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Results

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Introduction

The supervisory review and evaluation process (SREP) for 2024 shows that, as in the previous cycle, banks in Slovenia are maintaining strong capital and liquidity positions, and remain resilient to risks.

This year the banks have further strengthened their already high resilience to various risks, and have continued to record high profitability, driven in part by the effects of the monetary policy regime. Supervisors were cautious in their assessments, bearing in mind the key risks to the banking sector that are continuing to be posed by the internal and external environments and are limiting growth in the net interest margin.

Although there was an improvement in certain key indicators of financial stability, such as inflation, the risk of a deep recession, and high unemployment, the banks continued to operate in an uncertain environment in 2024, in light of the unending macroeconomic challenges and geopolitical risks, which are still worsening. Given the inherent uncertainties, geopolitical risks are often not assessed on the financial markets until they materialise, and their full impact might only be evident over the medium term. Strengthening resilience to geopolitical and macroeconomic shocks therefore remains one of the key priorities of banking supervision.

The aggregated SREP results from 2024 confirm the stability of the average SREP score and the capital requirements, and the broad palette of qualitative measures issued to banks for the remediation of the identified deficiencies.

The overall SREP score in the latest cycle remained at its level of 2023. The banks made improvements to their risk management in the areas of the business model and internal governance, which was reflected in an improved average score for the business model and internal governance. Increased risks were identified in the area of operational risk, particularly in the areas of cyber risk and legal risks, which resulted in a slightly worse average score for operational risk.

Despite the unchanged average SREP score, the overall capital requirement that will apply to the banks as of 1 January 2025 has increased slightly, and is estimated at 15.3% of risk-weighted assets at aggregate level. The increase is attributable to an increase of 0.6 percentage points in capital buffers at system level, which mostly derives from an increase in the countercyclical capital buffer. To be able to respond promptly and adequately to the increased geopolitical instability and macroeconomic changes, there is a need for robust frameworks for risk assessment, and close cooperation between microprudential and macroprudential supervision. This will steer the banks towards maintaining and improving resilience even in periods of rising risks.

Qualitative measures in the 2024 SREP were issued primarily to address deficiencies in the areas of internal governance, risks to capital, and the business model. Several requirements were also issued in this year's SREP cycle in the area of ESG[1] risks.

The **SSM SREP methodology** for significant institutions and the **SSM LSI SREP methodology** for less significant institutions under the direct supervision of Banka Slovenije can be found on the ECB website.

The results from the 2024 SREP cycle for banks in Slovenia are summarised below.

[1] Environmental, social and governance

1 SREP scores

The overall SREP score (ordinary mean of the SREP scores) has been relatively stable over the years, but a trend of improvement has been evident in recent years, in line with the gradual improvement in the scores for individual risks. The overall SREP score in the last cycle remained at 2.3,[2] unchanged from 2023.

The trend of improving scores for the risk inherent in the business model continued in this year's SREP cycle: the score improved from 2.4 to 2.3 as a result of improved profitability, higher interest margins, improved cost-efficiency, and, in part, improvements in business strategy. Supported by the favourable macroeconomic environment, new record heights of profitability have been attained in 2024: the ROE at system level increased from 19.5% in 2023 to 19.9% in the first half of 2024.

The banks have further strengthened their internal governance and risk management in 2024: the overall score decreased from 2.6 to 2.5, primarily as a result of improvements in the functioning of management bodies at banks.

The main increase in the risks to capital in 2024 was seen in operational risk, as a result of the findings from the stress tests of cyber resilience and a rise in the number of lawsuits related to Swiss franc loans on one hand, balanced against an improvement in the control environment on the other. Credit risk remained at the same level as the previous year, as non-performing loans remained low while the control environment improved. The market risk score primarily reflected the removal of credit spread risk in the banking book, as a result of an update to the SREP methodology for market risk. In addition to the inclusion of credit spread risk in the banking book, the main factors in the increased score for interest rate risk were changes in the interest rate environment, and findings from on-site inspections. In general the overall score for capital adequacy improved slightly, primarily thanks to the higher profitability in 2023, which drove an improvement in the banks' capital positions amid the sustainable dividend policy, and also issuance of Tier 2 capital instruments.

