

Disclosure of information on measure imposed on █████ on 10 October 2017

Information on person responsible for breach	
Business name and registered office of legal person	
Information on breach	
Description of circumstances and conduct entailing breach of ZBan-2 or Regulation (EU) No 575/2013	On the basis of the request for supervisory review no. PBH-24.60-005/17-001 of 12 May 2017 and Bank of Slovenia authorisation no. PBH-24.60-005/17-002 of 12 May 2017, between 22 May and 7 July 2017 Bank of Slovenia staff conducted a supervisory review of █████ in the areas of corporate governance, capital risk, strategic risk, profitability risk, credit risk, liquidity risk, interest rate risk and, in part, operational risk at █████. On the basis of the findings of the supervisory review and the discussion at the 587 th meeting of the Governing Board of the Bank of Slovenia, a resolution was passed issuing an order on the rectification of breaches.
Nature of identified breaches	The breaches identified were stated in the operational part of the Order on the rectification of breaches.
Operational part of the decision by which the relevant proceedings are completed	
<p>1. █████ has breached the first paragraph and point 1 of the second paragraph of Article 136 of the ZBan-2, by failing to clearly define and adopt strategic objectives and a strategy for the take-up and management of risks that would provide for the effective and prudent governance of █████ commensurate with the nature, scale and complexity of the risks inherent in the business model and the activities that █████ pursues. At the same time it has failed to clearly define the powers of individual functions and responsibilities, and has additionally increased strategic risk.</p> <p>To rectify the identified breach, █████ must formulate and adopt a business strategy and must formulate, adopt and regularly review a strategy for the take-up and management of risks such that the internal governance arrangements are commensurate with the nature, scale and complexity of the risks inherent in the business model of █████ and the activities that █████ pursues. In so doing █████ must at all times ensure capital adequacy in accordance with the first paragraph of Article 129 of the ZBan-2.</p>	
<p>2. █████ has breached points 2 and 3 of the first paragraph of Article 9 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, Nos. 73/15 and 49/16; hereinafter: the internal governance regulation), by failing to put in place a clear organisation structure, thereby failing to control the risk inherent in taking business decisions and decisions with regard to risk management at █████ owing to inadequately established reporting flows between hierarchical and organisational levels. █████ has also failed to provide for effective communications and cooperation on the part of employees.</p> <p>To rectify the identified breach, █████ must put in place adequate reporting flows, define regular reports and provide for procedures for effective communication between different hierarchical and organisational levels of decision-making.</p> <p>█████ must put in place an effective and documented process for taking business decisions and decisions in the risk management process at █████, and must grant responsible persons access to information that is material to the proper exercise of their powers and responsibilities.</p>	
<p>3. █████ has breached:</p> <ul style="list-style-type: none">- Points 1 and 2 of the first paragraph of Article 128 of the ZBan-2 in connection with Articles 9	

and 13, the first paragraph of Article 32 and the fourth paragraph of Article 33 of the internal governance regulation, by failing, as a result of the inadequate HR policy of ■■■, to provide for a sufficient number of qualified employees with regard to the operational needs, and the scale and complexity of the risk management function for the risks inherent in the business model and risk profile of ■■■. Within the risk management function, ■■■ has also failed to provide for adequate internal controls, by failing to ensure the requisite segregation of powers and responsibilities in the implementation of work procedures, in particular organisational separation, the implementation of the four eyes principle, and mutual vetting.

- The second paragraph of Article 38 of the internal governance regulation, by allowing persons who perform tasks of the risk management function in the areas of credit risk, liquidity risk and interest rate risk to perform other tasks owing to which a conflict of interest could arise (e.g. the same employee performs both functions: measurement and management of liquidity risk, and assessment of the value of real estate for the purposes of calculating individual impairments).
- The second paragraph of Article 138 and the second paragraph of Article 147 of the ZBan-2 in connection with Articles 9 and 13 and the first paragraph of Article 20 of the internal governance regulation, by failing, as a result of inadequate HR policy, to provide for a sufficient number of qualified employees with regard to operational needs, and the scale and complexity of the risks inherent in the risk management function, and in the back-office function, in areas where ■■■ does not have suitable replacement staff.

