

## Supervisory measure against credit institution of 3 May 2016

<b>Information on person responsible for breach</b>	
<b>Business name and registered office of legal person</b>	
<b>Information on breach</b>	
<b>Description of circumstances and conduct entailing breach of ZBan-2 or Regulation (EU) No 575/2013</b>	On the basis of Bank of Slovenia authorisation no. PBH-24.50-018/15-001 of 16 November 2015, a supervisory review of [REDACTED] in the area of corporate governance, the business model, and the internal governance arrangements was conducted between 1 December 2015 and 11 January 2016. Non-compliances with risk strategy and policies were identified in the area of business strategy and risk policy, a failure to observe the rules of prudential consolidation was identified, and deficiencies were identified in members of the governing body, in the area of the risk management function, in disclosures and in the area of the internal audit department.
<b>Nature of identified breaches</b>	The breaches identified in the area of corporate governance were stated in the operational part of the Order on the rectification of breaches.
<b>Operational part of the decision by which the relevant proceedings are completed</b>	
<p>1. [REDACTED] has breached point 2 of the first paragraph of Article 128 of the ZBan-2 in connection with the first and second paragraphs of Article 4 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. 73/15; hereinafter: the internal governance regulation) by failing to ensure that its adopted business objectives, strategies and policies (hereinafter: the business strategy) comply with the risk strategies and policies, and by failing to provide for commensurate effective internal governance arrangements despite a strategy of high propensity for the take-up of risks (hereinafter: risk appetite).</p> <p>To rectify the aforementioned breach, credit institution must ensure that its adopted business strategy complies with its risk strategies and policies. This means that the business strategy of [REDACTED] should in particular take account of the actual possibilities of risk take-up with regard to the risk absorption capacity of [REDACTED] referred to in point 10 of Article 3 of the internal governance regulation.</p> <p>2. [REDACTED] has breached Part One, Title II of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (hereinafter: the CRR), having failed to include its subsidiary [REDACTED] in its prudential consolidation, despite the fact that in substantive terms the aforementioned firm primarily provides mutually recognised financial services and that as at 30 June 2015 its total assets and off-balance-sheet items exceeded EUR 10 million and 1% of the total amount of assets and off-balance-sheet items of the parent undertaking.</p> <p>To rectify the aforementioned breach, credit institution must immediately begin activity to include the aforementioned [REDACTED] and all other subsidiaries in the prudential consolidation of [REDACTED] on the basis of Part One, Title II of the CRR, with its first reporting for the situation as at 31 December 2016. In so doing [REDACTED] must also ensure that the combined buffer is met on a consolidated basis in accordance with Article 228 of the ZBan-2.</p> <p>3. [REDACTED] has breached the first and second paragraphs of Article 34 and point 2 of the first paragraph of Article 50 of the ZBan-2 by failing to provide for all a number of the elements required by law in its policy for the selection of suitable candidates (e.g. specific criteria,</p>	

objectives and conditions for the purposes of selecting suitable candidates), as a result of which it is not possible to elicit from the policy the specific requirements of [REDACTED] in connection with the profile of candidates for its governing body.

To rectify the aforementioned breach, [REDACTED] must supplement its policy for upholding professional and ethical standards and assessing the suitability of members of the governing body with the following:

- the missing elements set out by the ZBan-2, namely:
  - the requirements and criteria that for the purposes of the first paragraph of Article 34 of the ZBan-2 provide for an appropriately broad range of knowledge, skills and experience on the part of the governing body as a collective,
  - incentives and targets to ensure diversity within the framework of the governing body (e.g. in terms of gender, in terms of age),
  - the conditions for performing a particular function, including the tasks and required conditions for appointment, and an estimate of the time that is likely to be required to perform the function.

4. [REDACTED] has breached the fifth paragraph of Article 34, the sixth paragraph of Article 49 and the third paragraph of Article 137 of the ZBan-2, all in connection with the second paragraph of Article 66 of the internal governance regulation, and the second paragraph of Article 138 of the ZBan-2 and the third paragraph of Article 36 of the internal governance regulation by failing to systematically plan and implement training for individual members of the governing body and staff in internal control functions.

To rectify the aforementioned breach, [REDACTED] must on an annual basis put in place and plan a financial budget and programme of training for the upcoming period, and define the conditions/criteria and method of implementation of training for individual members of the governing body and staff in internal control functions.

