

Disclosure of information on supervisory measure of 25 April 2024 imposed on credit institution

| Information on person responsible for breach | |
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| Business name and registered office of legal person | Deželna banka Slovenije d.d., Kolodvorska ulica 9, 1000 Ljubljana, Slovenia, registration number: 5349907000 |
| Information on breach | |
| Description of circumstances and conduct entailing breach of ZBan-3 or Regulation (EU) No 575/2013 | Breaches of the ZBan-3 (cited in detail in the operative part of the order below) were identified on the basis of an inspection, as a result of which Banka Slovenije issued the bank with the Order on the rectification of breaches referenced PBH-24.60-010/23-003 of 25 April 2024 |
| Nature of identified breaches | Breaches in the area of measurement and monitoring of exposure to interest rate risk in the banking book |
| <p>1. Deželna banka Slovenije d.d., of Kolodvorska ulica 9, 1000 Ljubljana, Slovenia, registration number: 5349907 (hereinafter: the bank), has breached point 2 of the first paragraph of Article 148 in connection with point 1 of the second paragraph of Article 156 and the first paragraph of Article 167 of the ZBan-3 in connection with Articles 4, 5 and 17 of the Regulation on internal governance arrangements, the management body and the internal capital adequacy assessment process for banks and savings banks (Official Gazette of the Republic of Slovenia, No. 115/21; hereinafter: the internal governance regulation), and paragraphs 32 and 33 of the Guidelines issued on the basis of Article 84(6) of Directive 2013/36/EU specifying criteria for the identification, evaluation, management and mitigation of the risks arising from potential changes in interest rates and of the assessment and monitoring of credit spread risk, of institutions' non-trading book activities (EBA/GL/2022/14 of 20 October 2022; hereinafter: the interest rate risk management guidelines)¹ by failing to provide for stable internal governance arrangements that encompass effective risk management processes for the identification, measurement or evaluation, management and monitoring of risks and risk reporting, and because the bank's management board and supervisory board failed to ensure the timely approval of the bank's strategic objectives, and the formulation, adoption and regular review of the strategy for the take-up of the risks to which the bank is or could be exposed in its operations, including risks inherent in the macroeconomic environment in which the bank operates, having regard for the business cycle at the time, by failing to:</p> <ul style="list-style-type: none"> - update the <i>Development strategy of Deželna banka Slovenije d.d. for the period to 2024</i> in timely fashion, which meant that the targeted investment strategies were no longer appropriate, because they had not been adjusted to account for significant changes in the macroeconomic environment (higher inflation, interest rate rises) or with the change in the bank's business environment with increased long-term lending at fixed rates. Similarly the bank failed to track the changes in the macroeconomic environment and the business environment in updating its objectives and in its approach to the take-up and management of interest rate risk. The latter meant that the <i>Development strategy of Deželna banka</i> | |

¹ The mandatory application of the interest rate risk management guidelines was set out by Banka Slovenije via the Regulation on the application of the Guidelines issued on the basis of Article 84(6) of Directive 2013/36/EU specifying criteria for the identification, evaluation, management and mitigation of the risks arising from potential changes in interest rates and of the assessment and monitoring of credit spread risk, of institutions' non-trading book activities (Official Gazette of the Republic of Slovenia, No. 49/23).

Slovenije d.d. for the period to 2024 was not aligned with the *Risk take-up and management strategy* or the *Policy for the take-up and management of interest rate risk in the banking book and credit spread risk inherent in non-trading book activities*;

- define the bank's appetite for interest rate risk in the banking book in the form of the acceptable impact of variable interest rates on all metrics of interest rate risk in the banking book, or the maximum level of credit spread risk in the banking book (CSRBB) that the bank is willing to take up for the purpose of realising its business objectives, having regard for its risk take-up capacity.

The bank must provide for stable internal governance arrangements in accordance with Article 148 of the ZBan-3, and ensure that the interest rate risk management strategies, policies and procedures put in place comply with the requirements of Articles 156 and 167 of the ZBan-3, in connection with Articles 4, 5 and 17 of the internal governance regulation and Articles 32 and 33 of the interest rate risk management guidelines. In so doing it must ensure that these strategies, policies and procedures are also implemented.

To rectify the identified breaches, the bank must draw up a new *Risk take-up and management strategy* and *Risk appetite statement*, or update the existing documents, such that the objectives and procedures with regard to the take-up and management of interest rate risk in the banking book and CSRBB follow the guidance previously defined by the bank in the new *Strategy of the Deželna banka Slovenije Group 2024 to 2027* effective as of 1 January 2024. Accordingly the bank must also adapt and update other bylaws in the area of interest rate risk in the banking book and CSRBB, drawing up the following reports for the situation as at 30 September 2024:

- a report on the implementation of the required alignments and adjustments to the strategies, policies and procedures for interest rate risk take-up and management, and
- a report on the realisation of the strategic objectives in the area of interest rate risk set out in the *Strategy of the Deželna banka Slovenije Group 2024 to 2027*.

