership (legal or beneficial) of [a substantial part/more then *% of] your issued share capital or in your [senior] management;

8. Judgement Currency

If, under any applicable law and whether pursuant to a judgement being made or registered against you or to your liquidation or otherwise, any payment obligation hereunder falls to be satisfied in a currency ("the Other Currency") other than the currency ("the Original Currency") in which such payment obligation is due hereunder, then, to the extent that any amount (when converted at the rate of exchange on the date of payment or, in the case of a liquidation, the nearest date thereto permitted by applicable law if conversion on the date of payment is not permitted thereby) actually received by us falls short of the amount due hereunder, you will, as a separate and independent obligation, indemnify and hold us harmless against the amount of such shortfall. For the purposes of this paragraph, "rate of exchange" means the rate at which we are able on the relevant date to purchase the Original Currency in Prague with the Other Currency.]

9. Miscellaneous

USUAL

(a) The Conditions shall, save as otherwise specifically agreed herein, apply to all transactions hereunder.

(b) You will reimburse us on demand [(and whether or not the Facilities become available)] an amount equal to all costs and expenses (including legal fees) incurred by us in the negotiation, preparation, execution and enforcement of this Agreement [and/,] the Conditions [and the Guarantee/the Charge/ the Assignment]. You will pay all stamp and other duties and taxes to which this Agreement [or/,] the Conditions [or the Guarantee/the Charge/the Assignment] may be subject or give rise.

[(c) Any communications or notices hereunder between us shall be sent by prepaid registered or recorded delivery mail, or by telex or cable, to our respective addresses indicated in this Agreement, or to such other addresses as one of us may hereafter notify to the other.]

(d) This Agreement shall be governed by and construed in accordance with the laws of the Czech Republic.

ADDITIONAL

Where the customer is not a Czech citizen or a Czech company

This Agreement shall be governed by and construed in accordance with the laws of the Czech Republic.

You agree that any legal action or proceeding arising out of or in connection with this Agreement [and the *] may be brought in the Court at * in the Czech Republic, irrevocably submit to the jurisdiction of such Court and agree that any writ, judgement or other notice of legal process shall be sufficiently served on you if delivered to * at *, or other its registered office for the time being.

Where the customer is more than one person

. Your obligations hereunder are joint and several and references to "you" and "your" shall be construed accordingly.

Where repayment (made after a demand therefor) otherwise than at the end of an interest period may cause a funding or other loss

. You will indemnify us on demand against any claim, cost, loss or expense (including funding costs) suffered or incurred by us in respect of the repayment of all or part of the [Loan] otherwise that on the last day of an Interest Period [relating thereto].

Please sign and return the enclosed duplicate of this letter to us by * to signify your acceptance of this offer.

Yours faithfully,

CESKOSLOVENSKA OBCHODNI BANKA A.S.

(on duplicate only)

Accepted and agreed:

for and on behalf of * A.S.

Dated:

Pursuant to a Board of Directors' Resolution dated

M.7. THE SUBORDINATION AGREEMENT

SUBORDINATION AGREEMENT

To Ceskoslovenska Obchodni Banka A.S.

Date

Gentlemen:

You are advised that * A.S. (the "Company") is now indebted to the undersigned in the following amount[s]: Kc *.

In consideration of your granting or continuing credit to the Company at any time, and in such manner, upon such terms and for such amounts as may be mutually agreeable to you and the Company, the undersigned hereby agrees as follows:

1. to subordinate and does hereby subordinate payment by the Company of all or any part of the above described indebtedness as may be hereafter extended, renewed or evidenced, to the payment to you of any or all indebtedness, direct or contingent, for which the Company may now or hereafter be under obligation to you, and in furtherance thereof does hereby agree not to ask, demand, sue for, take, accept or receive any payment, reward or consideration in discharge of, or in lieu of, all or any part of such indebtedness of the Company to the undersigned or any interest thereon unless or until any and all indebtedness of the Company to you now existing or hereafter arising shall have been paid to you in full.

2. That if any payment is made to us contrary to the terms hereof each and every amount so paid will be forthwith paid to you and applied in or towards discharge of any indebtedness owing to you by the Company.

