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GUVERNER

Pursuant to Article 50, paragraph (5), Article 101, paragraph (2), items (1) and (2), Article 102, paragraph (3) and Article 105, paragraph (3) of the Credit Institutions Act (Official Gazette 159/2013, 19/2015, 102/2015 and 15/2018), Article 43, paragraph (2), item (9) of the Act on the Croatian National Bank (Official Gazette 75/2008 and 54/2013), the Governor of the Croatian National Bank hereby issues the

Decision on governance arrangements

I GENERAL PROVISIONS

Subject matter

Article 1

- (1) This Decision governs in detail the requirements related to governance arrangements, as follows:
- 1) organisational structure;
 - 2) the tasks and method of organisation and operation of supervisory board committees;
 - 3) the internal controls system and control functions;
 - 4) general risk management rules;
 - 5) credit risk management rules;
 - 6) market risks management rules;
 - 7) operational risk management rules;
 - 8) liquidity risk management rules; and
 - 9) rules on managing risks arising from exposures to shadow banking entities.

(2) This Decision transposes into the legal system of the Republic of Croatia Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, hereinafter referred to as 'Directive 2013/36/EU'), as last amended by Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (OJ L 337, 23.12.2015).

Legal persons subject to the Decision

Article 2

- (1) The provisions of this Decision shall apply to credit institutions with head offices in the Republic of Croatia that have been authorised by the Croatian National Bank.
- (2) The provisions of this Decision shall apply *mutatis mutandis* to branches of third-country credit institutions that have been authorised by the Croatian National Bank to provide services.
- (3) Credit institutions shall apply the provisions of this Decision on an individual and consolidated basis in accordance with Title IV Scope of application of prudential requirements of the Credit Institutions Act.

Definitions
Article 3

The terms used in this Decision shall have the following meaning:

1. 'operation support function' means the activities of a credit institution performed by the persons authorised to keep bookkeeping records and carry out other back office tasks;
2. 'treasury back office function' means the credit institution's activities performed by the persons authorised to conduct treasury back office operations and keep bookkeeping records of contractual transactions;
3. 'front office function' means the credit institution's activities performed by the persons authorised to contract risk-bearing transactions;
4. 'the non-trading book' comprises all on-balance sheet and off-balance sheet items of a credit institution other than those considered to be trading book positions within the meaning of Article 4, paragraph (1), item (86) 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 (OJ L 176, 27.6.2013, hereinafter referred to as 'Regulation (EU) No 575/2013');
5. 'trading book' shall have the meaning as defined in Article 4, paragraph (1), item (86) of Regulation (EU) No 575/2013;
6. 'credit exposure' means exposure subject to credit risk as provided for in the Decision on the classification of exposures into risk categories and the method of determining credit losses (Official Gazette 114/2017, hereinafter referred to as 'Decision on the classification of exposures into risk categories and the method of determining credit losses');
7. 'risk culture' means ethical norms, attitudes and behaviours related to risk awareness, risk assumption and risk management, and the controls that shape decisions on risk;
8. 'non-performing credit exposures' means exposures meeting the conditions referred to in Article 6 of the Decision on the classification of exposures into risk categories and the method of determining credit losses;
9. 'risk containment' means the overall strategic determinants, methods, criteria and procedures to accept, avoid, mitigate or transfer the identified risk;
10. 'risk profile' means the measurement or assessment of all risks to which a credit institution is or might be exposed in its operation;
11. 'securitisation' and the terms related to 'securitisation' shall have the meaning as defined in Regulation (EU) No 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017);
12. 'risk appetite' means the level and types of risk a credit institution is willing to assume within its defined risk capacity to achieve its strategic objectives;
13. 'risk capacity' means the maximum level of risk a credit institution is able to assume given its capital base, its risk management and control capabilities, and its regulatory constraints;
14. 'entities treated as central governments' include exposures to local and regional self-government units and exposures to public sector entities which are treated as exposures to a central government as provided for in Articles 115 and 116 of Regulation (EU) No 575/2013;
15. 'internal controls system' shall have the meaning as defined in Article 104, paragraph (1) of the Credit Institutions Act;

16. 'risk management system' means the overall organisational structure, rules, processes, procedures, systems and resources to identify, measure or assess, contain, monitor and report on risk exposure and overall risk management, and it implies the establishment of an adequate corporate governance and risk culture, and the adoption of the strategy, policy and other internal bylaws on risk management;

17. 'stress testing' means an assessment of the impact of particular events and processes, including microeconomic and macroeconomic scenarios, on the overall capital position of a credit institution or funding sources and liquidity by means of a projection of capital sources and capital requirements of a credit institution or the impact of shocks on the credit institution's overall liquidity position. The testing shall include the determination of capital requirements;

18. 'external credit assessment institution' or 'ECAI' shall have the meaning as defined in Article 4, paragraph (1), item (98) of Regulation (EU) No 575/2013;

19. 'senior management' shall have the meaning as defined in Article 3, item (90) of the Credit Institutions Act;

20. 'significant credit institution' means any credit institution designated as global systemically important institution (G-SII) or other systemically important institution (O-SII) and any credit institution whose three-year average amount of assets reported in its audited financial statements at the end of the previous three business years exceeds seven billion kuna.

Risk definitions Article 4

For the purposes of risk management in accordance with this Decision, a credit institution shall apply the following definitions of risks:

1. 'interest rate risk in the non-trading book' means the risk of loss arising from potential changes in interest rates as they affect a credit institution's non-trading book items;

2. 'interest rate-induced credit risk' means the risk of loss to which a credit institution assuming credit risk arising from exposures linked to variable interest rates is additionally exposed;

3. 'concentration risk' means the risk arising from each individual, direct or indirect, exposure to a single person, a group of connected clients, a central counterparty or a group of exposures linked by common risk factors such as the same economic sector, the same geographic region, business activities or commodity, and the use of credit risk mitigation techniques, including in particular risks associated with large indirect credit exposures to a single collateral provider which may lead to losses that could jeopardise further operation of the credit institution or a materially significant change in its risk profile. 'Intra-risk concentration' refers to risk concentrations that may arise from interactions between different risk exposures within a single risk category. 'Inter-risk concentration' refers to risk concentrations that may arise from interactions between different risk exposures across different risk categories. The interactions between different risk exposures may stem from a common underlying risk driver or from interacting risk drivers;

4. 'counterparty credit risk' shall have the meaning as defined in Article 272, paragraph (1), item (1) of Regulation (EU) No 575/2013;

5. 'credit risk' means the risk of loss arising from a debtor's failure to meet its financial obligations to a credit institution;

6. 'liquidity risk' means the risk of loss arising from a credit institution's existing or expected inability to meet its financial obligations as they become due;

7. 'migration risk' means the risk of loss due to a change in the fair value of a credit exposure as a result of a change in client rating;

8. 'operational risk' shall have the meaning as defined in Article 4, paragraph (1), item (52) of Regulation (EU) No 575/2013;

9. 'business risk' means a negative, unexpected change in business volume and/or profit margins that may lead to significant losses and reduce the market value of a credit institution. In particular, a business risk may arise due to a significant deterioration in the market environment and changes in competition or consumer behaviour;
10. 'legal risk' means the risk which arises due to the possibility that failure to meet contractual obligations, court proceedings initiated against a credit institutions and business decisions taken which are found to be unenforceable might have a negative impact on the business operation or the financial position of a credit institution;
11. 'dilution risk' shall have the meaning as defined in Article 4, paragraph (1), item (53) of Regulation (EU) No 575/2013;
12. 'reputation risk' means the risk of loss of trust in the integrity of a credit institution caused by adverse public opinion on the credit institution's business practices, regardless of whether there are any grounds for such a public opinion or not;
13. 'residual risk' means the risk of loss arising when recognised credit risk mitigation techniques used by a credit institution prove less effective than expected;
14. 'country risk' means:
 - 1) the risk that the central government, the central bank and/or entities treated as central governments will not settle their liabilities to domestic creditors and/or creditors in other countries; and
 - 2) the risk that a counterparty having its head office or domicile outside the Republic of Croatia will not settle its liabilities due to economic and political factors specific for the country in which the counterparty has its head office or domicile;
15. 'outsourcing risks' is a collective name for all the risks associated with outsourcing by a credit institution on a contractual basis to a counterparty (service providers) of the activities that it would otherwise execute itself;
16. information system risk (ICT) is a risk arising from the use of information technology or information system. Information technology ensures automated collection, processing, generating, storage, transmission, presentation and distribution of information, and the disposal thereof. The information technology comprises software and hardware components. The information system is a total of technological infrastructure, organisation, human resources and procedures for the collection, processing, generating, storage, transmission, representation and distribution of information and the disposal thereof. The information system can also be defined as an interaction between information technology, data and data processing procedures and the people collecting and using these data;
17. 'funding liquidity risk' means the risk that a credit institution will not be able to meet successfully both expected and unexpected current and future cash flow and collateral needs without affecting its regular daily operations or its financial performance;
18. 'model risk' means the risk of loss a credit institution may incur, as a consequence of decisions that could be principally based on the output of internal models, due to errors in the development, implementation or use of such models;
19. 'settlement risk' means the risk of loss of a credit institution due to the difference in the agreed settlement price for a particular debt, equity, foreign currency or commodity instrument and its current market value;
20. 'conduct risk' means the current or prospective risk of losses to a credit institution arising from inappropriate supply of financial services, including cases of wilful or negligent misconduct;
21. 'risk of excessive leverage' shall have the meaning as defined in Article 4, paragraph (1), item (94) of Regulation (EU) No 575/2013;
22. 'credit valuation adjustment risk' or 'CVA risk' shall have the meaning as defined in Article 381 of Regulation (EU) No 575/2013;