2. The bank has breached the first and third paragraphs of Article 177 of the ZBan-3 in connection with paragraphs 11, 39, 41 and 44 of the interest rate risk management guidelines and in connection with Article 23 of the internal governance regulation, by failing to provide for reliable interest rate risk management, and paragraph 28 of the EBA's Guidelines on internal governance (EBA/GL/2021/05 of 2 July 2021; hereinafter: the internal governance guidelines), having failed to put in place appropriate limits on interest rate risk as defined in point 9 of the second paragraph of Article 3 of the internal governance regulation, and because the procedures for setting and altering individual limits are deficient, which is evidenced in particular in the following:

- By altering the limit on the maximum loss in the economic value of equity (EVE), which was confirmed by the bank's management board, the bank allowed the increased take-up of interest rate risk, thereby failing to ensure the compliance of the limit system with the *Risk take-up and management strategy* and the *Risk appetite statement*.
- The bank does not have specific limits in place for risks affecting metrics of net interest income, including change in market value. It also has no specific limit in place for the risk of changes in CSRBB that would also take account of the structure of the debt securities portfolio.

- The bank has not clearly defined whether the limits in the area of interest rate risk are set at the level of the Deželna banka Slovenije Group² (hereinafter: the DBS Group) or at the level of the bank.

The bank must put in place adequate internal systems for the identification, evaluation, management and mitigation of risks arising from adverse movements in interest rates and risks inherent in potential changes in credit spreads in accordance with the first and third paragraphs of Article 177 of the ZBan-3, and must ensure compliance with the requirements of Article 23 of the internal governance regulation, paragraph 28 of the internal governance guidelines, and paragraphs 11, 39, 41 and 44 of the interest rate risk management guidelines.

To rectify the breach, the bank must put in place and define appropriate limits on exposure to interest rate risk in the banking book and CSRBB, which will be confirmed by the management body at the bank and will be determined for all metrics of interest rate risk (risk of loss of EVE, risks affecting the metric of net interest income, risk of change in CSRBB) such that they are aligned with the *Strategy of the Deželna banka Slovenije Group 2024 to 2027* and the *Risk take-up and management strategy*, and must document this appropriately.

3. The bank has breached the fourth paragraph of Article 158 of the ZBan-3 in connection with the third and fourth paragraphs of Article 167 of the ZBan-3 in connection with Article 9 of the internal governance regulation and paragraph 34 of the internal governance guidelines, and paragraphs 40, 41, 42, 51, 65, 67 and 69 of the interest rate risk management guidelines, by failing to put in place regular monitoring and reporting of exposure to interest rate risk in the banking book and CSRBB in connection with interest rate risk management at various levels of decision-making (committees, management board, supervisory board), having regard for the bank's current operations. At meetings of the supervisory board, the management board and the asset and liability management committee (ALCO) with regard to the management of interest rate risk and CSRBB, decision-makers did not have at their disposal all information (reports and clarifications) that would allow them to engage in active discussions, thereby ensuring timely and appropriate decision-making, and monitoring of whether the bank is operating in accordance with the *Risk take-up and management strategy*. For exposures to interest rate risk and CSRBB, the bank also failed to put in place adequate specific procedures with regard to the approval, monitoring and reporting of the utilisation of limits at various levels of decision-making (management board, ALCO) such that the effective flow of information between them would be ensured.

The bank must ensure that the functioning of risk management complies with the fourth paragraph of Article 158 of the ZBan-3, and that the management board and the supervisory board are informed in timely fashion and actively participate in decisions on significant risks in accordance with the third and fourth paragraphs of Article 167 of the ZBan-3, having regard at all times for the requirements under Article 9 of the internal governance regulation, paragraph 34 of the internal governance guidelines, and paragraphs 40, 41, 42, 51, 65, 67 and 69 of the interest rate risk management guidelines.

To rectify the breach, the bank must put in place a framework for the management of interest rate risk in the banking book and CSRBB that clearly sets out the responsibilities, the procedures for

² The Deželna banka Slovenije Group consists of the bank, and the subsidiaries DBS Leasing d.o.o. and DBS Nepremičnine d.o.o., although only DBS Leasing is included in the prudential consolidation.

setting and approving exposure limits, and policies and procedures to ensure that the risk management objectives are attained. This means that the bank must provide up-to-date reports on exposure to interest rate risk in the banking book and CSRBB for the ALCO and its management body (management board and supervisory board), and must regularly inform them of changes to policies and procedures for measuring and managing the aforementioned risks, based on which decision-makers will be able to engage in constructive discussions on exposure to the aforementioned risks and to take appropriate decisions in timely fashion, and will be able to monitor whether the bank is operating in accordance with its strategy and the limits put in place.

