

**Disclosure of information on supervisory measure of 3 September 2019 imposed on credit institution**

<b>Information on person responsible for breach</b>	
<b>Business name and registered office of legal person</b>	<p>████████████████████</p> <p><i>The identity of the person responsible for the breach is not being disclosed, in accordance with point 3 of the first paragraph of Article 278 of the ZBan-2.</i></p>
<b>Information on breach</b>	
<b>Description of circumstances and conduct entailing breach of ZBan-2 or Regulation (EU) No 575/2013</b>	<p>On the basis of Bank of Slovenia request for inspection PBH-24.60-001/19-001 of 12 February 2019 and Bank of Slovenia authorisation PBH-24.60-001/19-002 of 13 February 2019, Bank of Slovenia staff conducted an inspection of ██████████ in the area of credit risk in lending to legal and natural persons.</p> <p>On the basis of the inspection the Bank of Slovenia found breaches of the ZBan-2 and Regulation (EU) No 575/2013, for which reason it issued an order on the rectification of breaches with an additional measure, against which ██████████ lodged an objection. The Bank of Slovenia consequently issued a decision on an objection, which partly amended the operational part of the order.</p> <p>The circumstances and conduct entailing a breach of ZBan-2 or Regulation (EU) No 575/2013 are cited in the operational part of the order below, which was amended in accordance with the decision on an objection.</p>
<b>Nature of identified breaches</b>	Breaches in the area of credit risk management
<b>Operational part of the decision by which the relevant proceedings are completed</b>	
<p>1. ██████████, registration number: ██████████ (hereinafter: ██████████), has breached Article 147 of the ZBan-2 in connection with the first paragraph of Article 7 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, 49/16, 68/17, 33/18 and 81/18; hereinafter: the internal governance regulation), because its management body has failed to provide for the regular review (at least once a year) of the adequacy of its risk take-up and management policies, including ensuring that they are updated in relation to the impact of factors in the bank's internal and external environment.</p> <p>██████████ must provide for the regular review (at least once a year) of the adequacy of its risk take-up and management policies, including ensuring their updating and compliance, in accordance with Article 147 of the ZBan-2 in connection with the first paragraph of Article 7 of the internal governance regulation.</p> <p>2. ██████████ has breached Article 128 of the ZBan-2 in connection with the second paragraph of Article 88 of the internal governance regulation, because it does not have stable internal governance arrangements that encompass effective risk management processes for identifying, measuring or assessing, controlling and monitoring risks, having failed to take account of the results of stress tests in the capital planning process and in the definition of measures in connection with risk strategies and policies.</p> <p>██████████ must take account of the results of stress tests in the capital planning process and in</p>	

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the definition of measures in connection with risk strategies and policies, in accordance with the second paragraph of Article 88 of the internal governance regulation.

3. [REDACTED] has breached Article 151 of the ZBan-2 in connection with Article 13 of the Regulation on credit risk management at banks and savings banks (hereinafter: the credit risk management regulation), because it has failed to put in place and implement adequate credit risk management policies and procedures, including counterparty risk, having failed during the credit approval and monitoring process to assign debtors and exposures to rating grades on the basis of clear credit rating criteria, thereby failing to assign debtors and exposures with similar credit risk to the same rating grades. The existing system of rating assignment of legal and natural persons does not conform to other systems of classification and credit risk monitoring at [REDACTED].

In its management of credit risk and counterparty risk, [REDACTED] has breached Article 178(1) of Regulation (EU) No 575/2013, because it fails to apply the definition of default referred to in the aforementioned article in its systems for assigning debtors and exposures to rating grades. [REDACTED] has failed to clearly define criteria for the debtor being unlikely to pay its credit obligations to the credit institution, as a result of which it is failing to provide for timely recognition of default status, before the occurrence of material arrears of more than 90 days, and consequently is failing to adjust the rating grade of the debtor or the exposure to the actual level of credit risk. Consequently it has also breached Article 127 of Regulation (EU) No 575/2013, because it erroneously assigns exposures to the class of exposures in default for the purposes of calculating capital requirements for credit risk under the standardised approach, and reports erroneously in template 18 F 18.00 of Annex V of Commission Implementing Regulation (EU) No 680/2014.