23. 'profit (earnings) risk' means the risk which arises due to inadequate composition and distribution of earnings or the inability of a credit institution to ensure an adequate and constant level of profitability;
24. 'free delivery risk' means the risk of loss of a credit institution which arises when securities, foreign currencies or commodities have been paid for before they are received or when the delivery has been made before they have been paid for, i.e. if the payment or delivery does not take place in accordance with the expected time dynamics;
25. 'market liquidity risk' means the risk that a credit institution will not be able to simply offset or eliminate a position at the market price because of market disruption or inadequate market depth;
26. 'property investment risk' means the risk of loss arising from changes in the market value of the property portfolio of a credit institution;
27. 'compliance risk' means the risk of imposition of measures and fines and the risk of substantial financial loss or loss of reputation to be suffered by a credit institution due to failure to comply with regulations, standards, codes and internal bylaws;
28. 'securitisation risk' means the risk arising from the economic transfer of one exposure or a group of exposures, i.e. the transfer of the credit risks of these exposures;
29. 'strategic risk' means the risk of loss caused by adverse business decisions, lack of responsiveness to changes in the economic environment, etc.;
30. 'market risks' shall include position risk, foreign-exchange risk and commodities risk:
- 1) 'position risk' means the risk of loss arising from a price change in financial instruments or, in the case of a derivative financial instrument, in underlying variables. Position risk is divided into general and specific risk. Position risk also includes interest rate risk and similar risks arising from trading positions;
 - 2) 'foreign-exchange risk' means the risk of loss arising from a change in currency exchange rates and/or the price of gold;
 - 3) 'commodities risk' means the risk of loss arising from a price change in the commodity;
31. 'governance risk' means the risk of loss caused by the fact that a credit institution, due to its size, has a limited capacity to put in place sophisticated governance mechanisms, systems and controls;
32. 'currency-induced credit risk' means the risk of loss to which a credit institution assuming credit risk arising from exposures denominated in or indexed to foreign currency is additionally exposed.

II ORGANISATIONAL STRUCTURE

Duties and responsibilities of supervisory and management boards

Structure and organisation Article 5

- (1) A credit institution shall insure that its management and supervisory boards, in line with their competences, have ultimate and overall responsibility for the establishment, implementation and oversight of governance arrangements.
- (2) Management and supervisory boards shall, in line with their competences, ensure and document a suitable and transparent organisational and operational structure for the credit institution and they shall ensure that it is in line with the approved business strategy, the risk management strategy and the risk appetite.
- (3) A credit institution shall ensure that the reporting lines and the allocation of competences and responsibilities, in particular among key function holders, are clear, well-defined, coherent, enforceable, and adequately and timely documented.
- (4) A credit institution shall ensure that its organisational structure does not impede the ability of the supervisory board to oversee the risks to which the credit institution is or might be exposed in its operation

or the management board to manage effectively the risks, or the Croatian National Bank to effectively supervise the credit institution.

(5) A credit institution shall ensure that decision-making by the management or supervisory board is not entrusted to a single member or a minority of management or supervisory board members.

(6) The management board and the supervisory board shall cooperate with each other and share relevant information necessary for the performance of their tasks.

(7) Management and supervisory boards of a credit institution shall devote sufficient time to consider the risks to which the credit institution is or might be exposed in its operation.

Complex structures and non-standard or non-transparent activities
Article 6

(1) A credit institution may not set up non-transparent or unnecessarily complex structures so that they could not be used for purposes connected with money laundering or other crimes.

(2) A credit institution may not carry out activities that have no clear business or legal purpose and that expose the credit institution to increased risk of money laundering and terrorist financing.

(3) For the purpose of identifying whether the structures could be used for purposes connected with money laundering or other crimes, at least the following shall be analysed:

- 1) the extent to which the jurisdiction in which the structure will be set up complies effectively with the European Union and international standards on tax transparency, anti-money laundering and countering the financing of terrorism;
- 2) the extent to which the structure serves an obvious economic and lawful purpose;
- 3) the extent to which the structure could be used to hide the identity of the ultimate beneficial owner;
- 4) the extent to which the client's request that leads to the possible setting up of a structure gives rise to concern;
- 5) whether the structure might impede appropriate oversight by the credit institution's supervisory board or its management board's ability to manage the related risk; and
- 6) whether the structure poses obstacles to effective supervision by the Croatian National Bank.

Duties and responsibilities of supervisory board members
Article 7

In the course of performance of their duties referred to in Article 49, paragraph (1), item (5) of the Credit Institutions Act, supervisory board members shall oversee:

- 1) that the risk culture of the credit institution is implemented consistently;
- 2) the implementation of a code of conduct;
- 3) the implementation of policies to identify, manage and mitigate actual and potential conflicts of interest; and
- 4) whether the credit institution's management board takes appropriate steps to address any deficiencies identified in the course of supervisory board's oversight.

Notification to the supervisory board
Article 8

(1) A credit institution shall ensure that supervisory board members have adequate access to information on the risk profile of the credit institution and, if necessary and appropriate, to the risk control function and to external expert advice.

(2) The supervisory board shall determine the nature, the amount, the format and the frequency of the information on risk to be reported to it by appropriate functions, persons and organisational units of a credit institution.

Duties and responsibilities of management board members

Article 9

(1) In the course of performance of their duties referred to in Article 41, paragraph (3) of the Credit Institutions Act, for the purpose of establishing and implementing requirements related to organisational structure, effective risk management and the internal controls system, a credit institution's management board shall:

- 1) establish clearly defined and consistent lines of responsibility, including the separation of authorities and responsibilities for the assumption and management of risks among the supervisory board, the management board, appointed boards and senior management;
- 2) ensure that adequate resources are allocated to the management of all material risks, including an adequate number of employees possessing the necessary knowledge and experience to be involved in risk management, and for the valuation of assets, the use of external credit ratings and internal models related to those risks;
- 3) establish and implement the risk culture;
- 4) adopt and implement a code of conduct and appropriate policies;
- 5) adopt and implement a policy to identify, assess, manage, mitigate or prevent actual and potential conflicts of interest.

(2) A credit institution's management board shall be actively involved in all material risk management processes.

(3) When assessing the adequacy of procedures and efficiency of control functions, a credit institution's management board shall, in accordance with the provisions of Article 41, paragraph (5) of the Credit Institutions Act, take into account at least the following:

- 1) the work methodology of a control function;
- 2) realisation of the work plan of a control function;
- 3) the number of employees included in the operation of a control function;
- 4) the structure and content of reports of a control function;
- 5) findings of a control function during the period covered by the assessment of the adequacy of procedures and efficiency of a control function;
- 6) credit institution's risk profile;
- 7) business and risk management strategy; and
- 8) other criteria and documentation which are deemed to have effect on the adequacy of procedures and efficiency of a control function.

Supervisory board committees

Establishment of supervisory board committees

Article 10

(1) The supervisory board of a credit institution which is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities shall establish a remuneration committee, a nomination committee and a risk committee.

(2) If a credit institution also establishes other supervisory board committees (e.g. ethics, conduct and compliance committees), it shall comply with the provisions on the functioning and composition of supervisory board committees referred to in the Credit Institutions Act and this Decision.

(3) A credit institution shall ensure a clear distribution of duties and responsibilities between individual supervisory board committees and establish appropriate working procedures for them.

Composition of supervisory board committees

Article 11

(1) A credit institution shall ensure that independent supervisory board members are members of supervisory board committees.

(2) A significant credit institution shall ensure that the chairperson of the risk committee is not the chairperson of either the supervisory board or any other supervisory board committee.

(3) Members of supervisory board committees shall have, individually and collectively, appropriate knowledge, skills and expertise in accordance with their competence in the committee.

Processes of supervisory board committees

Article 12

(1) Supervisory board committees shall document the agendas of committee meetings and their main conclusions.

(2) Supervisory board committees shall regularly report to the supervisory board on their conclusions.

(3) Supervisory board committees shall mutually cooperate.

(4) A credit institution shall ensure that supervisory board committees:

- 1) have adequate access to all information and data necessary to perform their tasks, including information and data from relevant corporate functions (e.g. legal, finance, human resources, ICT, etc.) and control functions;
- 2) receive regular reports, *ad hoc* information, communications and opinions from the persons responsible for control functions concerning the current risk profile of the credit institution, its risk culture and its risk exposure limits, as well as on any material breaches of internal rules and other regulations that may have occurred, with detailed information on and recommendations for corrective measures taken, to be taken or suggested to address them; and
- 3) have adequate access to control functions and other relevant functions or, where necessary, external expert advice.

(5) Supervisory board committees shall determine the nature, the amount, the format, and the frequency of the information which they are to receive from organisational units, persons or functions within the credit institution.

Risk committee

Article 13

In accordance with Article 52, paragraph (2), item (4) of the Credit Institutions Act, the risk committee shall perform the following activities:

- 1) advise and support the credit institution's supervisory board regarding the monitoring of the credit institution's overall current and future risk appetite and strategy, taking into account all types of risks, to ensure that they are in line with the business strategy, objectives, corporate culture and values of the credit institution;
- 2) oversee the implementation of the strategies for managing capital and all relevant risks, in particular liquidity, market, credit, operational and reputation risks, in order to assess their adequacy against the approved risk appetite and strategy;
- 3) provide the supervisory board with recommendations on necessary adjustments to the risk strategy resulting from, *inter alia*, changes in the business model of the credit institution, market developments or recommendations made by the risk control function;
- 4) provide advice on the appointment of external consultants that the supervisory board may decide to engage for advice or support;
- 5) analyse a number of possible scenarios, including stressed scenarios, to assess how the credit institution's risk profile would react to external and internal events;
- 6) oversee the alignment between material products and services offered to clients and the business model and risk assumption and management strategy of the credit institution;
- 7) assess the risks associated with the offered products and services and take into account the alignment between the prices assigned to and the profits gained from those products and services; and

- 8) analyse the recommendations of internal or external auditors and follow up on the appropriate implementation of measures taken.