To rectify the identified breaches, ■■■ must modify its organisational structure to ensure the requisite organisational separation between the risk measurement function and the risk management function in the areas of credit risk, liquidity risk and interest rate risk.

■■■ must draw up analysis and upgrade its HR policy to provide for a sufficient number of qualified employees. In so doing it must also provide for adequate deputisation for the responsible person performing the risk management function and the responsible person performing the back-office function. In drawing up the analysis and upgrading the HR policy, ■■■ must take account of the nature, scale and complexity of the risks inherent in its business model, and the requirements with regard to the effective implementation of risk management processes at ■■■.

4. ■■■ has breached point 2 of the first paragraph of Article 128 of the ZBan-2 in connection with the fourth and fifth paragraphs of Article 138 of the ZBan-2 (risk management function), the first paragraph of Article 147 of the ZBan-2 (risk management strategy and policy), and the first and second paragraphs of Article 148 of the ZBan-2 (risk management activities), by having deficiencies in its internal governance arrangements in the identification, assessment and reporting of risks, the preparation of a risk management strategy, and the formulation of a comprehensive overview of the risks to which ■■■ is or could be exposed in its operations. Direct access to the supervisory board of ■■■ has not been ensured for the head of the risk management function. ■■■ has failed to formulate and adopt risk management strategies and policies for all significant risks. The risk reporting system is incomplete. ■■■ has failed to define risk management activities and procedures for all significant risks.

To rectify the aforementioned breach, ■■■ must ensure that all significant risks are identified, assessed and measured, and reported on adequately. The active participation of the risk management function in the drafting of the risk management strategy of ■■■ and in all important decisions regarding risk management must be facilitated. The risk management function must ensure the formulation of a comprehensive overview of risk. Direct access to the supervisory board must be ensured for the head of the risk management function. The procedures and activities of the risk management function must be formally set out and appropriately documented.

■■■ must formulate and adopt strategies and policies for the management of all significant risks. The management board must put in place an effective risk reporting system.

■ must formulate an action plan for managing risks in accordance with the adopted strategies and policies that includes, in particular, procedures for identifying, measuring or assessing, and controlling risks, and a method for monitoring the implementation of those procedures.

■ must set out and appropriately document the procedures and activities for managing each type of risk to which it is or could be exposed in connection with the specific types of services that it provides.

5. ■ has breached:

- Point 2 of the first paragraph of Article 7 of the internal governance regulation in connection with section 2.1.1 of Appendix 1 of the internal governance regulation, by retaining in force a Methodology of work in the formulation of credit assessments that is still based on the ZBan-1. The bases for the determination of credit assessments and for assignment to appropriate rating grades are cited in the methodology. ■ generally assigns new clients to rating grade B, although this is not officially stated anywhere. Practically all credit assessment opinions are formulated by the head of monitoring and control, who does not have a suitable replacement. It is necessary to update and harmonise the methodology with applicable primary and secondary banking legislation.
- The first and second paragraphs of Article 131 of the ZBan-2 in connection with the second paragraph of Article 79 of the internal governance regulation, by failing to ensure that the opinion on a particular investment (before credit approval) contains information about the internal capital requirements.

To rectify the aforementioned breach, ■ must regularly (at least once a year) review the adequacy of the risk management strategies and policies, including ensuring that they are updated in relation to the impact of factors in the internal and external environment of ■. In this connection ■ must update the existing methodology of work in the formulation of credit assessments in accordance with section 2.1.1 of Appendix 1 of the internal governance regulation. The process for the classification of new clients must also be included in the methodology.

■ must put in place appropriate, effective and comprehensive strategies and processes to continuously assess and provide for the amounts, types and distribution of internal capital that it deems necessary as coverage with respect to the attributes and scale of the risks to which it is or could be exposed in its operations. ■ must ensure on the basis of regular reviews that the strategies and processes are comprehensive and commensurate with the nature, scale and complexity of the activities that it pursues, and must provide for internal capital to cover such risks. The management board must ensure that the results of the ICAAP, including the internal capital requirement and the internal capital assessment, are taken into account in the adoption of the business decisions of ■, in the definition and adoption of risk strategies, the risk propensity and the risk absorption capacity, and in the long-term capital planning of ■. A credit assessment opinion must be supplemented by an indication of the additional capital requirements and internal capital requirement, at least for the purposes of legal transactions that require the consent of the supervisory board pursuant to the first paragraph of Article 164 of the ZBan-2.