3. That upon any distribution of the assets or readjustment of the indebtedness of the Company whether by reason of re-organisation, liquidation, dissolution, composition, bankruptcy, arrangement, assignment for the benefit of creditors or any other action or proceeding involving the re-adjustment of all or any part of the indebtedness hereby subordinated or the application of the assets of the Company to the payment or liquidation thereof, you shall be entitled to receive payment in full of any and all indebtedness then owing to you by the Company prior to the payment of all or any part of the indebtedness (including interest) hereby subordinated and in order to enable you to enforce your right hereunder in any such action or proceeding, you are hereby irrevocably authorised and empowered at your discretion to make and present for and on behalf of the undersigned such proofs of claims against the Company on account of the indebtedness (including interest) hereby subordinated as you may deem expedient or proper and to vote such proofs of claims in any such proceedings and to receive and collect any and all dividends or other payments or disbursements made thereon

in whatever form the same may be paid or issued and to apply the same on account of any indebtedness owing to you by the Company.

4. To execute and deliver to you such assignments or other instruments as may be required by you in order to enable you to enforce any and all such claims and to collect any and all dividends or other payments or disbursements which may be made at any time on account of all or any of the indebtedness (including interest) hereby subordinated.

5. Not to assign or transfer or encumber or subordinate at any time while this agreement remains in effect any rights, claims or interest of any kind in or to any of the indebtedness (including interest) hereby subordinated without:-

   (i) first notifying you; and

   (ii) making such assignment, transfer, encumbrance or subordination expressly subject to this Subordination Agreement in form and substance satisfactory to you.

6. That you may at any time in your discretion renew or extend the time of payment of all or any existing or future indebtedness or obligation of the Company to you or waive or release any collateral which may be held therefor at any time and in reference thereto make and enter into any such agreement or agreements as you may deem proper or desirable without notice given to and/or further assent from the undersigned and without in any manner impairing or affecting this Agreement or any of your right hereunder.

7. This Agreement shall be governed by and construed in accordance with the Laws of the Czech Republic.

Yours faithfully,

By:____________
[*/For and on behalf of * A.S.]

(ON COPY ONLY)

We hereby acknowledge receipt of a copy of the foregoing Subordination Agreement and agree that we will not pay any indebtedness subordinated by the foregoing Subordination Agreement except as therein provided. In the event of any breach of the provisions of the foregoing Agreement, we agree that, in addition to any other rights and remedies that you may have, all of our obligations and liabilities to you shall, without notice or demand, become immediately due and payable unless you shall at your sole discretion, otherwise elect.

By:____________

For and on behalf of * A.S.

Dated:____________

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M.8. THE ASSIGNMENT

THIS ASSIGNMENT is made the day of 19*

BETWEEN:

(1) * A.S. with registered number * whose registered office is at * ("the Company") and

(2) CESKOSLOVENSKA OBCHODNI BANKA A.S. of * ("the Bank")

1. As a continuing and a fixed or specific security for the due and punctual payment or discharge on written demand of all moneys and liabilities ("the Secured Amounts") whether certain or contingent which now are or may hereafter (whether on or after any such demand) be due, owing or incurred, in any currency, to the Bank from or by the Company anywhere on any current or other account or in any manner whatsoever whether as principal or surety and whether alone or jointly with any other person, firm or corporation and in whatever name, style or form including commission and all banking, legal and other costs, charges and expenses whatsoever and also interest on the foregoing the Company as beneficial owner assigns to the Bank [all book debts now and from time to time due or owing to the company/all sums now and from time to time due or owing to the Company from * / the [agreement/contract] dated * between the Company and * ("the Agreement") and the full benefit thereof including (but without prejudice to the generality of the foregoing) the right of the Company to receive all payments whatsoever due or to become due under or by virtue of the Agreement and all rights and remedies whatsoever of the Company under or by virtue of the Agreement which are now accrued or may hereafter accrue to the Company/the right or receive all payments whatsoever due or to become due under or by virtue of the Contract(s) more particularly described in the Schedule hereto/all sums (whether of principal, interest or otherwise) now or from time to time standing to the credit of or earned on account number * in the name of the Company on the books of the branch of * at */all the right, title and interest of the Company in all sums due, payable or owing to the Company under any documentary letter of credit opened in favour of the Company and in respect of which the Bank has, at the request of and for and on behalf of the Company, opened a documentary letter of credit on substantially similar terms]("the Assigned Property") to hold the same unto the Bank absolutely Provided only that if the Company duly and punctually pays or discharges all the Secured Amounts the Bank will thereafter at the request and cost of the Company reassign to the Company the Assigned Property.