Nomination committee

Article 14

(1) In accordance with Article 51, paragraph (6) of the Credit Institutions Act, the risk committee shall perform the following activities:

- 1) prepare a description of duties and qualifications to perform the functions of a member of the management or supervisory board and the expected commitment to performing those functions; and
- 2) determine the target percentage of the less represented gender in a credit institution's management and supervisory boards and propose a strategy to increase the number of the less represented gender.

(2) A credit institution shall disclose the target percentage of the less represented gender and the method to achieve such percentage in accordance with Article 435, paragraph (2), item (c) of Regulation (EU) No 575/2013.

Risk culture and business conduct

Risk culture Article 15

- (1) A credit institution shall establish a risk culture based on high professional and ethical business standards.
- (2) A credit institution shall prescribe in its internal bylaw the main features of the risk culture and adjust this culture to its risk assumption and management strategy and managing the risks and its risk profile.
- (3) A credit institution shall ensure that all employees are informed about the risk culture and organise education for employees on the risk culture in such a way that employees at all levels are clearly informed of the authorities, roles and responsibilities assigned to them in the risk assumption and management process.

Corporate values and code of conduct Article 16

- (1) A credit institution shall adopt, promote and adhere to high ethical and professional standards and ensure the implementation of such standards through a code of conduct.
- (2) A credit institution shall ensure the oversight of adherence to the standards referred to in paragraph (1) of this Article.
- (3) A credit institution shall prescribe the standards referred to in paragraph (1) of this Article in policies which shall include the following:
 - 1) the obligation that all the credit institution's activities are conducted in compliance with the applicable law and with the institution's corporate values;
 - 2) expectations that the credit institution's activities will not go beyond the defined risk appetite and internal limits and the respective responsibilities of employees;
 - 3) examples of acceptable and unacceptable behaviours linked in particular to financial misreporting and misconduct, economic and financial crime;
 - 4) expectations that employees conduct themselves with honesty and integrity and perform their duties with due skill, care and diligence; and
 - 5) expectations that employees are aware of the potential internal and external disciplinary actions, legal actions and sanctions that may follow misconduct and unacceptable behaviours.
- (4) The compliance function or another function defined by a credit institution shall monitor and review compliance with the standards referred to in paragraph (1) of this Article and establish a process for dealing with issues of non-compliance. The results of the review shall be regularly reported to a credit institution's management board.
- (5) A credit institution shall ensure that all employees are made adequately aware of the standards referred to in paragraph (1) of this Article.

Conflict of interest policy at credit institution level Article 17

- (1) A credit institution shall adopt, implement and appropriately manage adequate policies to identify, assess, mitigate or prevent actual and potential conflicts of interest at credit institution level.
- (2) A credit institution shall take adequate measures to prevent conflicts of interest from adversely affecting the interests of its clients.
- (3) A credit institution shall adopt measures to manage or, where appropriate, mitigate conflicts of interest, which shall at a minimum include:

- 1) an appropriate segregation of duties, e.g. entrusting conflicting activities within the processing of transactions or when providing services to different persons, or entrusting supervisory and reporting responsibilities for conflicting activities to different persons;
- 2) establishing the physical separation of certain business lines or units; and
- 3) establishing adequate procedures for transactions with related parties, e.g. requiring transactions to be conducted at arm's length.

Conflict of interest policy for employees
Article 18

(1) A credit institution shall adopt, implement and adequately manage effective policies to identify, assess, mitigate or prevent actual and potential conflicts between the interests of the credit institution and the private interests of its employees, including members of the supervisory board.

(2) In the policies referred to in paragraph (1) of this Article, a credit institution shall cover at least the following situations or relationships where conflicts of interest may arise:

- 1) economic interests (e.g. shares, holdings or similar economic interests in undertakings or entities that are the credit institution's clients, intellectual property rights, loans granted by the credit institution to an undertaking or entity owned by employees, membership in a body or ownership of a body or entity with conflicting interests);
- 2) personal or professional relationships with the owners of qualifying holdings in the credit institution;
- 3) personal or professional relationships with employees of the credit institution or entities included within the scope of prudential consolidation;
- 4) other employment and previous employment within the recent past;
- 5) personal or professional relationships with relevant external stakeholders (e.g. being associated with material suppliers, consultancies or other service providers); and
- 6) political influence or relationships with politically exposed persons.

(3) In the policies referred to in paragraph (1) of this Article, a credit institution shall:

- 1) define the function responsible for receiving reports on actual and potential conflicts of interest of employees and processes for reporting and communication to that function;
- 2) differentiate between conflicts of interest that persist and need to be managed permanently and conflicts of interest that occur unexpectedly with regard to a single event (e.g. a transaction, the selection of service provider, etc.) and can usually be managed with a one-off measure; and
- 3) set out procedures, measures, documentation requirements and responsibilities for the identification and prevention of conflicts of interest, for the assessment of their materiality and for taking mitigating measures.

(4) Measures to mitigate conflicts of interest shall at a minimum include:

- 1) entrusting conflicting activities or transactions to different persons;
- 2) preventing employees who are also active outside the credit institution from having inappropriate influence within the credit institution regarding those other activities;
- 3) establishing the responsibility of employees to abstain from voting on any matter where the employee has or may have a conflict of interest or where the employee's objectivity or ability to properly fulfil duties to the credit institution may be otherwise compromised; and
- 4) establishing adequate procedures for transactions with related parties.

(5) A credit institution shall ensure that employees promptly disclose to the function referred to in paragraph (3), item (1) of this Article any matter that may result, or has already resulted, in a conflict of interest.

(6) A credit institution shall assess and appropriately manage all actual or potential conflicts of interest of employees.

(7) A credit institution shall document each identified conflict of interest of employees and take measures to mitigate or remedy this conflict of interest.

(8) A credit institution shall take into account conflicts of interest within a group-wide conflict of interest policy that may arise on a consolidated or sub-consolidated basis.

Procedures for internal reporting of breaches of regulations
Article 19

(1) For the purpose of meeting the requirements referred to in Article 359 of the Credit Institutions Act, a credit institution shall enable its employees to report any possible breach of regulations outside regular reporting lines and, in accordance with the regulations governing personal data protection, ensure the protection of the personal data of:

- 1) the persons reporting the breach; and
- 2) the persons who are allegedly responsible for the breach.

(2) A credit institution shall ensure that all employees within the credit institution are aware of internal procedures and channels for reporting on any breaches of regulations. A credit institution shall ensure that information provided by employees in reporting procedures are made available to the credit institution's management board and other responsible persons and/or functions designated for that purpose in the policy on internal reporting of breaches of regulations.

(3) A credit institution shall ensure that, where required by the employee reporting a breach, the information is provided to the management board and other responsible persons and/or functions in an anonymised way. A credit institution shall provide for a process that allows information to be submitted in an anonymised way.

(4) A credit institution shall also adequately protect persons who have been reported from any negative effects in case the investigation finds no evidence that justifies taking measures against those persons.

(5) A credit institution shall ensure that procedures for internal reporting of breaches of regulations:

- 1) are documented;
- 2) provide clear rules that ensure that information on the reporting and the reported persons and the breach are treated confidentially, unless disclosure to third parties is required under law for the purpose of further investigations in criminal proceedings or initiation of other judicial proceedings;
- 3) protect credit institution's employees who raise concerns from being victimised because they have disclosed reportable breaches;
- 4) ensure that the potential or actual breaches raised are assessed and, where necessary, appropriately notified to the Croatian National Bank and other relevant authorities or persons;
- 5) ensure, where possible, that confirmation of receipt of information is provided to credit institution's employees who have raised potential or actual breaches;
- 6) ensure the tracking of the outcome of an investigation into a reported breach of regulations; and
- 7) ensure appropriate record keeping on reported breaches.

III INTERNAL CONTROLS SYSTEM AND CONTROL FUNCTIONS

Internal controls system
Article 20

(1) A credit institution shall ensure that the internal controls system covers all business lines and organisational units, including control functions, outsourced activities and distribution channels and that all employees, in particular senior management, the management board and the supervisory board participate appropriately in the establishment and implementation of the internal controls systems.

(2) A credit institution shall ensure a clear, transparent and documented decision-making process and a clear allocation of authorities and responsibilities within its internal controls system, including its business lines, organisational units and control functions.

(3) The internal controls system shall ensure effective and efficient operations; prudent conduct of business; adequate identification, measurement and mitigation of risks; the reliability of financial and non-financial information and reports; sound administrative and accounting procedures; and compliance with laws, regulations, supervisory requirements and the institution's internal policies, processes, rules and decisions.

Control functions and a bylaw on the control function

Control functions and a bylaw on the control function Article 21

(1) A credit institution shall establish control functions in accordance with the provisions of Articles 105 and 106 of the Credit Institutions Act.

(2) A credit institution shall adopt a work methodology of each control function.

(3) The compliance function shall implement a compliance program by realising the work plan referred to in Article 23 of this Decision in accordance with the methodology and the internal bylaw of the compliance function referred to in this Article.

(4) The internal audit function shall adopt an audit programme for each area to be covered by audit.