6. ■ has breached Article 13 of the Regulation on the assessment of credit risk losses of banks and savings banks (Official Gazette of the Republic of Slovenia, No. 50/15; hereinafter: the loss assessment regulation) and section 3.4 of Appendix 1 of the internal governance regulation, by retaining in force internal guidelines on credit protection that do not comply with applicable legislation. Residential real estate and commercial real estate are also valued by means of generalised market values (hereinafter: the SMARS valuation) without the opinion of an independent appraiser. The values are outdated, and old sale and purchase agreements have also been taken into account. The subject of the collateral and the collateral value are questionable as a result. The SMARS valuation is perhaps justifiable for ■ from the perspective of conservativeness, but this method does not comply with applicable legislation, and in many cases fails to disclose the true state of real estate collateral. Evidence of insurance policies and

confirmation of assignment in its favour is missing from the credit files.

To rectify the aforementioned breach, ■■■ must update its bylaws on monitoring the value of credit protection in accordance with Article 13 of the loss assessment regulation. Real estate collateral must be valued in accordance with the second paragraph of Article 13 of the loss assessment regulation, and its value must be monitored in accordance with the fourth and fifth paragraphs of Article 13 of the loss assessment regulation. In the case of credit protection by means of a mortgage, when the real estate collateral is not in its possession ■■■ must have at least the following documentation in accordance with the third paragraph of Article 13 of the loss assessment regulation:

- a directly enforceable notarial record of credit protection in the form of the entry of a mortgage on the pledger's real estate or of credit protection in the form of the establishment of a land debt via an entry in the land register and the issue of a land deed, and, when necessary, evidence that the real estate is justifiably in the possession of another;
- a final court decision allowing the entry of a mortgage or land debt on real estate in the land register with a notarial record of the conclusion of an agreement on the pledging of real estate, and, when necessary, evidence that the real estate is justifiably in the possession of another,
- a current extract from the land register,
- an insurance policy for the real estate assigned to the bank, and
- a real estate valuation report determined in accordance with the second paragraph of the aforementioned article, which the bank obtains when establishing the real estate collateral.

■■■ must provide for regular monitoring of the value and legal certainty of credit protection at appropriate time intervals beginning from the approval of the transaction, which depends on the type of credit protection. ■■■ must monitor the value of credit protection more frequently in the event of significant changes in market conditions of relevance to the credit protection, and must review it each time that the information at the disposal of ■■■ indicates a significant decline in the value of the credit protection. ■■■ must put in place processes to ensure:

- the monitoring of the value of credit protection, including a definition of the criteria requiring the revaluation of the credit protection with regard to the market situation;
- the monitoring of the LTV ratio;
- the independence of the valuation of credit protection, even in cases when the valuation is provided by a third party;
- the determination of the level of correlation between the value of the credit protection and the debtor's credit quality;
- special treatment of credit protection whose value is very volatile and/or that is the subject of a very lengthy realisation process;
- the vetting of the legal certainty and enforceability of the credit protection received.

7. ■■■ has infringed point 2 of the first paragraph of Article 128 of the ZBan-2 in connection with Article 142 of the ZBan-2 (internal audit function), by having deficiencies in its internal governance arrangements in properly ensuring the scope and tasks of internal auditing.

To rectify the aforementioned breach, ■■■ must provide for a scope of internal auditing and the execution of internal auditing tasks in accordance with the standards for the professional practice of internal auditing and the corresponding codes (code of internal auditing principles and code of ethics of internal auditors).

8. ■■■ has infringed point 2 of the first paragraph of Article 128 of the ZBan-2 in connection with point 2 of the second paragraph of Article 136 of the ZBan-2 (functioning of the management board, compliance) and with the second paragraph of Article 146 of the ZBan-2 (compliance function), by having deficiencies in its internal governance arrangements in ensuring the functioning of the compliance function of ■■■.

To rectify the aforementioned breach, ■■■ must ensure the effective functioning of the compliance function that identifies the compliance risks to which ■■■ is or could be exposed in its operations owing to a breach of the applicable regulations.

■■■ must review and update all the key bylaws of ■■■.

The management board of ■■■ is responsible for ensuring the compliance of ■■■ with the applicable regulations and standards.