The overall score for liquidity risk remained unchanged at 1.8 in this year's SREP cycle, and in general reflects the good liquidity situation at the banks. The banks are maintaining a favourable liquidity position largely as a result of the structure of their liabilities, where diverse and stable household deposits are prevalent.

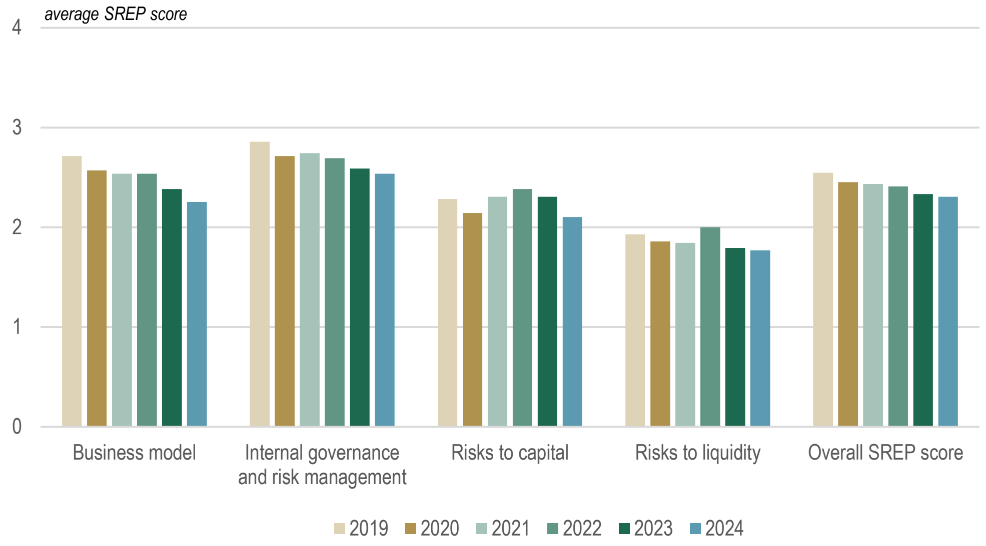
The evolution of the scores for individual risks over time is illustrated in Figure 1.

[2] Scale of SREP scores:

Score	Risk level
1	low risk
2	medium-low risk
3	medium-high risk
4	high risk

In accordance with the EBA's guidelines on the SREP, the overall SREP score, which ranges from 1 to 4, reflects the supervisor's overall assessment of the viability of the institution: higher scores reflect higher risks to the viability of the institution stemming from one or more features of its risk profile.

Figure 1: **Average SREP scores for each element and overall scores in the SREP cycles between 2019 and 2024**



Source: Banka Slovenije
Note: The data in the entire document relates to banking institutions in Slovenia on a consolidated basis.

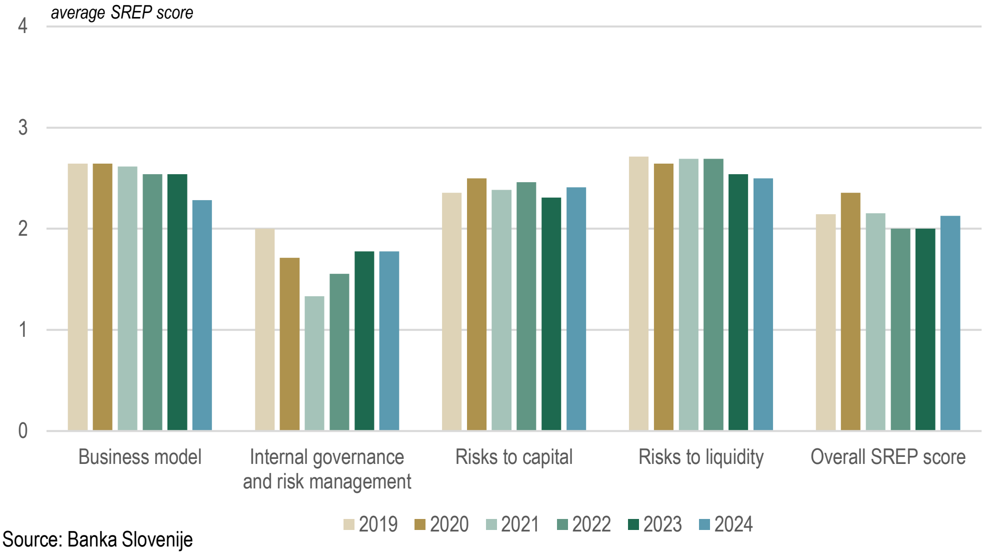
The highlights of the inherent risk assessment are the score for credit risk, which has remained practically unchanged for the last three years, which is largely attributable to the stable quality of the credit portfolio, despite the uncertainty in the market, and the opposite trend seen in the interest rate risk score as a result of higher exposure to changes in interest rates, and in the operational risk score, where this year we are again highlighting the importance of cyber risk management.