(5) A credit institution shall, by means of an internal bylaw, lay down for each control function, at a minimum:

- 1) the objectives, scope and mode of operation of a control function;
- 2) the organisational structure and the role of the control function;
- 3) the position of the control function within the credit institution;
- 4) the measures ensuring the independence and objectivity of each control function;
- 5) the authorities, responsibilities and relationships with other organisational units;
- 6) mutual relationships with other control functions;
- 7) the duties and responsibilities of the person responsible for the operation of each control function as a whole;
- 8) the measures for ensuring and monitoring professional qualification, adequate expertise and experience of the persons responsible for carrying out control functions;
- 9) the authorities and responsibilities of control functions associated with examination of outsourced activities in accordance with the provisions of relevant regulations governing outsourcing of credit institution's business activities, where applicable;
- 10) the right of access to all the relevant data, information, information systems and other resources necessary to carry out the activities;
- 11) the manner of cooperation with external auditors and supervisors; and
- 12) the reporting system.

(6) A credit institution shall ensure to control functions:

- 1) the right of access to all business lines, organisational units and, where applicable, subsidiaries and undertakings included within the scope of accounting or prudential consolidation; and
- 2) where necessary, the right of direct reporting to the supervisory board and/or a supervisory board committee.

Persons carrying out control functions Article 22

(1) A credit institution shall employ on a full time basis at least one person who has attained the title of auditor or internal auditor in accordance with the law governing audits or the rules and a programme of

a professional organisation competent for professional education of internal auditors to carry out internal audits.

(2) A credit institution shall ensure the necessary resources and funding in the financial plan for the execution of the annual plan of each control function and provide regular professional education and training of the persons responsible for carrying out the control function activities.

Control function work plan
Article 23

(1) A control function shall adopt an annual control function work plan.

(2) A credit institution's management board, subject to the prior approval of relevant supervisory board committee and/or the supervisory board, shall adopt each control function's work plan.

(3) The annual control function work plan shall at a minimum include:

- 1) a list of all the planned activities of the control function;
- 2) a list of business areas to be covered by the annual control function work plan; and
- 3) the period during which the planned activities and controls shall be carried out.

(4) A credit institution's management board shall ensure that the person responsible for the work of each control function is notified about planned organisational changes, projects, new products and other initiatives, to ensure that this person can identify in advance and assess whether it affects the scope of that control function's activities.

Control function activities
Article 24

(1) The control functions shall verify that the policies, processes and procedures set out by the credit institution for the purpose of establishing and implementing an effective internal controls system are correctly implemented within their respective areas of competence.

(2) A credit institution shall put in place a follow-up procedure regarding proposals, recommendations and measures for the elimination of illegalities, irregularities, deficiencies and weaknesses identified by the control functions, including appropriate addressing and reporting.

(3) Each control function shall carry out its activities in accordance with regulations and professional standards.

Activities of the risk control function
Article 25

(1) The risk control function shall provide relevant independent information, analyses and expert judgement on risk exposures, and advice on proposals and risk decisions made by business lines or organisational units, and inform the management board, the supervisory board or the relevant supervisory board committee as to whether risk exposures and risk decisions are consistent with the credit institution's risk appetite and risk management strategy.

(2) A credit institution shall, within its risk control function, ensure the carrying out of the following activities:

- 1) participating in the risk management strategy and policy development and review;
- 2) participating in the adoption of all major decisions related to risk management;
- 3) analysing the risks of new products, implementation of significant changes to existing products, including significant changes to related processes and systems, exceptional transactions, as well as the entry to new markets and dealing in new instruments;
- 4) risk analysis, including the identification, measurement and assessment of risks to which the credit institution is or might be exposed in its operation;

- 5) participating in the development, application and oversight of risk management methods and models;
 - 6) making proposals and recommendations for improving the risk management system;
 - 7) monitoring the risk profile and analysing it against the strategic goals and risk appetite;
 - 8) carrying out stress testing;
 - 9) evaluating possible ways to mitigate risks;
 - 10) analysing breaches of risk appetite or limits, proposing remedial measures and informing the business units concerned and the management board, the supervisory board or the risk committee of the breaches and measures;
 - 11) identifying and assessing the risks in transactions with related parties;
 - 12) analysing, monitoring and reporting on the adequacy of the credit institution's internal capital and internal liquidity, and reviewing the strategies and procedures for the assessment of the necessary internal capital and internal liquidity;
 - 13) reporting on risk management to the management board, the supervisory board and the relevant supervisory board committee, and other relevant persons; and
 - 14) making other verifications necessary for adequate risk control.
- (3) The risk control function shall inform the management board, the risk committee or the supervisory board of the assumptions used in and potential shortcomings of the risk models and analysis.

Activities of the compliance function
Article 26

- (1) A credit institution shall have in place a compliance function to ensure that compliance risk is adequately identified, assessed and monitored.
- (2) A credit institution shall, within its compliance function, ensure the carrying out of the following activities at a minimum:
- 1) identifying and assessing the compliance risk to which the credit institution is or might be exposed;
 - 2) advising the management board and other responsible persons on the implementation of relevant laws, standards and rules, including informing them on developments in these areas;
 - 3) assessing the effects that changes in relevant regulations will have on the operation of a credit institution;
 - 4) verifying compliance of new products or new procedures with relevant regulations as well as amendments to such regulations in cooperation with the risk control function;
 - 5) reporting on compliance risk to the management board, the supervisory board and the relevant supervisory board committee, and other relevant persons;
 - 6) cooperating and exchanging information with the risk control function in relation to compliance risk and its management; and
 - 7) providing advice as regards the preparation of training programmes related to compliance.
- (3) An RC parent credit institution and an EU parent credit institution having its head office in the RC shall ensure:
- 1) that their subsidiaries and branches take steps to ensure that their operations are compliant with local laws and regulations; and
 - 2) if local laws and regulations prevent the disclosure and exchange of information related to compliance monitoring between entities within the group, that subsidiaries and branches inform the person responsible for the operation of the compliance function or the person responsible for the operation of the compliance function of an RC parent credit institution and an EU parent credit institution having its head office in the RC.

Activities of the internal audit function
Article 27

(1) The internal audit function shall, following a risk-based approach, carry out independent audit and provide objective assurance of the compliance of all activities and organisational units, including outsourced activities, with the credit institution's policies and procedures and with supervisory and other external requirements. Each undertaking within the group of credit institutions in the RC shall fall within the scope of internal audit function activities.

(2) A credit institution shall ensure that the internal audit function assesses whether the internal controls system is both effective and efficient and that the following activities are carried out within the internal audit function:

- 1) assessment of the appropriateness of governance arrangements;
- 2) assessment of the adequacy of existing policies and of their compliance with regulations and other regulatory requirements and with the risk appetite and risk management strategy of the credit institution;
- 3) assessment of the correctness and effectiveness of implementation of the procedures referred to in Article 24, paragraph (1) of this Decision and the compliance of these procedures with the applicable laws and regulations and with decisions of the credit institution's management board and the supervisory board;
- 4) assessment of the adequacy, quality and effectiveness of the controls performed and the reporting done by the business units and the risk control and compliance functions;
- 5) assessment of the accuracy and reliability of the accounting records system and financial statements;
- 6) audit of outsourced activities;
- 7) assessment of strategies and procedures in place to assess the adequacy of internal capital and internal liquidity;
- 8) audit of the information system;
- 9) verification of the reliability of the internal and external reporting systems and timeliness and accuracy of the reports prescribed in the Credit Institutions Act, regulations adopted under that Act and other regulations;
- 10) assessment of the methods of asset protection;
- 11) assessment of data collection systems and the validity of information that is publicly disclosed in accordance with Title XIV of the Credit Institutions Act, Regulation (EU) No 575/2013, and other regulations;
- 12) making other assessments as prescribed by the Credit Institutions Act, regulations adopted under that Act, Regulation (EU) No 575/2013, the relevant technical standards and other regulations;
- 13) reporting on audits carried out and on other activities to the management board, the supervisory board and the relevant supervisory board committee, and other relevant persons; and
- 14) all other activities necessary to achieve internal audit objectives.

(3) A credit institution shall ensure that the internal audit function evaluates the reliability of the credit institution's methods and techniques, and the assumptions and sources of information used in its internal models, as well as the quality and use of qualitative risk identification and assessment tools and the risk mitigation measures taken.

Control function work reports
Article 28

(1) Control functions shall prepare work reports.

(2) Depending on the control function's activities, control function work reports shall at a minimum contain the following:

- 1) a report on the realisation of the annual work plan;
- 2) a list of all the planned work activities carried out;
- 3) a list of all the extraordinary work activities carried out;
- 4) a list of planned but not executed work activities, specifying the reasons for the non-execution;

- 5) a summary of the most important facts identified during controls, audits and other work activities carried out;
- 6) a general assessment of the adequacy and efficiency of the internal controls system in the areas covered by control or audit;
- 7) a general assessment of the adequacy and efficacy of the system for the management of individual risks or all risks in a credit institution; and
- 8) a report on the implementation of proposals, recommendations and measures for the elimination of illegalities, irregularities, deficiencies and weaknesses identified in the course of controls or audits and the reasons for their non-execution.

(3) The internal audit function shall deliver the report referred to in paragraph (1) of this Article to the credit institutions' management board and the audit committee or another relevant supervisory board committee on a quarterly basis, to the credit institution's supervisory board on a semi-annual basis, and to the Croatian National Bank on an annual basis.

(4) The compliance function and the risk control function shall deliver the report referred to in paragraph (1) of this Article to the credit institutions' management board and the risk committee or another relevant supervisory board committee, and the credit institution's supervisory board on a semi-annual basis, and to the Croatian National Bank on an annual basis.

(5) Each control function work report shall be signed by the person responsible for the work of the control function concerned.