5. [REDACTED] has breached point 1 of the first paragraph of Article 128 of the ZBan-2 in connection with point 4 of the first paragraph of Article 55 of the ZBan-2 and the second paragraph of Article 66 of the internal governance regulation by failing to ensure that all members of the supervisory board devote sufficient time to performing the function of a member of the supervisory board for the purpose of ensuring the effective performance of their functions.

To rectify the aforementioned breaches, [REDACTED] must:

- a) set an appropriate expected lower threshold of participation by supervisory board members in ordinary and correspondence sessions of the supervisory board and in meetings of its committees, whereby the percentage participation should be at least 75% (except in cases of justified grounds for absence), and the measures and method for systematically monitoring the performance of supervisory board members,
- b) ensure that the chairperson of the supervisory board is more active in encouraging supervisory board members to perform their functions effectively and actively, including their appropriate participation in sessions of the supervisory board and meetings of supervisory board committees. Should it be found that specific supervisory board members are failing to act effectively and actively, and failing to contribute appropriate added value to the functioning of the body, the chairperson of the supervisory board shall take appropriate action, including a reassessment of the suitability of the board members in question,
- c) take account of the participation of supervisory board members in ordinary and correspondence sessions of the supervisory board, including participation in meetings of supervisory board committees, as one of the key elements in the annual assessment of the suitability of supervisory board members pursuant to the first paragraph of Article 35 of the ZBan-2, in particular in the sense of the realisation of the duties and responsibilities of a supervisory board member referred to in point 4 of the first paragraph of Article 55 of the ZBan-2, pursuant to which supervisory board members must dedicate sufficient time to the

effective performance of the function. The supervisory board shall also take account of board members' participation in sessions of the supervisory board and meetings of its committees as one of the key elements in the assessment of the supervisory board as a collective body pursuant to point 5 of the first paragraph of Article 50 of the ZBan-2 in the sense of the actual contribution by individual board members to the functioning of the supervisory board and its committees. In the assessment of the suitability of supervisory board members for the purpose of their potential reappointment (owing to the approach of the end of their current term of office), [REDACTED] must also take account of all circumstances to which the Bank of Slovenia has drawn attention in point 3 of this order.

6. [REDACTED] has breached points 1 and 3 of the first paragraph of Article 128 of the ZBan-2 and point 1 of the first paragraph of Article 9 and the fourth paragraph of Article 33 of the internal governance regulation because the [REDACTED]'s individual authorisation for decision-making, statutory representation and signing referred to in the seventh indent of point 3 of the Resolution on the work and division of labour of the management board of [REDACTED] of 26 September 2007 (hereinafter: the individual authorisation) substantively abrogates two rulebooks setting out the realisation of the powers and responsibilities of responsible persons on the governing body.

In this connection [REDACTED] has also breached points 1 and 6 of the first paragraph of Article 142 of the ZBan-2, in connection with points 1 and 3 of the first paragraph of Article 128 of the ZBan-2 and the first paragraph of Article 35 and the fourth paragraph of Article 33 of the internal governance regulation (or points 1 and 7 of Article 198 of the Banking Act [Official Gazette of the Republic of Slovenia, Nos. 99/10 (official consolidated version), 52/11 (correction), 9/11 (ZPlaSS-B), 35/11, 59/11, 85/11, 48/12, 105/12, 56/13, 63/13 (ZS-K), 96/13, 25/15 (ZBan-2) and 27/16 (ZSJV); hereinafter: the ZBan-1] in connection with points 1 and 3 of the first paragraph of Article 124 of the ZBan-1 and point (a) of the first paragraph of Article 27 of the Regulation on risk management and the implementation of the internal capital adequacy assessment process for banks and credit institutions [Official Gazette of the Republic of Slovenia, Nos. 135/06, 28/07, 104/07, 85/10, 62/11, 3/13, 38/13, 60/13, 74/13 12/14, 25/14 and 19/15]) by failing to ensure that the internal audit department would monitor and assess the effectiveness of the internal governance arrangements (note: the governance system pursuant to the ZBan-1), and would verify the compliance of the actions of [REDACTED] with the regulations in the part relating to the realisation of the president of the management board's individual authorisation.