To rectify the identified breaches, within the framework of the credit approval and monitoring process [REDACTED] must supplement its policies and procedures with clear assignment criteria that are sufficiently precise to allow employees in the credit approval and monitoring process to make the same interpretations and consistently assign debtors and exposures with similar credit risk to the same rating grades. In the formulation of criteria for assigning debtors and exposures to rating grades, [REDACTED] must take full account of the definition of default set out in Article 178 of Regulation (EU) No 575/2013.

The internal systems of assignment at [REDACTED] must provide for the correct reporting of non-performing exposures in template 18 F 18.00 of Annex V of Commission Implementing Regulation (EU) No 680/2014, and must provide for the correct assignment of exposures to the class of exposures in default in accordance with Article 127 of Regulation (EU) No 575/2013 for the purposes of calculating capital requirements for credit risk under the standardised approach.

4. a) [REDACTED] has breached the first paragraph of Article 148 of the ZBan-2 and Article 167 of the ZBan-2 in connection with the second paragraph of Article 30 of the internal governance regulation, because it does not have an action plan for managing the risks of a new consumer lending product, and its practices in taking up the risks of a new consumer lending product do not comply with the policy of [REDACTED] with regard to the management of such risks, [REDACTED] thereby having failed to provide for comprehensive and impartial risk assessment based on relevant risk scenarios, having regard for any deficiencies in the risk management process and in internal controls for effective risk management, the impact of the introduction of the new product on the risk absorption capacity, etc. The product was introduced despite the

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identification of numerous risks that could arise during its introduction. ██████ failed to take account of all the deficiencies in the risk management process and in internal controls for effective management of the corresponding risks, and failed to ensure that the new product and its use would meet the requirements with regard to risk management that ██████ would have had to meet itself had it offered the product directly.

To rectify the breaches, ██████ must produce a comprehensive and impartial risk assessment of the new consumer lending product, in which it must take a position with regard to all the identified risks and assess whether it is possible to ensure their adequate management. In the risk assessment ██████ must also take account of factors and principal issues referred to in point 2 of Article 28 of the internal governance regulation. In particular it must assess whether the new product complies with regulations, standards and the bylaws of ██████. ██████ must ensure that the new consumer lending product and its use meet all the requirements with regard to risk management in the same manner as if ██████ had offered the product itself directly.

b) ██████ has breached the first paragraph of Article 151 of the ZBan-2 in connection with the third paragraph of Article 19 of the credit risk management regulation, because it has failed to put in place adequate credit risk management procedures, having failed to provide for the documentation of the assignment process with regard to the new consumer lending product, including the internal control system in this area.

To rectify the breach, ██████ must ensure that the organisation of the assignment process is properly documented.

c) ██████ has breached the first paragraph of Article 152 of the ZBan-2 in connection with Article 5 of the credit risk management regulation, because it failed to put in place appropriate and precisely defined criteria for deciding on credit approval for the new consumer lending product, in particular the client's risk profile and current credit repayment capacity.

██████ has breached the second and third paragraphs of Article 152 of the ZBan-2 in connection with the first paragraph of Article 6 of the credit risk management regulation, because, in the procedure for concluding an agreement on the sale/assignment of claims, it fails to assess and analyse the debtor's ability to settle the liabilities to it, and fails to obtain a transcript of credit assessment information from the debtor. Accepting a portfolio without reviewing whether the portfolio has the agreed attributes constitutes an elevated risk for ██████.

To rectify the breaches, for the new consumer lending product ██████ must provide for appropriately and precisely defined credit approval criteria such that it is possible to make a complete assessment of the consumer's creditworthiness on their basis. In the related procedure for the acceptance of credit into the portfolio via the sale/purchase of claims, which is the foundation of the creation of ██████'s exposure to credit risk, ██████ must on each occasion assess and analyse quantitative and qualitative information and other significant factors that facilitate a comprehensive assessment of the debtor's ability to settle the liabilities to it, and must obtain a transcript of the debtor's credit assessment information. ██████ must provide for an appropriately professional and objective evaluation of the credit risk assessment, and must obtain sufficient information about the client to be able to determine his/her/its risk profile or to assess his/her/its creditworthiness and to assign an appropriate credit assessment

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thereto. It must be particularly prudent with clients with whom it is entering into a contractual relationship for the first time. The quality of the claims and the content of the existing credit documentation must be known to [REDACTED] before the purchase.

d) [REDACTED] has breached Article 151 of the ZBan-2 in connection with Article 38 of the credit risk management regulation, because it has failed to put in place and implement adequate credit risk management procedures for a new consumer lending product, having failed to put in place appropriate information infrastructure for the collection and storage of data deriving from the processes of the identification, measurement or assessment, control and monitoring of credit risk. IT support is not yet provided integrally, and the booking and payment of loans is still manual, which increases the risk of human errors during entry in the system.