(6) A credit institution shall deliver the control function work report to the Croatian National Bank by 31 March of the current year for the previous year.

IV GENERAL RISK MANAGEMENT RULES

Risk management system
Article 29

- (1) A credit institution shall establish and implement an effective and sound risk management system that is proportionate to the nature, scale and complexity of its activities and the risks inherent in its business model that is extending across all its business lines and organisational units.
- (2) A credit institution shall ensure that decisions on risk assumption are adopted based on appropriate and clearly defined criteria and complete information.
- (3) A credit institution shall determine the key employees and their deputies to be involved in the risk management system.
- (4) A credit institution shall establish and appropriately document the risk management process, which shall also include defining the risk profile and aligning the risk profile with the risk appetite.
- (5) A credit institution shall on an ongoing basis identify the risks to which it is or might be exposed in its operation and it shall analyse the causes of risk exposure.
- (6) A credit institution shall regularly measure or assess the risks which it has identified in its operation. The risk measurement or assessment procedures must include appropriate quantitative and qualitative methods to measure or assess risks, which are also to enable the detection of changes in the credit institution's risk profile, including the emergence of new risks. The measurement and assessment of risk exposure may not be based only on model outputs or quantitative information.
- (7) A credit institution shall:
- 1) clearly define decision-making criteria and procedures for the containment of risks, taking into account both the existing and desired risk profile and the risk appetite; and
 - 2) appropriately document the risk containment method and risk containment, including the reasons for risk acceptance, mitigation, avoidance or transfer.
- (8) A credit institution shall assess the potential impact of relevant macroeconomic trends and data on risk exposures and individual portfolios and include these assessments in significant decisions on risks.
- (9) A credit institution shall establish such a risk reporting and monitoring system as to regularly provide the management board, the supervisory board and/or supervisory board committees, relevant organisational units and persons in the credit institution with timely, accurate and sufficiently detailed information on risk management required for making business decisions and ensuring its safe and stable operation.
- (10) The information referred to in paragraph (9) of this Article shall at a minimum comprise the relevant information on exposure to individual risks and key risk indicators, including the information on the risk profile and changes therein, data on significant internal losses, information on the measures and activities that are to be or have been implemented to contain risk, information on exceeding the limits and other exemptions from compliance with internal bylaws, including the exemptions from the determined risk appetite, as well as the information on positive and negative changes in business indicators which suggest or might suggest a change in risk exposure.
- (11) A credit institution shall adequately monitor the risks transferred to a third party, in particular concentration risk that may arise from such transfers.

Risk assumption and management strategy
Article 30

- (1) A credit institution shall adopt a risk assumption and management strategy and clearly determine and document the risk appetite.
- (2) The risk assumption and management strategy shall be set out in one or several written documents which shall at a minimum include the objectives and fundamental principles of risk assumption and management and the credit institution's risk appetite.
- (3) When determining the risk appetite, a credit institution shall take into account, in addition to quantitative information or model results, adequate qualitative information, such as for instance expert judgement.
- (4) A credit institution shall regularly align the risk assumption and management strategy with the business strategy, taking into account developments in the market where the credit institution operates and changes within the credit institution (e.g. changes in assets and revenue; any increase in the complexity of the credit institution's business; changes in the risk profile and operating structure; geographic expansion; mergers and acquisitions; and the introduction of new products or business lines).

Risk management duties and responsibilities of senior management
Article 31

Senior management shall:

- 1) implement the risk assumption and management strategies and policies;
- 2) establish and maintain the risk management process;
- 3) establish procedures and compile instructions and guidelines for carrying out the credit institution's business activities which result in risk exposures;
- 4) maintain the efficiency of internal controls embedded in the risk management system; and
- 5) establish adequate procedures to assess the impact of the introduction of new products on the credit institution's risk exposure.

General rules on the management of individual risks

Credit risk
Article 32

- (1) A credit institution shall adopt and implement sound policies and procedures for credit risk management.
- (2) A credit institution shall adopt decisions on credit granting based on sound and well-defined criteria and define the decision-making procedure for approving, amending, renewing and refinancing credits.
- (3) A credit institution shall establish a sound and efficient system for management and ongoing monitoring of portfolios and individual credit risk-bearing exposures and ensure its implementation, which includes:
 - 1) management of portfolios and individual credit risk-bearing exposures, identification and management of non-performing credit exposures and distribution of exposures into risk groups based on recoverability; and
 - 2) carrying out value adjustments for on-balance sheet items and forming provisions for risk-bearing off-balance sheet items.
- (4) A credit institution shall ensure that the diversification of its credit risk-bearing portfolios is in line with its credit strategy and target markets.

(5) A credit institution shall determine an internal methodology which enables an assessment of credit risk exposure to individual debtors, securities or securitisation positions and credit risk at the portfolio level.

(6) The internal methodology referred to in paragraph (5) of this Article shall not be based exclusively on a rating by an external credit assessment institution.

Securitisation risks
Article 33

(1) A credit institution shall adopt and implement sound policies and procedures for managing the risks arising from securitisation transactions in which the credit institution's acts as the investor, originator or sponsor, including reputation risks arising from complex structures or products. The management of risks arising from securitisation transactions shall be based on the economic substance of the transaction.

(2) A credit institution acting as the originator of revolving securitisation transactions with early amortisation provisions shall adopt liquidity plans for resolving the consequences of planned and early amortisation.

Residual risk
Article 34

A credit institution shall adopt and implement sound policies and procedures for residual risk management.

Concentration risk
Article 35

A credit institution shall adopt and implement sound policies and procedures for concentration risk management.

Market risks
Article 36

(1) A credit institution shall adopt and implement sound policies and procedures for managing all significant sources and effects of market risks.

(2) A credit institution shall prescribe by means of the policies and procedures referred to in paragraph (1) of this Article at a minimum:

- 1) the inclusion and active management of positions in the trading book; and
- 2) a valuation system for trading book positions.

(3) Where short positions become due before long positions, a credit institution shall take measures against the risk of liquidity shortfall.

Interest rate risk in the non-trading book
Article 37

A credit institution shall adopt and implement sound policies and procedures for managing the interest rate risk arising from the non-trading book.

Operational risk
Article 38

- (1) A credit institution shall adopt and implement sound policies and procedures for operational risk management, including model risk, the risks arising from outsourcing, and low-frequency high-severity events.
- (2) A credit institution shall, for the purpose of operational risk management, define operational risk so as to articulate what constitutes operational risk for the credit institution. The definition shall at a minimum cover the risks of loss referred to in Article 4, paragraph (1), item (52) of Regulation (EU) No 575/2013.
- (3) A credit institution shall adopt contingency plans and business continuity plans ensuring its ability to operate on an ongoing basis and to limit losses in the event of serious disruption or discontinuation of operation.

Liquidity risk
Article 39

- (1) A credit institution shall adopt and implement appropriate strategies, policies, procedures and systems for liquidity risk management.
- (2) The strategies, policies, procedures and systems referred to in paragraph (1) of this Article shall be considered appropriate provided they:
- 1) are proportionate to the complexity, risk profile, scope of operations and the defined risk tolerance of a credit institution;
 - 2) ensure liquidity risk management during relevant periods including intraday;
 - 3) ensure the management of liquidity risk in kuna and in all foreign currencies;
 - 4) ensure maintenance of adequate levels of liquidity buffers;
 - 5) reflect the significance of a credit institution in each Member State in which it operates;
 - 6) are adjusted to business lines, currencies, branches and legal persons; and
 - 7) include adequate allocation mechanisms.
- (3) A credit institution shall have a clearly defined liquidity risk tolerance in the form of liquidity risk exposure which it is ready to assume and which needs to enable a credit institution to manage its liquidity under normal conditions in such a way as to withstand protracted periods of stress. All relevant business lines need to be informed of the defined tolerance.
- (4) A credit institution shall, taking into account the type, scope and complexity of operations, define the liquidity risk profile which ensures stable operations of a credit institution and a robust risk management system.

Risk of excessive leverage
Article 40

- (1) A credit institution shall adopt and implement sound policies and procedures for managing the risk of excessive leverage. Indicators for the risk of excessive leverage shall include the leverage ratio determined in accordance with Article 429 of Regulation (EU) No 575/2013 and mismatches between assets and liabilities.
- (2) A credit institution shall address the risk of excessive leverage in a precautionary manner by taking due account of potential increases in the risk of excessive leverage caused by reductions of the credit institution's own funds through expected or realised losses, in accordance with the accounting rules. To that end, the credit institution must be able to withstand a wide range of different stress events with respect to the risk of excessive leverage.

Other risks

Article 41

A credit institution shall adopt and implement sound policies and procedures for managing strategic risk, reputation risk, country risk and other risks to which it is or might be exposed in its operation.

Risk assumption and management policies

Article 42

(1) Risk assumption and management policies shall be set out in one or several documents which shall at a minimum include the following:

- 1) a determination of the risk appetite as regards specific risks;
- 2) clearly-defined powers and responsibilities to manage risks within a credit institution;
- 3) a methodology for the identification and measurement or assessment of the risks to which a credit institution is or might be exposed in its operation, including a stress testing methodology;
- 4) internal limits and controls and other risk containment and monitoring procedures;
- 5) procedures and measures in the event of non-compliance with the adopted policies and procedures, including breaches of internal limits;
- 6) procedures and measures for crisis situations; and
- 7) where applicable, risk management within the group.

(2) The policies referred to in paragraph (1) of this Article shall be set out in writing, clearly defined and documented, and accessible to all the employees of a credit institution involved in the risk assumption and management process.

(3) A credit institution shall update the policies referred to in paragraph (1) of this Article at least on an annual basis and at each significant change in risk exposure and it shall ensure that they are applied at the level of the whole credit institution.