To rectify the aforementioned breaches, [REDACTED] must provide for:

- a) the cancellation of the individual authorisation referred to in part of the seventh indent of point 3 of the Resolution on the work and division of labour of the management board of [REDACTED] of 26 September 2007,
  - b) the execution of an independent audit of work procedures, by the internal audit department pursuant to point 1 of the first paragraph of Article 142 of the ZBan-2, having regard for Appendix 1 of the internal governance regulation, in connection with the implementation of procedures in operational and organisational activities referred to in the fourth paragraph of Article 33 of the internal governance regulation, in particular from the perspective of the adequacy of rules with regard to powers and responsibilities, the allocation of tasks, and decision-making in the area of lending.
7. [REDACTED] has breached point 2 of the fourth paragraph of Article 56 of the internal governance regulation by failing to provide for transcripts of the audio recording of sessions of the governing body, whereby the minutes of sessions of the governing body, committees and commissions referred to in points 1 and 3 of the fourth paragraph of the aforementioned article are substantively sparse. [REDACTED] has also breached point 3 of the first paragraph of Article 7 of the internal governance regulation by largely allowing important decisions to be discussed in correspondence sessions of the supervisory board, whereby the number of correspondence sessions of the supervisory board significantly exceeds the number of ordinary sessions, having

regard for Article 25 of the Rules of procedure of the supervisory board, which stipulates that a correspondence session be convened in exceptional circumstances when the management board must take a business decision within a maximum of five days.

To rectify the aforementioned breaches, [REDACTED] must provide for:

- a) transcripts of the audio recording of sessions of the supervisory board,
- b) substantively detailed minutes of sessions of the governing body and its committees, primarily on the basis of the inclusion of information on the persons in attendance, a brief summary of important discussions, positions and votes of participating members, and information on any late arrivals at or early departures from a session, including confirmation of the adequacy of each set of minutes by the participants in the session,
- c) a formal definition of the supervisory board with regard to the adequacy of its handling of a large number of important matters at sessions of the supervisory board, whereby the supervisory board takes account of Article 25 of the Rules of procedure of the supervisory board, and the actions to date of supervisory board members at correspondence sessions (in general, lower participation than in ordinary sessions),
- d) consistent observation of the Article 25 of the Rules of procedure of the supervisory board and, except in justifiable cases, details of the explicit positions and voting of all supervisory board members with regard to each matter that is the subject of discussion on the supervisory board at correspondence sessions.

8. [REDACTED] has breached the first and second paragraphs of Article 147 of the ZBan-2 in connection with point 2 of the first paragraph of Article 7 of the internal governance regulation by failing to ensure that the management board and the supervisory board have a unified, consistent, long-term strategic overview of the planned recapitalisations of [REDACTED]. The supervisory board has breached point 3 of Article 48 of the ZBan-2 by failing to provide its consent to the management board for the organisation of the internal control system. [REDACTED] has breached Article 148 of the ZBan-2 by failing to set out an action plan for managing risks that is adopted by the management board of [REDACTED] with the consent of the supervisory board, after consultation with the risk committee.

To rectify the aforementioned breaches, pursuant to point 2 of the first paragraph of Article 7 of the internal governance regulation the governing body must:

- a) formally repeal the version of the recapitalisation strategy that is no longer current, and define the potential/envisaged resources of the planned recapitalisations of [REDACTED] and the envisaged (target) changes in the ownership structure of [REDACTED] in the period to 2020, including the treatment of the issue of the expansion of the supervisory board to include representatives of the other owners of [REDACTED],
- b) provide for a clear process for the supplementation, amendment and repeal of adopted strategies, including a review of the frequency of the amendment of strategies within the framework of the documents in question.

On the basis of an appropriate assessment referred to in Article 71 of the internal governance regulation, the supervisory board must provide its consent for the internal control system referred to in point 3 of Article 48 of the ZBan-2, or propose appropriate measures to ensure the adequacy of the aforementioned system.

The management board must adopt an action plan for managing risks referred to in Article 148 of the ZBan-2 with the consent of the supervisory board, after consultation with the risk committee.

9. [REDACTED] has breached the third paragraph of Article 147 of the ZBan-2 in connection with point 1 of the first paragraph of Article 26 of the internal governance regulation by failing to provide the supervisory board with comprehensive information on operations and risks, thereby preventing the supervisory board from effectively supervising the work of the management board and effectively exercising the powers based on which the supervisory board accepts general

responsibility for the effective and diligent governance of ██████████ in conjunction with the management board.

To rectify the aforementioned breach, the supervisory board of ██████████ must formally define the following pursuant to the first paragraph of Article 26 of the internal governance regulation:

- the risk reports that it wishes to receive, including their frequency,
- which reports must contain additional clarifications of risks for the purpose of better understanding of the operating position at any particular time (the position with regard to limits, recapitalisations, internal assessment of risk-based capital requirements, etc.),
- the quantitative and qualitative attributes of loans regarding which it wishes to be regularly informed before and/or after their approval, even if the overall exposure to the client does not reach 10% of the capital of ██████████ (the supervisory board determines the appropriate percentage),
- the amount of capital, total assets or number of exposures regarding which it wishes to be regularly informed in connection with existing exposures in collective form,
- the issue of timely information about moratoriums provided to specific borrowers, and must request appropriate clarifications from the management board in the case of reports that do not contain the relevant information about a moratorium provided (██████████).