To rectify the breach, for the new consumer lending product [REDACTED] must put in place appropriate information infrastructure for the collection and storage of data deriving from the processes of the identification, measurement or assessment, control and monitoring of credit risk. [REDACTED] must regularly review the appropriateness of the information infrastructure. [REDACTED] must design procedures and processes that ensure data quality from the perspective of its accuracy, completeness and appropriateness in all credit risk management processes. The accuracy of the data relates to the level of confidence that the data is correct. It should be high enough to ensure that [REDACTED] avoids the significant distortion of the final data used in decision-making processes. The completeness of the data relates to the inclusion of all significant data required in individual credit risk management processes, whereby [REDACTED] minimises the occurrence of data shortfalls. The appropriateness of the data means that the data may not be biased. For the purpose of reducing the impact of human error, [REDACTED] must provide for the automation of all material processes. Information systems must be reliable, appropriately documented and regularly reviewed.

e) Owing to the breaches cited in point 4 of the operational part of this order, in accordance with points 5 and 12 of the second paragraph of Article 250 of the ZBan-2 in connection with the first paragraph of Article 250 of the ZBan-2, the Bank of Slovenia hereby orders [REDACTED] to:

- limit its operations in the new consumer lending product to a maximum of EUR 1,500,000 in total gross on-balance-sheet exposure from operations in the new product, in order to mitigate the risks that it takes up in connection with the new consumer lending product that entail a material risk to [REDACTED]'s financial position;
- regularly report to the Bank of Slovenia, i.e. within three business days, on each occasion that the total gross on-balance-sheet exposure from operations in the new product exceeds an additional EUR 200,000;
- uphold the limitation and the obligation to report until the rectification of the breaches identified in this point of the order.

5. a) [REDACTED] has breached the first paragraph of Article 148 of the ZBan-2 in connection with the second paragraph of Article 30 of the internal governance regulation, because it does not have an action plan for managing the risks of a new product for lending to real estate projects, and it failed to provide for comprehensive and impartial risk assessment based on relevant risk scenarios in respect of the new product for lending to real estate projects, having regard for any deficiencies in the risk management process and in internal controls for effective risk management, the impact of the introduction of the new product on the risk absorption capacity, etc.

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To rectify the breaches, ██████ must produce a comprehensive and impartial risk assessment of the new product for lending to real estate projects, in which it must take a position with regard to all the identified risks and assess whether it is possible to ensure their adequate management.

Should ██████ determine that adequate risk management referred to in the first paragraph of Article of 23 of the internal governance regulation has not been ensured, it must defer the introduction of the new product until adequate risk management processes have been put in place.

b) ██████ has breached Article 151 of the ZBan-2 in connection with the fourth paragraph of Article 33 and the seventh paragraph of Appendix 1 of the internal governance regulation, because it has failed to adopt and implement adequate credit risk management policies and procedures. ██████ has failed to adopt a special credit policy for project financing, which demands adjusted procedures and controls.

██████ fails to apply appropriate and precisely defined criteria for making decisions on the approval of investments in the area of project financing. ██████ has failed to draw up operational instructions for the approval, monitoring and process of project financing, and ██████ has also failed to define individual powers and responsibilities. According to the internal governance regulation, work procedures must be set out by means of appropriate instructions, rulebooks and other bylaws of ██████ that include rules with regard to powers and responsibilities, the allocation of tasks, decision-making in the implementation of procedures, and descriptions of business processes. To rectify the breach, for the new product of lending to real estate projects (project financing) ██████ must draw up and adopt a special project financing policy with adjusted procedures and controls, and must include experts specialising in this form of financing in the credit process. They must be included in the initial phase of the project financing approval process. Monitoring must be the responsibility of persons who are professionally qualified in this area, particularly in more-demanding real estate projects. ██████ must stipulate the frequency of monitoring of real estate projects (at least on a monthly basis), which depends on the complexity and difficulty of the project. ██████ must also draw up operational instructions for the approval, monitoring and actual process of project financing. Work procedures must be set out by means of appropriate instructions, rulebooks and other bylaws of ██████ that include rules with regard to powers and responsibilities, the allocation of tasks, decision-making in the implementation of procedures, and descriptions of business processes.

c) ██████ has breached Article 128 of the ZBan-2 in connection with Articles 27 and 29 of the internal governance regulation, because it does not have a policy for the use of outsourcing, and fails to include risks inherent in the use of outsourcing in the risk assessment process. ██████ is defined as an external contractor at ██████ who is envisaged in all phases of the credit process (approval and monitoring) in respect of the new product for lending to real estate projects for the market (project financing) in larger, more complex real estate projects.