New products

Article 43

(1) The risk management of a credit institution shall also cover the risks arising from the conclusion of transactions relating to the introduction of new services or products, significant changes in the existing products or services, including significant changes to related processes (e.g. new outsourcing arrangements) and systems (e.g. IT change processes), exceptional transactions, as well as the entrance to new markets and trading in new instruments.

(2) Significant changes or exceptional transactions referred to in paragraph (1) of this Article shall include:

- 1) mergers and acquisitions, including the potential consequences of conducting insufficient due diligence that failed to identify all post-merger or post-acquisition risks and liabilities;
- 2) setting up new subsidiaries or single purpose vehicles;
- 3) new products;
- 4) changes to the risk management system and procedures; and
- 5) changes to the credit institution's organisation.

(3) A credit institution shall prescribe in its internal bylaws the criteria and procedures relating to the conclusion of transactions referred to in paragraph (1) of this Article and within them at a minimum:

- 1) define what it considers to be a new product and significant change;
- 2) establish the processes and procedures for the introduction of new products;
- 3) define the powers and responsibilities for the approval and verification of new products; and
- 4) establish adequate control procedures to be implemented by the control functions of the credit institution.

(4) Prior to concluding a transaction referred to in paragraph (1) of this Article, a credit institution shall analyse, define and document all the relevant aspects of such a conclusion, including an analysis of the risk arising therefrom, and within this at a minimum:

- 1) describe the new product;
 - 2) analyse the impact of the new product on its existing and future risk exposure, and capital adequacy and profitability;
 - 3) ensure the required organisational, technical and human resources;
 - 4) define the procedures to be used to manage the risks related to new products; and
 - 5) comply with the accounting, tax and legal requirements, including supervisory requirements.
- (5) A credit institution shall carry out an analysis of the risks inherent in new products, which shall at a minimum include:
- 1) an objective assessment of all the risks arising from new activities, using different scenarios;
 - 2) an assessment of whether the introduction of a new product leads to potential weaknesses in risk management and internal controls; and
 - 3) an assessment of the ability of the credit institution to manage a new risk efficiently.

Stress testing
Article 44

- (1) Within risk management, a credit institution shall carry out stress testing at the level of significant risks to which it is exposed, at portfolio level and at the level of the whole credit institution or, where applicable, the group of credit institutions, and it shall ensure adequate human, material and financial resources for that purpose.
- (2) A credit institution shall include the following in its policies and procedures governing stress testing:
- 1) types of stress testing and their objectives;
 - 2) the frequency of individual stress testing exercises;
 - 3) internal governance arrangements, including defined, transparent and consistent lines of responsibility and processes;
 - 4) in carrying out stress testing on a consolidated basis, a list of entities covered by the testing as well as the scope of testing carried out at the level of individual entities;
 - 5) the infrastructure of the data used in stress testing;
 - 6) a description of the stress testing methodology, including a description of internal models used for that purpose and links with the stress testing referred to in Article 77 of this Decision; and
 - 7) assumptions used in stress testing, which are related to business activities and management decisions, as well measures provided for as a consequence of stress testing results and actions to be taken in cases of adverse stress testing results.
- (3) The risk control function shall report to a credit institution's management board about the results of planned tests on an annual level.
- (4) A credit institution shall enable analysis of stress testing results by the competent body and senior management of the credit institution.
- (5) An RC parent credit institution and an EU parent credit institution having its head office in the RC shall carry out stress testing on a consolidated basis. All requirements of this Decision relating to the carrying out of stress testing of an individual credit institution shall apply *mutatis mutandis* to the carrying out of stress testing of a parent credit institution.
- (6) In stress testing, a credit institution shall use sensitivity analysis, scenario analysis and reverse stress testing. In carrying out stress testing, account should be taken of the stage of the economic cycle of the economy and it should be ensured that it is not based only on historical experience, but should also consider hypothetical scenarios and external data sources. Stress testing exercises should include various impact intensities and at least one scenario must include a significant economic recession.
- (7) By way of derogation from paragraph (6) of this Article, a credit institution which is not significant need not use scenario analysis, except for liquidity risk exposure.
- (8) A credit institution shall ensure that the stress testing procedure is supported by an adequate data infrastructure based on effective risk data aggregation and risk reporting.

- (9) A credit institution shall include stress testing results at least in the following activities:
- 1) reviewing strategic planning;
 - 2) reviewing the risk appetite;
 - 3) reconsidering the funding policy;
 - 4) reviewing internal limits;
 - 5) use of risk mitigation techniques;
 - 6) reviewing capital and liquidity adequacy; and
 - 7) reviewing or developing activities related to contingency and recovery plans.
- (10) A credit institution shall assess the appropriateness of stress testing regularly and at least on an annual basis, and at each significant change in risk exposure and it shall cover the following:
- 1) the frequency of stress testing exercises and their compliance with objectives;
 - 2) the need for development work;
 - 3) the adequacy of informing relevant employees, committees established by the supervisory or management board, the management board and the supervisory board;
 - 4) the quality of used data and other information; and
 - 5) documentation of stress testing results.
- (11) A credit institution shall adequately document the stress testing procedure and regularly update that documentation.
- (12) The internal audit shall include the audit of the stress testing procedure in its work plan.

V CREDIT RISK MANAGEMENT RULES

Organisational requirements

Article 45

(1) A credit institution shall ensure that the front office function is clearly separated, operationally and organisationally, from the risk control function and the operation support function, up to the level of the management board.

(2) A credit institution shall establish a clearly defined and consistent organisational structure for the decision-making process on the granting of credit exposures, ensuring:

- 1) the establishment of criteria, policies and procedures for the granting of new exposures and the restructuring of existing exposures;
- 2) the establishment of rules on the granting of exposures at the level of individual debtors and collateral providers and at the level of the group of clients connected with the debtors and collateral providers, depending on the exposure amount and risk; and
- 3) the establishment of the competences of the supervisory board, the management board and boards appointed by them, as well as of the powers to grant exposures assigned to individual management levels, depending on the exposure amount and risk.

(3) A credit institution shall ensure that a credit exposure may be granted only subject to the approval of the authorised persons responsible for credit risk assessment. A credit institution shall establish decision-making rules for the granting of credit exposures which are to apply when the authorised persons contracting transactions and the authorised persons responsible for credit risk assessment cannot reach an agreement on a decision to grant exposures.

(4) Exceptionally, where a credit institution grants a credit exposure which is materially insignificant with regard to credit risk, the granting procedure may be simplified by making decisions on the granting of exposures within the front office function. In this case, the credit institution shall prescribe the identification criteria for materially insignificant credit exposures, the rules governing the granting of these exposures, including their classification based on similar characteristics, and the rules governing their monitoring on an aggregate basis which must be performed within the risk control function.

(5) A credit institution may not carry out value adjustments or form provisions for credit exposures within the front office function.

Credit process

Article 46

The credit process shall at a minimum include the following:

- 1) a credit exposure granting process;
- 2) a risk exposure monitoring process;
- 3) a credit risk exposure analysis;
- 4) an early warning system;
- 5) the treatment of non-performing credit exposures;
- 6) a credit exposure classification process; and
- 7) the content of and keeping records on credit exposures.

Credit exposure granting process
Article 47

- (1) Before granting a credit exposure and before any material subsequent increase in the credit exposure amount and during the legal relationship giving rise to the credit exposure, a credit institution shall assess the creditworthiness of the debtor and the timeliness in meeting the obligations to the credit institution and other creditors.
- (2) Before granting a credit exposure, a credit institution shall assess the quality, marketability, availability, value and validity of the collateral. Where the collateral value to a great extent depends on the creditworthiness of a third-party collateral provider, the credit institution shall assess the creditworthiness of such collateral provider.
- (3) A credit institution shall assess the creditworthiness of the debtor, taking into account its own criteria prescribed in an internal bylaw and the minimum requirements referred to in the Decision on the classification of exposures into risk categories and the method of determining credit losses and, where the debtor is a consumer, additional criteria to be taken into account in accordance with consumer protection regulations.
- (4) A credit institution shall establish a sound process to assess the consumer's ability to meet obligations under the credit agreement and it shall review this process at regular intervals. When assessing the consumer's creditworthiness, a credit institution shall take into account consumer's committed and other non-discretionary expenditures at least by examining available credit registers and systems for collecting, exchanging and providing data, which have been organised by credit/financial institutions or in another appropriate way.
- (5) When analysing the riskiness of an exposure, a credit institution shall primarily take into account the creditworthiness of the debtor and treat, as a rule, the collateral received for the exposure as the secondary collection source.
- (6) A credit institution shall adopt a policy on eligible collateral and the methodology for assessing collateral value, taking into account the minimum requirements referred to in the Decision on the classification of exposures into risk categories and the method of determining credit losses.

Risk exposure monitoring process
Article 48

- (1) The risk exposure monitoring process shall include an assessment of the creditworthiness of the debtor and of the group of clients connected with the debtor as well as an assessment of the collateral quality during the legal relationship giving rise to the credit exposure.
- (2) During the legal relationship giving rise to the credit exposure, a credit institution shall monitor the operation of the debtor, as well as the quality, marketability, availability, value and validity of the collateral for its claims, taking into account the minimum requirements referred to in the Decision on the classification of exposures into risk categories and the method of determining credit losses.
- (3) A credit institution shall monitor debtor's compliance with contractual terms and conditions and, when the credits have been granted for designated purposes, monitor whether the funds placed have been used exclusively for these purposes.
- (4) A credit institution shall ensure that the monitoring of individual exposures is established in such a manner as to enable a timely implementation of adequate measures to mitigate credit risk if the creditworthiness of the debtor or collateral provider deteriorates.
- (5) A credit institution shall adopt procedures prescribing the collection and monitoring of all relevant information which might point to an increase in the risk of the exposures and collateral, and a procedure of reporting this information to all authorised persons included in the credit risk management process, so that the risk of exposures could be reassessed.