10. ██████████ has breached Articles 50, 51 and 52 of the ZBan-2 by failing to provide for the comprehensive and sufficiently high-quality treatment of all the tasks of the supervisory board committees (audit committee, nomination committee, remuneration committee, risk committee) set out by law.

To rectify the aforementioned breach, the supervisory board must provide for the comprehensive and high-quality treatment of all the tasks of the supervisory board committees set out by law in 2016. The governing body must examine and adopt a formal position (on the basis of an agenda item discussed at a session of the governing body) with regard to the possibility of the hiring of external advisors referred to in the sixth paragraph of Article 49 of the ZBan-2 for the purpose of expert support for the supervisory board and its committees in the treatment of complex tasks in the area of risk.

11. ██████████ has breached the first paragraph of Article 147 of the ZBan-2 in connection with the second paragraph of Article 17 of the internal governance regulation by failing to define and adopt a risk propensity with regard to any significant risks other than credit risk, as a result of which the governing body has not yet adopted its concise risk statement.

To rectify the aforementioned breach, the governing body of ██████████ must adopt its concise risk statement, thereby clarifying the approach of ██████████ to the realisation of the risk propensity, and must ensure that the concise risk statement is taken into account in any risk take-up by ██████████ at the level of policy and business processes.

12. ██████████ has breached the first paragraph of Article 147 of the ZBan-2 and Articles 27, 28 and 29 of the internal governance regulation by failing to put in place an adequate framework for managing the risks inherent in new products and the use of external contractors.

To rectify the aforementioned breach, ██████████ must:

- update the rulebook governing the approval of new products, in particular by means of an expansion in the concept of a new product, and an approach to the inclusion of new products in the risk management process and the internal capital adequacy assessment process (hereinafter: the ICAAP), including a definition of the elements that need to be taken into account in the approval process for new products on each occasion,
- formulate a policy for the use of external contractors, including an approach to the inclusion of such risks in the risk management process of ██████████.

13. [REDACTED] has breached the first and second paragraphs of Article 140 of the ZBan-2 by putting in place a whistleblowing system for reporting breaches whose framework of application is too narrow with regard to the provisions of law.

To rectify the aforementioned breach, pursuant to the first paragraph of Article 140 of the ZBan-2 [REDACTED] must appropriately expand the Protocol on the whistleblowing system for the anonymous reporting of breaches (hereinafter: the protocol) by means of a statement that the whistleblowing system also includes the prevention of non-compliance with the regulations referred to in the second paragraph of Article 9 of the ZBan-2 and the bylaws of [REDACTED]. Pursuant to the second paragraph of Article 140 of the ZBan-2, [REDACTED] must, for the purpose of ensuring application of the four eyes principle in connection with whistleblowing, define clear procedures for receiving and handling reports, including reporting on findings in connection with reports received and activities carried out, in particular:

- a) in addition to the internal audit department, the protocol must also include the role of the compliance function (or the legal department). This must have:
- the function of recipient of the report of the breach,
  - responsibility for the anonymisation of the report of the breach,
  - responsibility for the appropriate storage of the whistleblower's personal data,
  - responsibility for monitoring the procedure for handling reported breaches and ensuring that the entire procedure complies with Article 140 of the ZBan-2 and is executed within a reasonable timeframe.

Note: The internal audit department therefore retains the function of handling the (anonymised) report of the breach that is obtained on each occasion from the compliance department (or legal department), and compiling the corresponding report with findings and proposals (as under the existing protocol).

- b) On the basis of the aforementioned conceptual solutions and for the purposes of more precisely defining the procedures for receiving and handling reports, the protocol must define and clarify:
- the function, and first name and surname, of the person who is responsible for receiving reports of breaches, including persons authorised to perform this function in the absence of the former,
  - the procedure for anonymisation of the report of the breach by the person responsible for receiving the report of the breach,
  - the manner of storage of the whistleblower's personal data, and a clarification of the authorisations of other persons with regard to access to this data,
  - the provision of an audit trail for each viewing or modification of the whistleblower's personal data,
  - the data that is expected from the whistleblower, for the purpose of easier investigation of the breach:
    - the whistleblower's first name and surname,
    - the first name and surname of the person responsible for the breach,
    - the first name and surname of others involved in the breach,
    - the desired information about support documentation,
    - the conditions and procedure for subsequent communication (when necessary) with the whistleblower by the compliance function,
  - measures to prevent retaliatory acts, discrimination or other forms of inappropriate treatment of staff at [REDACTED] who have reported breaches, and measures to reverse the consequences of retaliatory acts, when inappropriate treatment has occurred.