To rectify the breach, ██████ must put in place a policy for the use of outsourcing in accordance with Article 29 of the internal governance regulation. ██████ must take account of the use of outsourcing in the risk assessment in accordance with Article 27 of the internal governance regulation. ██████ must clearly define the role and responsibility of the external ██████, must draw up a set of potential external ██████, and must

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define the method for choosing them for an individual real estate project (required references, professional qualifications, etc.).

6. [REDACTED] has breached the third paragraph of Article 136 of the ZBan-2, because the management board of [REDACTED] failed to ensure that the senior management of [REDACTED] would adequately rectify the irregularities identified by the internal audit department in accordance with the agreed deadlines. As at 31 December 2018 [REDACTED] had failed to meet 54 recommendations by the internal audit department that had already fallen due. The management board of [REDACTED] passed a resolution on the take-up of risks for the non-implementation of recommendations whose deadline for implementation has passed even after their deadlines for implementation had been extended by three months. The management board of [REDACTED] has thereby also breached Article 45 of the ZBan-2 with regard to the duties and responsibilities of the management board, as the management board of [REDACTED] must act with professional diligence, and in particular must ensure that the management board of [REDACTED] acts in accordance with Article 136 of the ZBan-2.

[REDACTED] has also breached the third paragraph of Article 35 of the internal governance regulation, because the management board of [REDACTED]

[REDACTED] failed to ensure that the failure to observe the recommendations of the internal audit department and the delays in the rectification of identified irregularities were systematically explained in writing by the recipient of the recommendations by the internal audit department.

In accordance with the third paragraph of Article 136 of the ZBan-2, the management board of [REDACTED] must provide for appropriate measures to ensure that the senior management of [REDACTED] adequately rectifies the irregularities identified by the internal audit department in accordance with the agreed deadlines. In accordance with the third paragraph of Article 35 of the internal governance regulation, the management board of [REDACTED] must also ensure that the failure to observe the recommendations of the internal audit department and the delays in the rectification of identified irregularities are systematically explained in writing by the recipient of the recommendations by the internal audit department.

7. The management board of [REDACTED] must submit a detailed action plan stating the measures selected to rectify the breaches referred to in points 1 to 6 of this order to the Bank of Slovenia by 15 October 2019. By 15 October 2019 it 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 internal organisational structure of [REDACTED], or the names of the external contractors of [REDACTED], who will be responsible for implementing individual activities to rectify breaches and for preparing and implementing the plan of measures referred to in this order.

In the action plan the management board of [REDACTED] 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 [REDACTED].

[REDACTED] must provide interim reporting to the Bank of Slovenia on the rectification of breaches, by 15 January 2020 (as at 31 December 2019) and by 15 April 2020 (as at 31 March 2020). With regard to the rectification of the breaches referred to in point 3, [REDACTED] must also

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provide interim reporting by 15 July 2020 (as at 30 June 2020) and by 15 October 2020 (as at 30 September 2020).

██████ must rectify the breaches referred to in points 1, 2, 4, 5 and 6 of the order by 31 May 2020, and the breach referred to in point 3 of the order by 31 December 2020. ██████ must deliver a report to the Bank of Slovenia by 15 June 2020 with regard to the rectification of the breaches referred to in points 1, 2, 4, 5 and 6 of the order, and by 15 January 2021 with regard to the rectification of the breach referred to in point 3 of the order, enclosing documents and other evidence from which it is evident that the breaches have been rectified.

8. 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 are completed; and
  - information as to whether judicial review 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.

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

An order on the rectification of breaches with an additional measure referenced PBH-24.60-001/19-004 was issued on 3 September 2019, against which an objection was lodged by the stipulated deadline. The Bank of Slovenia issued a decision on an objection referenced PBH-24.60-001/19-005 on 19 November 2019, by virtue of which it partly found in favour of the objection. Judicial review proceedings have not been initiated against the decision on an objection.