Credit risk exposure analysis
Article 49

(1) A credit institution shall establish a system for an ongoing analysis of the structure and quality of the overall credit risk exposure portfolio that shall include an analysis of concentration risk inherent in the portfolio and an assessment of future trends in the structure and quality of the overall credit risk exposure portfolio. A credit institution shall take into account these analyses when defining the strategies and policies for credit risk assumption and management.

(2) A credit institution shall monitor and analyse the overall credit risk exposure portfolio in such a manner as to enable a timely implementation of adequate measures to mitigate credit risk.

Early warning system
Article 50

(1) A credit institution shall:

- 1) establish an early warning system that enables a timely identification of exposures with increased credit risk; and
- 2) keep records of exposures with increased credit risk.

(2) The early warning system referred to in paragraph (1), item (1) of this Article should be based on internal or external ratings or indicators, and it should enable the detection of exposures with increased credit risk at the earliest moment of deterioration of the credit quality of an exposure on an individual basis as well as on the basis of exposures with common credit risk characteristics.

Treatment of non-performing credit exposures
Article 51

(1) A credit institution shall establish an adequate organisational and management framework for the treatment of non-performing credit exposures.

(2) The treatment framework referred to in paragraph (1) of this Article shall include:

- 1) the method of determining, measuring, monitoring and overseeing non-performing credit exposures as well as measures to avoid the origination of non-performing credit exposures in the credit institution's assets;
- 2) objectives in terms of time and value established regarding the treatment of non-performing credit exposures and exposures subject to forced collection proceedings;
- 3) strategic objectives of the credit institution associated with non-performing credit exposures in short-term, mid-term and long-term periods.
- 4) implementation of the operational plan for the treatment of non-performing credit exposures; and
- 5) complete integration of the strategy for the treatment of non-performing credit exposures in credit institution's management processes, including the regular monitoring and independent oversight of such treatment.

(3) A credit institution shall analyse the impact of non-performing credit exposures on its regulatory capital, profitability, liquidity and other business indicators.

(4) In determining the strategic objectives referred to in paragraph (2), item (3) of this Article, a credit institution shall take into account various methods of managing non-performing credit exposures, such as:

- 1) a monitoring and restructuring strategy;
- 2) a strategy for active reduction of non-performing credit exposures;
- 3) a change in the type of exposure or a swap of credit exposure for debtor's equity; and
- 4) different legal options such as bankruptcy or out-of-court settlement.

- (5) A credit institution with increased levels of non-performing credit exposures shall establish a permanent and efficient function responsible for the monitoring and treatment of non-performing credit exposures, independent from the activities performed by the front office function.
- (6) In its policies for the treatment of non-performing credit exposures granted to consumers, a credit institution shall take into account consumer protection regulations.
- (7) Within its policies for the treatment of non-performing credit exposures, a credit institution shall:
- 1) prescribe policies, methods and frequency of evaluating movable or immovable property collateral, oversight and control of such valuation, and criteria for appraisers of collateral; and
 - 2) prescribe the criteria, procedure and decision-making levels for a full or partial accounting write-off of the claims against the debtor with non-performing credit exposures.
- (8) Within the treatment of non-performing credit exposures, a credit institution shall prescribe in its internal bylaw the criteria, procedure and decision-making levels for taking appropriate legal actions necessary for the activation and liquidation of the collateral.

Treatment of restructured credit exposures
Article 52

- (1) A credit institution shall adopt and implement policies for the treatment of restructured credit exposures which shall at a minimum include the following:
- 1) the process and procedures for granting restructuring measures, the method of making decisions on restructuring measures, including the persons and functions involved in the process, where the credit institution shall take into account measures that would enable sustainable repayment of debt and avoid cases of forced collection;
 - 2) the use of specific short-term and long-term restructuring measures depending on the reasons why credit exposures have been identified as non-performing credit exposures;
 - 3) a description of available restructuring measures; and
 - 4) information that are taken into account when deciding on the justification of restructuring measures, the process and procedures for monitoring and overseeing restructuring measures.
- (2) Based on the performance results of implemented restructuring measures, a credit institution shall regularly update policies for the treatment of restructured credit exposures.
- (3) Prior to adopting a decision on the restructuring, a credit institution shall assess the economic justification of restructuring credit exposures to an individual debtor or a group of debtors with similar economic characteristics. If such restructuring of credit exposures is economically justified, the credit institution shall establish an adequate restructuring plan and monitor its implementation and effects.
- (4) When determining whether the restructuring of credit exposures to an individual debtor or a group of debtors is economically justified, a credit institution shall obtain:
- 1) a detailed analysis of the reasons that led to difficulties in the operation of the debtor or, where applicable, a group of debtors;
 - 2) a plan for the operational, financial and ownership restructuring of the debtor; and
 - 3) a cash flow projection for the period defined in the restructuring plan.
- (5) On the basis of the information referred to in paragraph (4) of this Article, a credit institution shall make:
- 1) an assessment of the feasibility of a plan for the operational, financial and ownership restructuring of the debtor, where applicable;
 - 2) an analysis of possible methods of credit exposure restructuring and the rationale for the chosen method; and
 - 3) a new repayment plan for the exposure which shall be the basis for monitoring the implementation of the credit exposure restructuring plan.
- (6) Prior to approval of any restructuring measure, a credit institution shall assess the creditworthiness of a debtor or, where applicable, a group of debtors.

(7) After approval of restructuring measures, a credit institution shall continuously monitor, at least on a quarterly basis, the implementation of the overall restructuring plan and cash flows of the debtor or, where applicable, of a group of debtors with similar economic characteristics.

Credit exposure classification process
Article 53

A credit institution shall establish an adequate classification process in accordance with the Decision on the classification of exposures into risk categories and the method of determining credit losses.

Content of and keeping records on credit exposures
Article 54

(1) A credit institution shall keep records on credit exposures which shall at a minimum include the following:

- 1) basic data on debtors (first and last name, address or company name, head office, number of employees, ownership structure, first and last name of management board members, connection of a debtor with other persons in case a debtor belongs to a group of connected clients within the meaning of Article 4, paragraph (1), item (39) of Regulation (EU) No 575/2013);
- 2) a credit contract and/or a contract on other credit exposures;
- 3) main debtors and creditors of every debtor to whom credit institution's exposure is individually significant;
- 4) where applicable, financial reports of a debtor for the last three years;
- 5) an analysis and assessment of a financial and economic position of a debtor, including internal rating of a debtor;
- 6) for individually significant exposures, evidence, if any, of impairment of debtor's financial assets, analysis and assessment of debtor's future cash flows relative to his liabilities;
- 7) proposal for approval of a credit exposure, opinion of an expert service, and a decision of the credit institution's body competent for such approval;
- 8) analytical bookkeeping records of on-balance and off-balance sheet items relating to an individual debtor of a credit institution;
- 9) documentation concerning instrument of collateral;
- 10) documentation on initiated forced collection proceedings, including records on court proceedings initiated by a credit institution in order to collect its receivables;
- 11) records on court proceedings that may be initiated against a credit institution in relation to that credit exposure;
- 12) documentation related to the treatment of restructured credit exposures referred to in Article 52 of this Decision; and
- 13) other documentation that may complement the information on the debtor's financial position.

(2) A credit institution shall adopt and implement the procedure for keeping credit exposure records and appoint persons responsible for completeness and integrity of individual records.

(3) In addition to requirements on documentation keeping governed by other regulations, a credit institution shall keep all documentation referred to in paragraph (1) of this Article as well as all other documentation and records that constitute the content of credit exposure records for the duration of the business relationship or until the end of court proceedings that may have been initiated in relation to such relationship.

Personal data processing
Article 55

(1) When assessing the debtor's creditworthiness and monitoring his timeliness in meeting obligations, a credit institution shall be authorised to collect, process, keep, submit and use any personal data that are under this Decision necessary to assess risk and debtor's creditworthiness and timeliness in meeting obligations.

(2) When assessing the debtor's creditworthiness in accordance with this Decision, for the purpose of ensuring the accuracy of personal data and unambiguous identification of a person in all cases prescribed in credit institution's internal policies adopted pursuant to the Credit Institutions Act and this Decision, a credit institution shall be authorised to process personal data by collecting copies of relevant personal identification documents and other public documents issued by competent government authorities, applying adequate technical and organisational measures to protect the rights and freedoms of the persons whose data is being collected.

(3) When collecting the data referred to in this Decision, a credit institution shall prescribe in its internal policies the scope of data necessary to assess risks and implement the procedure to assess the creditworthiness and timeliness in meeting obligations. The scope of data required from the debtor should be proportionate to the risk arising for the credit institution from that credit exposure.

(4) The scope of data referred to in the previous paragraph shall include data on the timeliness in meeting obligations and data necessary to assess the creditworthiness, of which the credit institution or a group of credit institutions in the Republic of Croatia becomes aware in the course of providing services to its clients (internal data) as well as data of which the credit institution becomes aware by exchanging data with other credit institutions and members of their groups, and financial institutions, by obtaining and using data from available credit registers and systems for collecting, exchanging and providing data, which have been organised by credit/financial institutions, or in another appropriate way (external data).

(5) When collecting data in accordance with the Credit Institutions Act and this Decision, a credit institution shall obtain a copy of the relevant personal identification document and keep it during the periods prescribed in Article 54 of this Decision.