Figure 2: **Average scores for inherent risk in the SREP cycles between 2019 and 2024**

Source: Banka Slovenije

The assessment of the control environment for individual risks was affected by the findings from ongoing supervision and on-site inspections during the current SREP cycle, and also the banks' success in remedying the previously identified deficiencies and in upgrading the control environment. The latter primarily acted to drive an improvement in the control environment for credit risk and operational risk, while deficiencies identified on the basis of supervisory activity mainly drove a deterioration in the control environment for interest rate risk and liquidity risk.

Figure 3: **Average scores for the control environment in the SREP cycles between 2019 and 2024**

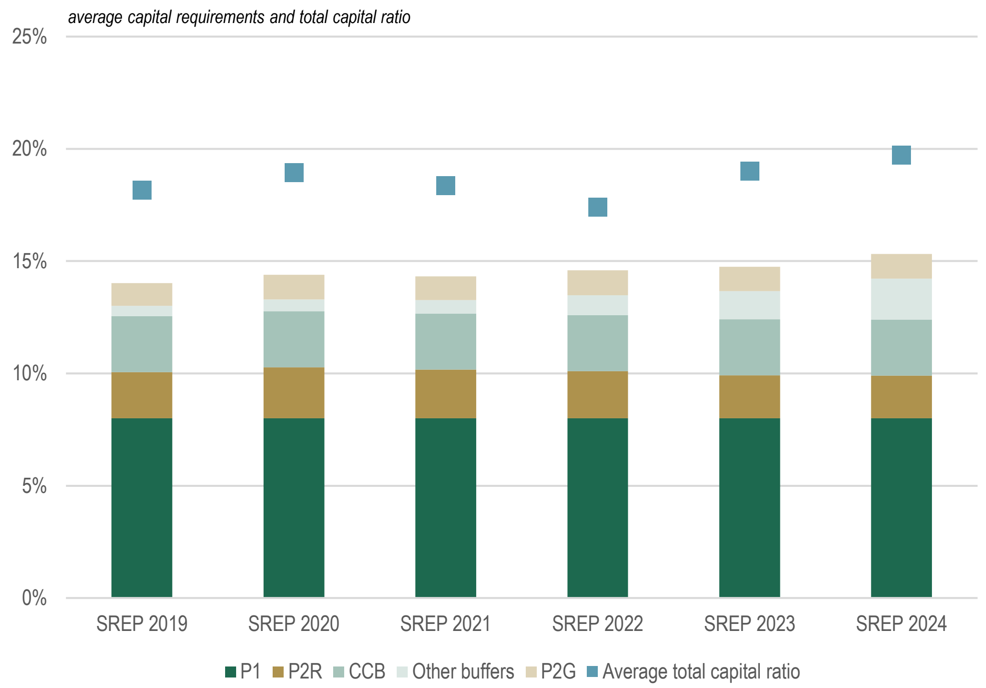


Source: Banka Slovenije

2 Capital requirements and capital surplus

The overall capital requirement that will apply to the banks as of 1 January 2025, including the Pillar 2 guidance, has increased slightly as a result of the 2024 SREP, and is estimated at 15.3% of risk-weighted assets at aggregate level. The overall capital level at all banks in the system stood at just under 20% of risk-weighted assets at the end of September 2024. A simulation of the capital surplus over the capital requirements for 2025 indicates that all the banks and savings banks in Slovenia will exceed the capital requirements in January of next year. The estimated capital surplus over the overall capital requirement for 2025 including the Pillar 2 guidance amounted to EUR 1.5 billion at system level.