14. [REDACTED] has breached points 2 and 3 of the third paragraph of Article 88 of the ZBan-2 by failing to make certain disclosures in the area of corporate governance, or making deficient disclosures.

To rectify the aforementioned breach, [REDACTED] must provide for the missing disclosures

referred to in point 2 of the third paragraph of Article 88 of the ZBan-2.

██████████ must also supplement the deficient disclosures referred to in point 3 of the third paragraph of Article 88 of the ZBan-2, in particular in connection with:

- rules with regard to the ratio between fixed and variable remuneration, including the requirement that an individual's variable remuneration may not exceed 100% of the individual's fixed remuneration (point 6 of the first paragraph of Article 170 of the ZBan-2),
- rules with regard to the deferral of variable remuneration and rules for the adjustment of variable remuneration to risks, including the criteria for the application of internal rules on malus or clawback arrangements (points 8 to 10 of the first paragraph of Article 170 of the ZBan-2),
- rules with regard to payments to each individual in connection with early termination of contract (point 12 of the first paragraph of Article 170 of the ZBan-2).

15. ██████████ has breached the first paragraph of Article 147 of the ZBan-2 in connection with point 2 of the first paragraph of Article 7 of the internal governance regulation by failing to provide for the governing body's regular review of the adequacy of the strategies and policies for taking up and managing risks, including the methodologies and processes of ██████████.

To rectify the aforementioned breach, on the basis of analysis of the gaps between the ZBan-1, the ZBan-2 and the corresponding regulations referred to in the second paragraph of Article 9 of the ZBan-2 the governing body must conduct a documented review of the adequacy of all bylaws in the area of risk take-up and management. In so doing the governing body must in particular provide for the formulation or updating of policies, methodologies and processes in the following areas:

a) General:

- defining the propensity of ██████████ to take up significant risks referred to in point 8 of the second paragraph of Article 3 of the internal governance regulation (where it has not yet been adopted),
- appropriately including the "forward view" in methodologies and approaches for identifying and assessing significant risks on the basis of stress tests referred to in the first paragraph of Article 22 of the internal governance regulation,
- updating the governance of the ICAAP referred to in Section 4.1.1 of the internal governance regulation, in particular in the part providing for the consistent application of the results of the ICAAP in taking and supervising business decisions.

b) Credit risk management: For the purposes of ensuring that risk exposure is appropriately taken into account in the calculation of internal risk-based capital requirements in the ICAAP, ██████████ must:

- provide for the adequate assessment and treatment of residual risk referred to in Article 155 of the ZBan-2 in respect of loans where the initial or subsequent risk assessment (credit opinion) identifies poor collateral quality or a difficulty in liquidation,
- take account of the strategy of planned lending and collateral quality for each upcoming period on an annual basis, for example on the basis of a definition of planned exposure across exposure classes and grades (government, retail, etc.) and the gradual inclusion of the corresponding projections of internal risk-based capital requirements for the upcoming year, divided across months (e.g. in twelfths), in the ICAAP for the current month. These projections take account of the client's risk assessment and the results of stress tests on the basis of a relevant projection of a deterioration in the credit portfolio for the same period.

c) Operational risk management: For the purposes of ensuring that risk exposure is appropriately taken into account in the calculation of internal risk-based capital requirements in the ICAAP, ██████████ must take account of the specifics of the

rapid development and growth of [REDACTED], which has exposed it to significant operational risk, for example through the use of a moving average over the last three years in the calculation of average gross income under the basic indicator approach to the calculation of the capital requirement for operational risk.