■■■ must put in place a system for controlling potential breaches of applicable regulations, contracts entered into, prescribed practices or ethical standards.

9. ■■■ has breached point 3 of the first paragraph of Article 128 of the ZBan-2 in connection with point 1 of Article 167 of the ZBan-2 (internal control mechanisms), by having deficiencies in its internal governance arrangements in providing for adequate internal control mechanisms and in reviewing the adequacy of risk management in connection with the assessment and provision of internal capital for all the risks to which ■■■ is or could be exposed in its operations.

To rectify the aforementioned breach, ■■■ must put in place appropriate internal methodologies for assessing and providing internal capital for all the risks to which ■■■ is or could be exposed in its operations.

10. ■■■ has breached:

- Point 2 of the first paragraph of Article 128 of the ZBan-2 in connection with points 1 and 2 of the second paragraph of Article 24 of the internal governance regulation, by failing to put in place effective risk management processes for identifying, measuring or assessing, controlling and monitoring the area of liquidity risk, as ■■■ has failed to put in place a procedure for dealing with breaches of risk limits or for determining the causes of breaches, including corresponding measures.

To rectify the aforementioned breach, ■■■ must put in place a system that provides for the identification of breaches of limits in the area of liquidity risk within an appropriate time with regard to the nature and type of the risks, and must put in place procedures for dealing with breaches of limits in the area of liquidity risk and for determining the causes of breaches, including corresponding measures.

- Point 5 of the second paragraph of Article 26 of the internal governance regulation, by failing to provide for timely reports in the area of liquidity risk.

To rectify the aforementioned breach, ■■■ must put in place a system to provide timely reports on liquidity risk and to facilitate decision-making within an appropriate time with regard to the nature and type of the risks.

- The third paragraph of Article 23 of the internal governance regulation, by failing to ensure that the risk management function proposes appropriate measures for the risks identified and assessed.

To rectify the identified breaches, ■■■ must rectify the deficiencies in liquidity risk management such that the risk management function proposes appropriate measures for risks identified and assessed or measured, and guides and monitors their implementation.

11. The management board of ■■■ must submit an action plan detailing the measures selected to rectify the breaches referred to in points 1 to 7 of this order to the Bank of Slovenia by 30 November 2017. ■■■ must rectify the breach referred to in point 1 by 30 November 2017, and must rectify the remaining breaches by 30 September 2018.

In the action plan the management board of ■■■ 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 internal organisational structure of ■■■.

■■■ must report to the Bank of Slovenia on a quarterly basis on the implementation of the measures to rectify the identified breaches, by the 20th day of the month following the end of the quarter. ■■■ shall draw up the first report for the situation as at 31 December 2017. ■■■ shall enclose documents and evidence of the rectification of breaches in the quarterly report. ■■■ must deliver the final report to the Bank of Slovenia by 20 October 2018, enclosing documents and other evidence from which it is evident that the breaches have been rectified.

By 30 November 2017 ■■■ must report to the Bank of Slovenia the name of the responsible member of the management board and the names of the responsible persons designated in accordance with the internal organisational structure of ■■■, or the names of the external contractors of ■■■, who will be responsible for implementing individual activities to rectify breaches and for preparing and implementing the action plan referred to in point 8 of this order.

12. In accordance with Article 277 of the ZBan-2, the following information in connection with this supervisory measure shall be published on the Bank of Slovenia website after these proceedings have been completed:

- information on the breach;
- a description of the circumstances and conduct constituting the breach,
- the nature of the identified breaches;
- the operational part of the decision by which the relevant proceedings were completed; and
- information as to whether judicial protection proceedings have been initiated against the decision in accordance with the ZBan-2.

In accordance with the second paragraph of Article 278 of the ZBan-2 in connection with the first paragraph of Article 278 of the ZBan-2, the identity of the person responsible for the breach, i.e. the identity of ■■■, shall not be published.

Information as to whether judicial protection proceedings have been initiated against the decision in accordance with the ZBan-2

Judicial protection proceedings have not been initiated against the decision.

Information on any rectification of breaches or implementation of ordered measures

The credit institution has eliminated the breaches within the set deadline. On 2 April 2019, Banka Slovenije issued a decision stating that the breaches have been remedied.