2. This Assignment is expressly made for securing present and further advances.

3. The Company covenants with the Bank:

   (a) not to create, assume or permit to exist on all or any part of the Assigned Property any further mortgage, charge, pledge, lien or other security interest whatsoever;

   (b) except with the prior written consent of the Bank not to sell, transfer, part with or in any other way whatsoever deal with the Assigned Property (or any of its rights thereunder or interests therein);

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(c) to pay into the Company's account with the Bank all monies which it may receive under or by virtue of the Assigned Property or any part thereof; and

(d) forthwith to execute all deeds and documents whatsoever and do all acts and things which the Bank may in its sole and absolute discretion specify with a view to:

(i) ensuring that the assignment contained in Clause 1 above shall take effect as a legal or statutory assignment so far as regards the Assigned Property; or

(ii) perfecting or improving this Assignment in any other manner whatsoever.

4. At any time after the Bank has served a demand it may appoint a receiver ("the Receiver") in respect of the Assigned Property who shall:

(a) be the agent of the Company which shall be solely responsible for his remuneration, acts and defaults;

(b) have full power:

(i) to collect, call in and take possession of the Assigned Property;

(ii) to sell or in any way whatsoever deal with the Assigned Property; and

(iii) in the name of the Company or otherwise to bring, defend, compromise, submit to arbitration or abandon any claims and proceedings whatsoever in connection with the Assigned Property and also to enter into any arrangement or schemes whatsoever.

5. The Company will upon demand fully indemnify the Bank and the Receiver against all costs, expenses, claims, losses and liabilities whatsoever in any manner incurred by the Bank or the Receiver in connection with this Assignment.

6. The Company irrevocably and by way of security appoints the Bank its attorney (with full power to appoint substitutes and to sub-delegate) on behalf of the Company and in the name of the Company or otherwise to execute and sign all deeds and documents whatsoever and to do all acts and things which the Company is obliged to execute, sign or do by virtue of this Assignment or which the Bank may in its sole and absolute discretion deem appropriate for the purpose of or in connection with the enforcement of any of its rights under or by virtue of this Assignment.

7. Nothing in this Assignment shall affect any right or remedy of the Bank under the general law or oblige the Bank or the Receiver to take any steps to recover any sum due under the Assigned Property or render the Bank or the Receiver liable for any failure to take such steps.

8. This Assignment shall be without prejudice and in addition to any other security, indemnity, guarantee or similar agreement which the bank may now or from time to time hold in connection with the Secured Amounts.

9. A demand or notice hereunder shall be in writing signed by an officer of the Bank and may be served on the Company either by delivering the same to any officer of the Company at any place or by post addressed to the Company at its registered office last known to the Bank and a demand or notice so addressed and posted shall be effective after 48 hours after posting notwithstanding that it be returned undelivered.

10. References in this Assignment to the Company and to the Bank include references to the persons deriving title under them respectively, and references to the Secured Amounts and the Assigned Property include references to any of them.

11. This Assignment shall be governed by and construed in accordance with the laws of the Czech Republic.

IN WITNESS whereof this Assignment has been executed the day and year first above written

[THE SCHEDULE above referred to

Project	Contract Date	Employer]

For and on behalf of * A.S.

Dated:

For and on behalf of
CESKOSLOVENSKA OBCHODNI BANKA A.S.
Dated:

(letterheading of * A.S.)

To: *

Dear Sirs,

We hereby give you notice that by an assignment dated * we * A.S. have assigned to CESKOSLOVENSKA OBCHODNI BANKA A.S. of * ("CSOB") all our right, title and interest in and to [all payments due or to become due from you to us/all payments due or to become due to us under or by virtue of the Contract dated * between yourselves and ourselves including all monies for the time being and from time to time payable to us thereunder or pursuant thereto/all sums (whether of principal, interest or otherwise) now or from time to time standing to the credit of or earned on account number * in our name on the books of your branch at */all sums due, payable or owing to us from you under or pursuant to your letter of credit Reference * in our favour].

We request and unconditionally and irrevocably authorise you to remit such monies to [* for the account of} CSOB. This authority is to be irrevocable without the consent of CSOB.