- d) Management of other risks: For the purposes of ensuring that risk exposure is appropriately taken into account in the calculation of internal risk-based capital requirements in the ICAAP, [REDACTED] must select a methodology that ensures compliance with the Bank of Slovenia's guidelines on the ICAAP and the bylaws of [REDACTED] (e.g. the Development strategy of [REDACTED] for the 2016 to 2020 period, page 20 of which stipulates: "[REDACTED] must disclose risk-based capital requirements for other risks of at least 5% to 15% of the capital requirements, if it uses a basic indicator approach to the calculation of risk-based capital requirements. This method of calculation will be applied consistently until it develops an in-house methodology for the estimation of risk-based capital requirements for other significant risks.").
- e) Other areas:
- bringing the remuneration policy into line with the requirements of the ZBan-2 (in particular points 3, 6 and 10 of the first paragraph of Article 170 of the ZBan-2),
  - providing for policy and procedures in connection with persons in a special relationship with [REDACTED] referred to in Article 149 of the ZBan-2, including updates to the list of such persons,
  - providing for rules of operation for the credit analysis department, and other committees and commissions that do not yet have complete rules of procedure (e.g. the non-performing investment commission, the claims forbearance commission).

16. [REDACTED] has breached the third paragraph of Article 136 of the ZBan-2 by failing to ensure that the management board regularly assesses the effectiveness of the risk management function.

To rectify the aforementioned breach, the management board must provide for a regular (at least annual) assessment of the effectiveness of the risk management function, whereby it must in particular address the risk management department and the credit analysis department. The assessment of the effectiveness of the aforementioned departments must take account of the success of the realisation of tasks deriving from the rulebooks and rules of operation of the individual departments, and must define the strengths and weaknesses of the two departments, including measures to rectify weaknesses. The management board must set out the procedure and the content of the regular assessment of the departments within the framework of the risk management function by the governing body in bylaws.

17. [REDACTED] has breached the second paragraph of Article 138 of the ZBan-2 in connection with the second paragraph of Article 41 of the internal governance regulation, as a result of deficient rules with regard to direct access to the supervisory board of [REDACTED] on the part of heads of department within the framework of the risk management function.

To rectify the aforementioned breach, [REDACTED] must provide for the supplementation of the bylaw governing the organisation and work of the risk management function with a definition of the method of notification of the management board and the supervisory board by the head of the risk management function at the level of expert departments in the cases referred to in the sixth and seventh paragraphs of Article 138 of the ZBan-2.

To rectify the aforementioned breach, the supervisory board must supplement point 7 of its rules of procedure such that the head of the risk management function at the level of expert departments is provided with regular participation in sessions of the supervisory board in the parts relating to the issue of risk, and not "as necessary, according to judgement or if invited to a session".

18. [REDACTED] has breached point 2 of the first paragraph of Article 128 of the ZBan-2 in connection with Sections 2.1 and 3.1 of Appendix 1 of the internal governance regulation by maintaining the development and custody of the methodology for classifying clients into rating grades separate from the credit analysis department, as a result of which in certain cases there is a discrepancy between the credit opinion and the credit assessment of a specific borrower, including the provision of regular monitoring of the credit quality of the debtor.

To rectify the aforementioned breach, [REDACTED] must provide for the transfer of the development and custody of the Methodology for classifying clients into rating grades (hereinafter: the methodology) from the risk management department to the credit analysis department, and must ensure that analysts at the credit analysis department have a comprehensive understanding of the methodology while having regard for the importance of the independent expert assessment of each client. The risk management department must identify weaknesses that derive from the sample of formulated credit opinions and credit assessments, and must provide training for the credit analysis department in connection with the proper use of the methodology. The procedure for classifying a debtor or exposure into rating grades or pools must be documented in a manner that allows third parties to understand the classification, reclassification and evaluation of the suitability of classification.

The credit analysis department must monitor the debtor's operations regularly to determine whether the debtor's creditworthiness is still appropriate, having regard for the type of debtor, and the size and complexity of the exposure, proposing reclassifications as necessary. [REDACTED] must put in place an effective process for obtaining and updating relevant information on the attributes of the debtor and the exposure in accordance with Section 3.1 of Appendix 1 of the internal governance regulation.

19. [REDACTED] has breached point 2 of the first paragraph of Article 128 of the ZBan-2 in connection with the second and third paragraphs of Article 137 of the ZBan-2 and Article 26 of the internal governance regulation by:
- failing to provide the risk management department with relevant and timely information about key issues in connection with the operations of [REDACTED] and its risks,
  - failing to ensure that reports on risks intended for discussion on the supervisory board are understandable, sufficient, useful and timely for supervisory board members.