Figure 4: **Average overall capital requirements and guidance under SREP cycles 2019 to 2024 and total capital ratios**



Source: Banka Slovenije
Note: Average weighted by risk-weighted assets; capital requirements determined during the SREP cycle in question and estimate of capital buffers in force in the next year; the 2024 SREP requirement takes account of a countercyclical capital buffer rate for Slovenia in the amount of 1.0%, which banks are required to meet as of 1 January 2025; total capital ratio at year end for 2019 to 2023, and at end of the third quarter for 2024.

The improvement in the overall SREP scores over the last four years has consequently reduced the additional capital requirements (P2R[3]), which amount to 1.9% of risk-weighted assets. The overall capital requirement (OCR) will nevertheless increase slightly in 2025, as a result of an increase in **capital buffer** requirements (the CCB,[4] which is set in accordance with the Banking Act, and the macroprudential instruments in the form of the O-SII buffer, the systemic risk buffer and the countercyclical capital buffer) in the amount of 0.6 percentage points, primarily as a result of an increase in the countercyclical capital buffer for Slovenia.

[3] *Pillar 2 requirement*
[4] *Capital conservation buffer*

The Pillar 2 guidance (P2G), which institutions are required to meet using common equity Tier 1 capital (CET1) above the OCR, remains stable over the recent period at 1.1%.

Despite the worsening economic and macroeconomic situation, and persistent geopolitical tensions, the banking sector remains resilient and strong in terms of capital, the banks' capital position having been strengthened slightly by increased profitability, where retained earnings remain at banks and are available for lending to the economy.

3 Qualitative findings

Qualitative requirements and recommendations addressing the supervisory findings were issued to the majority of Slovenian banks in the 2024 SREP cycle.

More than half of the SREP requirements and recommendations address deficiencies in the area of internal governance and risk management (54%), followed by risks to capital (36%) and risks to the business model (7%).

- Qualitative requirements and recommendations in the area of internal governance and risk management were issued to more than half of the banks in Slovenia. The findings in the assessment of internal governance mainly encompass deficiencies in the working and composition of the supervisory board or management board, the remuneration system, the working of the compliance and internal audit functions, the coordination of governance at the level of the banking group, and the governance of bylaws.
- The share of qualitative requirements and recommendations accounted for by risks to capital was down relative to previous years (2022 in particular). The findings with regard to risks to capital relate primarily to capital planning and the preparation of strategy, and to interest rate risk in the banking book (assumptions for measurement, consideration of hidden losses on debt securities measured at amortised cost).
- The share of qualitative requirements accounted for by the business model was up this year (performance indicators, and rebalancing of the plan in the event of deviations).
- Several requirements were also issued in the area of ESG risks, where the findings relate to the internal governance framework and to risks to capital.

Figure 5: **Breakdown of qualitative requirements across individual SREP elements under the SREP cycles of 2021 to 2024**

Source: Banka Slovenije

Conclusion

The results of the 2024 SREP cycle reflect the resilience of the Slovenian banking sector, but also highlight the existing vulnerabilities and increasing risks. In general the SREP scores and capital requirements have been stable over recent years, with the improvement in bank solidity balancing out the environment of increased risks. Despite high profitability, the banks are facing a number of challenges, including a slowdown in net interest income, cost pressures, and certain downgrades in the outlook in key lines of business.

As supervisors we remain focused on the future, and will continue to advocate proactive risk management, as despite their financial strength and stability the banks remain vulnerable to exogenous factors, such as rising geopolitical risks, current macroeconomic challenges, and certain trends such as digitalisation, climate change, demographic changes and the threat of cyber incidents.