Please acknowledge receipt of this notice and give confirmation of the above matters by signing and returning to CSOB the enclosed duplicate of this letter.

Yours faithfully,

For and on behalf of
* A.S.

(on duplicate only)

To: Ceskoslovenska Obchodni Banka A.S.

We acknowledge receipt of the notice of which this is a duplicate.

Signed:

for and on behalf of *

Dated:

THIS REASSIGNMENT made the   day of   19

BETWEEN the within named CESKOSLOVENSKA OBCHODNI BANKA A.S. of the one part and the within named

of the other part WITNESSES that the said CESKOSLOVENSKA OBCHODNI BANKA A.S. as Mortgagee HEREBY ASSIGNS AND RELEASES unto the said

* the property comprised in or assigned by the within written Assignment free from all moneys secured by and from all claims and demands under the within written Assignment

For and on behalf of
CESKOSLOVENSKA OBCHODNI BANKA A.S.

13.1

APPENDIX N.

STRUCTURE OF A CREDIT FILE

STRUCTURE OF A CREDIT FILE

A Credit File shall be maintained in respect of each borrowing relationship. It shall be the duty of the Credit Officer with primary responsibility for a relationship to maintain this file and ensure that it is kept up to date. The file shall be made available as required for inspection by credit auditors or other authorised personnel.

The file shall provide information in clear and structured format evidencing the background to the relationship, together with details of facilities granted and all other aspects relevant to the client.

The structure of a Credit File shall consist of:

1. Fact Sheet

   . Request for Approval

2. Credit Proposal

   . Credit Analysis

   . Projections

   . Business Plan

3. Spread Sheets

   . Three Years Audited Financial Statements

   . Interim Statements

4. Credit Checkings and Information from other Sources

   . Banks

   . Suppliers

   . Newspaper Cuttings

   . Advertising

5. Credit Memoranda

- Call Reports
- Internal Memoranda
- Internal Instructions

6. Correspondence

- Correspondence and Communications with the Client
- Correspondence with Outside Parties

7. Documentation

- Details of Collateral, Support and Related Valuations
- Copies of Loan and Security Documentation
- Copy Documentation Checklist

All original loan and security documentation together with the original documentation checklist is to be retained under dual control, as set out in the Bank's Credit Policy and Procedures Manual.

At periodic intervals, non-critical papers should be pruned from the current file for placing in storage. Although due regard must be given to legal requirements with regard to document retention, it is recommended that papers should be retained for a minimum period of five years.

In order to assist those who are unaccustomed to a credit file structured in this manner, a brief explanation of the various sections is provided:

1. Fact Sheet

This form should contain:

- Details of the facilities requested
- Conditions Precedent
- Covenants
- Events of Default
- Support

- Collateral
- Pricing and Fees
- Estimated Annual Earnings

2. Credit Proposal

This should contain key financial highlights as calculated by the Credit Officer together with the provision of the information required.

A detailed analysis of the facility should be attached covering:

- Purpose of the transaction
- History, background and structure of the Borrower
- Management experience and background
- Existing banking facilities
- Business plan and requested facilities
- Collateral, support and risk/reward ratio
- Industry Condition
- Competition
- Financial highlights and analysis
- Operating figures
- Projections
- Conclusion
- Recommendation

3. Spread Sheets

Three years audited financial statements are required together with the latest interim statement. The information contained therein should be analysed by the Credit Officer using spread sheets, ratio and cash flow analysis.

The results of the analysis should be included in the detailed write up attached to the Credit Proposal.

4. Credit Checkings and Information from other Sources

The Credit Officer should take up status reports and write to other banks with whom the borrower retains any form of relationship. Wherever possible checkings should be taken up on other entrepreneurs, shareholders, partners and executive management.

If possible checkings should be taken up on suppliers and other parties with whom the borrower deals. It is accepted that these may only be in verbal format. Any market intelligence should also be attached at this section as should copies of newspaper clippings, advertising etc'.

5. Credit Memoranda

Call reports should document all matters discussed with a client whether arising from a visit to a factory, meetings with the client or his representatives or telephone conversations.

Internal memoranda and instructions should include information obtained from other sources as well as communications with and instructions to operating departments.

6. Correspondence

Written correspondence and communications with the client and outside parties.

7. Documentation

Full details of all collateral, support and related valuations together with copies of all important or relevant loan and security documentation and a copy of the documentation checklist.