To rectify the aforementioned breach:

- a) The credit analysis department must consistently provide for the formulation of opinions on the individual investments of [REDACTED] on the basis of bylaws, for the purpose of ensuring comprehensive oversight of risk by the risk management department.
- b) The investment management section must provide regular reports on non-performing investments to the risk management department, the latter defining the content and frequency of this information.
- c) The vote exercised by representatives of departments on the central credit committee must represent the documented position of the department, and not merely the vote of the committee member. In the event of a change in a committee member's position during the actual voting on material exposures (i.e. not all exposures), the reasonable grounds for such a change must be cited in the minutes.
- d) The credit analysis department must provide for the timely notification of the risk management department regarding each credit opinion for the purposes of discussion and voting on loans at the level of the central credit committee to allow for the formulation of a position on the borrower (at least two days before the meeting of the committee).
- e) Credit opinions intended for discussion at the level of the supervisory board, and for the purpose of ensuring the proper understanding of credit opinions by members of the supervisory board, must include understandable information with regard to the links between individual internal risk-based capital requirements and the corresponding indicators and limits (e.g. capital adequacy, recapitalisation issues).

20. [REDACTED] has breached the second paragraph of Article 146 of the ZBan-2 in connection with point 1 of the first paragraph of Article 7 and Article 42 of the internal governance regulation by failing to adopt a compliance policy.

To rectify the aforementioned breach, [REDACTED] must adopt a compliance policy. The compliance policy must take account of analysis of the differences between the ZBan-1 and the ZBan-2, and changes in the corresponding regulations referred to in Article 9 of the ZBan-2, must formally assess the existing compliance risk, and must take a position as to whether compliance risk is significant to [REDACTED], including corresponding measures at the level of the ICAAP and risk management measures. The analysis of the differences must in particular include:

- the ZBan-1 (previous) and the ZBan-2, and the CRR in the parts relating to risk management processes, the governing body and disclosures,
- the Regulation on risk management and the implementation of the internal capital adequacy assessment process for banks and [REDACTED] / the Regulation on the diligence of members of the management and supervisory boards of banks and savings banks (previous) and the internal governance regulation,
- the Regulation on the application of the EBA Guidelines on Internal Governance (Official Gazette of the Republic of Slovenia, No. 47/15),
- the Regulation on the application of the Guidelines on the assessment of the suitability of members of the management body and key function holders (Official Gazette of the Republic of Slovenia, No. 47/15),
- Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

[REDACTED] must apply the findings of the analysis of differences between the ZBan-1 and the ZBan-2 and the corresponding regulations in the formulation and realisation of the annual plan of the compliance department in 2016 and in subsequent periods.

21. [REDACTED] has breached the third paragraph of Article 136, the second paragraph of Article 146 of the ZBan-2 and the first paragraph of Article 9 of the internal governance regulation by putting in place a deficient framework for the compliance function.

To rectify the aforementioned breach, for the purposes of establishing a department to perform the tasks of the compliance function referred to in the second paragraph of Article 146 of the ZBan-2 [REDACTED] must adopt rules of operation that provide for the functioning of the department, and must adopt and update other bylaws in the area of risk management and the action of internal control functions on which the establishment of the department in question has an impact. The department's rules of operation and other relevant bylaws must regulate the following *inter alia*:

- the appropriate organisation, scale of operation and reporting of the department referred to in Article 146 of the ZBan-2, whereby [REDACTED] must in particular ensure the independence of the department and its functional and organisational segregation from other functions of [REDACTED] in respect of which conflicts of interest could arise,
- the manner of the realisation of the tasks of the compliance department referred to in Article 44 of the internal governance regulation,
- the notification of the supervisory board regarding the appointment (dismissal) of the head of department, the rules with regard to reporting to the governing body and direct access to the chairperson of the supervisory board, and the process of appropriate treatment of adopted measures proposed by the department referred to in Article 43 of the internal governance regulation,
- the methodology for assessing compliance risk, and the procedures for including compliance risk in risk management processes and the ICAAP, if such risk is significant.

██████████ must provide for the proper briefing of staff with regard to the adopted bylaws governing the area of compliance at ██████████, and the department in question, including for the purpose of acting as a contact address for queries from staff in connection with compliance risk.

The governing body must provide for the regular (at least annual) assessment of the effectiveness of the department that will perform the tasks of the compliance function.

22. ██████████ has breached point 3 of the first paragraph of Article 128 of the ZBan-2 in connection with point 2 of the third paragraph of Article 35 of the internal governance regulation by failing to provide for closer cooperation between the internal audit department (hereinafter: the IAD) and the risk management department in the area of the regular notification of the IAD with regard to risks for the purposes of formulating an annual work plan tailored to risk.