4. The bank has breached Article 53 of the ZBan-3 in connection with paragraphs 58, 59 and 61 of the internal governance guidelines, by failing to ensure that the risk committee and its members, at meetings of the risk committee between 1 January 2022 and 30 June 2023, during which time the risk committee held seven meetings, were able to engage in open and critical discussions, and were thus able to advise the supervisory board with regard to the bank's current and future general appetite for interest rate risk in the banking book and CSRBB, and with regard to the strategy for managing the aforementioned risks. According to the minutes of the meetings of the risk committee, its members did not engage in any discussions in connection with the measurement and management of interest rate risk, although it did discuss items in the area of interest rate risk (e.g. item 2.1 of the agenda at the 11th ordinary meeting, item 3 of the agenda at the 12th ordinary meeting).

The bank must ensure that the functioning of the risk committee complies with Article 53 of the ZBan-3, whereby members of the risk committee must actively engage in open and critical discussions and present their conclusions to the supervisory board, such that the latter is able to implement the risk strategy and adequately monitor the utilisation of limits, and must appropriately document the main results and conclusions as required by paragraphs 58, 59 and 61 of the internal governance guidelines.

To rectify the breaches, the bank must ensure an active role for the risk committee, which is an advisory body of the supervisory board, such that it is evident from the minutes of the committee that its members have actively discussed the management of interest rate risk in the banking book and CSRBB and have adopted resolutions as necessary.

5. The bank has breached the first paragraph of Article 177 of the ZBan-3 in connection with paragraphs 26, 67 and 112 of the interest rate risk management guidelines, by failing to take appropriate account of behavioural assumptions in the inclusion of sight deposits in the measurement of interest rate risk, and by failing to conduct regular sensitivity analysis and back-testing of assumptions for the purposes of assessing the impact of behavioural assumptions on exposure to interest rate risk in the banking book.

The bank must put in place adequate internal systems for the identification, evaluation, management and mitigation of risks arising from adverse movements in interest rates in accordance with Article 177 of the ZBan-3, and must ensure compliance with paragraphs 26, 67 and 112 of the interest rate risk management guidelines.

To rectify the identified breach, in formulating its behavioural assumptions the bank must ensure the adequate definition of stable deposits, draw up an assessment of migration between individual deposits (e.g. between sight deposits and fixed-term deposits), and apply appropriate assumptions

with regard to the expected future developments in deposits in its sight deposits model. In so doing the bank must also draw up analysis, at least once a year, of the sensitivity of key parameters to various metrics of interest rate risk, and conduct stress testing of individual risk metrics with regard to changes in key assumptions, taking this into account in decisions on the allocation of internal capital.

6. The bank's management board must submit a detailed action plan stating the measures selected to rectify the breaches referred to in points 1, 2, 3, 4 and 5 of this order to Banka Slovenije by **31 May 2024**. By the same date the bank must also report the name of the responsible member of the management board and the names of the responsible persons designated in accordance with the bank's internal organisational structure, or the names of the bank's external contractors who will be responsible for implementing individual activities to rectify breaches and for preparing and implementing selected measures under the action plan.

In the action plan the bank's management board must set out the timetable and deadlines for the implementation of the individual measures, and must designate the persons responsible for the implementation of specific measures and/or activities in accordance with the bank's internal organisational structure.

The bank must rectify the breaches referred to in points 1, 2, 3, 4 and 5 of this order by **30 September 2024**, and must deliver a report to Banka Slovenije by **15 October 2024**, attaching documents and other evidence from which it is evident that the breaches have been rectified.

7. In accordance with Article 310 of the ZBan-3, the following information in connection with this supervisory measure is published on the Banka Slovenije website after these proceedings have been completed:
1. information about the person responsible for the breach (business name and registered office of legal person);
 2. information about the breach:
 - a description of the circumstances and conduct entailing a breach of the ZBan-3 or Regulation (EU) No 575/2013,
 - the nature of the identified breaches;
 3. the operative part of the decision by which the relevant proceedings are completed; and
 4. information as to whether judicial review proceedings have been initiated against the decision in accordance with the ZBan-3.

Information as to whether judicial review proceedings have been initiated against order on rectification of breaches in accordance with ZBan-3

The bank has not initiated judicial review proceedings against the order on the rectification of breaches.