To rectify the aforementioned breach, the management board must provide for the timely notification of the IAD with regard to the significant risks of ██████████ by the risk management department. The IAD must set out the manner of systematic cooperation with the risk management department, and the manner of regular notification with regard to risks.

23. ██████████ has breached point 3 of the first paragraph of Article 128 of the ZBan-2 in connection with the first paragraph of Article 36 of the internal governance regulation by failing to put in place an effective and structured process for the selection of candidates for employment at the IAD to allow for the timely and comprehensive internal discussion of the adequacy of the knowledge, skills and experience of candidates for the performance of their tasks (including specific tasks) at the appropriate hierarchical and professional levels of ██████████.

To rectify the aforementioned breach, ██████████ must provide for the involvement of the head of the IAD in the selection and assessment of candidates for employment, for the purposes of appropriately strengthening the IAD in terms of human resources and maximising the provision of the requisite knowledge, skills and experience for the performance of internal audit tasks (including specific areas and activities of ██████████) by the examined candidates for employment.

24. ██████████ has breached point 3 of the first paragraph of Article 128 of the ZBan-2 in connection with the first paragraph of Article 35 of the internal governance regulation by failing to provide adequate support for the provision of an appropriate independent assessment by the IAD with regard to the quality and effectiveness of the internal governance arrangements, including the risk management systems and processes and the internal controls of ██████████.

To rectify the aforementioned breach, pursuant to the first paragraph of Article 35 of the internal governance regulation, which *inter alia* stipulates that the IAD should support and assist the governing body in safeguarding the long-term interests of ██████████ and in protecting its reputation, in planning and adopting the annual plan of audits, and having regard for the independence of the IAD the governing body must provide for active discussion with the IAD on the range of other potentially significant areas for internal auditing, including guidance and additional information where necessary. The chairperson of the supervisory board must organise bilateral meetings on a quarterly basis between the chairperson of the supervisory board or the chairperson of the audit committee and the head of the IAD.

25. ██████████ has breached Article 142 of the ZBan-2 in connection with point 1 of the second paragraph of Article 35 of the internal governance regulation by failing to provide for the effective performance of all the tasks of the IAD prescribed by law, including those with an emphasis on risks.

To rectify the aforementioned breach, for the purposes of monitoring and assessing the effectiveness of the internal governance arrangements the IAD must:

- a) conduct an audit of the risk management function in the 2016 to 2017 period, in particular in the part relating to the quality of the realisation of the processes of risk identification, assessment and monitoring,
- b) conduct an audit of the compliance department in the 2017 to 2018 period, in particular in the part relating to the quality of its assessment of the compliance risk of [REDACTED].

For the purposes of assessing the internal capital adequacy assessment process (ICAAP) with regard to the internal risk assessment in connection with the deficiencies identified in the area of the ICAAP in 2016, the IAD must substantively audit the adequacy of the ICAAP of [REDACTED].

[REDACTED] must in general ensure that in its future audits the IAD will devote greater emphasis to the substantive assessment of the quality and effectiveness of the internal governance arrangements, including the risk management systems and processes and the internal controls of [REDACTED].

26. The management board of [REDACTED] must submit an action plan detailing the measures selected to rectify the breaches referred to in points 1 to 25 of this order to the Bank of Slovenia by 15 July 2016, and must rectify the aforementioned breaches **by 31 December 2016**. The action plan of the management board of [REDACTED] must define the timetable for the implementation of individual measures, and the persons responsible for the implementation of individual measures and activities in accordance with the internal organisational structure of [REDACTED]. [REDACTED] must report to the Bank of Slovenia on the implementation of measures on a monthly basis in accordance with the action plan, by the tenth day of the current month for the previous month (regular report), or without delay in the event of material facts and circumstances affecting the implementation of the action plan (*ad hoc* report), compiling the first regular report for the situation as at 30 June 2016.
27. By 15 July 2016 [REDACTED] must report to the Bank of Slovenia the name of the responsible member of the management board and the names of the responsible persons defined in accordance with the internal organisational structure at [REDACTED], or the names of external contractors of [REDACTED] who will be responsible for implementing individual activities to rectify breaches and for preparing and implementing the action plan referred to in point 26 of this order.
28. 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 entailing 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 [REDACTED], shall not be published.

29. An objection to this order shall not stay its enforcement.

**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.

<b>Information on any rectification of breaches or implementation of ordered measures</b>
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The credit institution has eliminated the breaches within the set deadline. On 10 May 2017, Banka Slovenije issued a decision stating that the breaches have been remedied.
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