(6) When, for the purpose of carrying out a creditworthiness assessment in accordance with this Decision, a credit institution collects and processes data not obtained from the person whose creditworthiness is being assessed, Article 14, paragraph 5, item (c) of Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), OJ L 119/1, 4.5.2016, hereinafter referred to as 'Regulation (EU) No 2016/679' shall apply.

(7) When, for the purpose of a creditworthiness assessment in accordance with this Decision, a credit institution implements automated processing, including profiling that produces legal effects concerning the person whose creditworthiness is being assessed, Article 22, paragraph (2), item (b) of Regulation (EU) No 2016/679 shall apply.

(8) When collecting and processing data referred to in paragraphs (6) and (7) of this Article, a credit institution shall ensure adequate measures to protect legitimate interests of the person whose creditworthiness is being assessed in accordance with Regulation (EU) No 2016/679.

Currency-induced credit risk and interest rate-induced credit risk
Article 56

(1) In its credit risk management system, a credit institution shall also include the management of:

- 1) currency-induced credit risk; and
- 2) interest rate-induced credit risk.

(2) Within the process of granting credit exposures denominated in or indexed to foreign currency and/or credit exposures with variable interest rates, a credit institution shall define criteria for assessing a debtor's creditworthiness. The criteria shall at a minimum include an assessment of a significant increase in the debt repayment amount in case of material adverse fluctuations in relevant variable parameters.

(3) A credit institution shall take into account the results of the assessment referred to in paragraph (2) of this Article when assessing a debtor's creditworthiness.

(4) When using instruments to hedge against the risks referred to in paragraph (1) of this Article, a credit institution shall prescribe in its internal methodologies the methods of hedging credit exposures.

(5) A credit institution shall ensure that the risk management system referred to in paragraph (1) of this Article enables at a minimum the following:

- 1) the identification of debtors exposed to the risks referred to in paragraph (1) of this Article;
- 2) the calculation of impairment of and provisions for exposures subject to the risks referred to in paragraph (1) of this Article in case of changes in currency exchange rates or interest rates; and
- 3) linking credit exposures and underlying hedging instruments used by the credit institution, where applicable.

(6) A credit institution shall carry out stress testing for the risks referred to in paragraph (1) of this Article. In doing so, a credit institution shall take into account the relationship between movements in currency exchange rates and/or interest rates and the increase in the repayment amount arising from credit exposures in terms of the ratio between total payments under the credit exposure and debtor's revenue or income.

(7) A credit institution shall ensure that the internal audit work plan includes also the management systems referred to in paragraph (1) of this Article.

Concentration risk
Article 57

(1) In its concentration risk management policy, a credit institution shall at a minimum include:

- 1) concentrations associated with individual persons and groups of connected clients;
- 2) concentrations associated with a group of exposures connected by common risk factors, such as the same economic sector, geographic region or activities, or the application of credit risk mitigation techniques; and
- 3) concentrations associated with the overall credit portfolio.

(2) A credit institution shall adopt adequate methodologies to monitor and mitigate concentration risk. These methodologies shall at a minimum include the following:

- 1) an active management of diversification of the credit exposure portfolio;
- 2) a determination of concentration limits; and
- 3) credit risk transfer or mitigation.

Country risk
Article 58

A credit institution exposed to country risk shall have in place:

- 1) sound policies and procedures for country risk management; and
- 2) an assessment of the feasibility of contracts which have provided a basis for individual exposures and of the possibility of liquidating the collateral under the laws of the country in question in a specific period.

VI MARKET RISKS MANAGEMENT RULES

Organisational requirements
Article 59

(1) A credit institution shall ensure that the front office function is clearly separated, operationally and organisationally, from the risk control function and the treasury back office function, up to the level of the management board.

(2) The operational separation of the front office function from the treasury back office function shall include the establishment of adequate safety and operating procedures and the rights of access to information technologies as well as the physical separation of these functions.

Transaction contracting
Article 60

(1) A credit institution shall ensure that the contracting parties reach an agreement on all the essential elements of a transaction prior to its conclusion.

(2) A credit institution shall ensure that transactions are arranged in line with market conditions. Exceptionally, a credit institution may contract transactions which are not in line with market conditions, provided that all of the following conditions are met:

- 1) a transaction has been contracted based on a clearly defined and justified client request, with the agreed on deviation from market conditions clearly specified in the documentation accompanying the transaction; and
- 2) each transaction which has not been contracted in line with market conditions must be accompanied by a clearly specified description of the deviation from market conditions and the reasons for it.

(3) A credit institution shall prescribe in its internal bylaw the procedure of reporting to the management board and senior management on all significant transactions which have not been contracted in line with market conditions.

(4) A credit institution shall ensure that trading is conducted only in its business premises.

(5) Where transactions are contracted by telephone, a credit institution shall ensure that all telephone conversations of the employees authorised to contract transaction are recorded.

(6) A credit institution shall ensure that each contractual transaction is accompanied by written documentation containing all essential elements of the contractual transaction and other relevant information. The certificate for the contractual transaction and the accompanying documentation are to be forwarded to the treasury back office function in the shortest possible period. The transactions concluded after the working hours of the treasury back office function must be specifically marked and included in the daily trading position.

(7) A credit institution shall ensure that the employees authorised to contract transactions enter transaction data into the information system using their own identification marks. The time of data entry and employee identification mark must be automatically generated.

Transaction recording and control
Article 61

(1) A credit institution shall ensure that each contractual transaction is adequately recorded and without delay included into internal reports on contractual transactions.

(2) A credit institution shall verify whether the certificates for contractual transactions received from the counterparty are timely and complete. The receipt of certificates for contractual transactions from the counterparty is to fall within the scope of the treasury back office function. A credit institution shall without delay notify the counterparty of untimely received or incomplete transaction certificates.

(3) A credit institution shall establish the regular control of the transaction contracting process, including the control of:

- 1) the completeness of documentation on a contractual transaction and its timely forwarding to the treasury back office function;

- 2) the consistency of contractual transaction data with contractual transaction certificates, electronic trading systems certificates and other sources;
- 3) whether contractual transactions are in line with market conditions;
- 4) the deviations from internal trading rules; and
- 5) the consistency of the front office function transaction records with those of other independent organisational units.

Market risk exposure analysis
Article 62

(1) When analysing its market risk exposure, a credit institution shall at a minimum take into account the following:

- 1) all the credit institution's activities sensitive to changes in market factors, also taking into account trading book and non-trading book positions;
- 2) the development and liquidity of relevant financial markets and market price volatility of financial instruments;
- 3) actual and projected mismatches and open positions arising from the credit institution's activities;
- 4) risk concentration in the trading book;
- 5) correlations between market prices of various financial instruments;
- 6) correlations with other risks to which the credit institution is exposed, e.g. credit risk and liquidity risk;
- 7) complex financial instruments (e.g. OTC derivatives or instruments valued using mark-to-model techniques);
- 8) embedded options; and
- 9) profit and capital simulations under various scenarios, including the maximum loss quantification under extreme market conditions.

(2) When analysing its interest rate risk exposure, a credit institution shall, in addition to the elements referred to in paragraph (1) of this Article, take into account various aspects of interest rate risk, including, at a minimum, the risk arising from:

- 1) changes in the yield curve and the correlations between various yield curves which are relevant for the credit institution's activities; and
- 2) the possible execution of embedded interest rate options.

(3) When analysing its foreign-exchange risk exposure, a credit institution shall, in addition to the elements referred to in paragraph (1) of this Article, at a minimum, take into account the following:

- 1) the impact of adverse exchange rate fluctuations on the value of the open foreign exchange position; and
- 2) changes in carrying values of the credit institution's foreign currency positions arising from changes in the exchange rates.

(4) A credit institution shall regularly assess the profit and capital simulations in relation to its actual performance. The simulations shall relate to the following:

- 1) interest and interest-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various interest rate scenarios;
- 2) foreign exchange and foreign exchange-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various exchange rate scenarios; and
- 3) other market factors and market-sensitive income and expense as well as the economic value of on-balance and off-balance sheet items under various market scenarios.

Market risk monitoring
Article 63

(1) The monitoring of risks arising from trading activities shall comprise daily monitoring of data on:

- 1) trading positions and the volatility of their prices;
- 2) utilisation and excesses of the limits; and

3) trading results.

(2) When determining limits for restricting losses, a credit institution shall take into account the capital and income levels. The structure of the limits shall be based on an assessment of the level of risk and the maximum permitted losses. A credit institution shall ensure that the limits are adjusted on a regular basis in accordance with stress testing results. The limits shall comprise each contractual transaction.

(3) A credit institution shall establish an authorisation system for the transactions exceeding the established limits and a system of explaining the reasons for exceeding the established limits.

(4) A credit institution shall establish a system of reporting to its senior management and, if it deems it necessary, to the management board, on all excesses of the established limits. If limits are exceeded, it should be without delay recognised and included in a daily report on limits.

(5) The system of monitoring the utilisation and excesses of the limits shall comprise the control of contractual transactions' alignment with the established limits; the control of the authorisation system for transactions exceeding the established limits and the control of the system of explaining the reasons for exceeding the established limits.

(6) The reports providing a basis for a credit institution's monitoring of data on contractual transactions and limits are also to include a breakdown of open positions by transaction type, risk type, organisational unit or portfolio, as well as a breakdown of the established limits and their utilisation levels. A credit institution shall monitor the excesses of the limits on a daily basis, during and at the end of the working hours. The reports providing a basis for a credit institution's monitoring of data on trading results are to include current and cumulative results on a monthly and annual basis broken down by areas of trading.

VII OPERATIONAL RISK MANAGEMENT RULES

Management system Article 64

(1) A credit institution shall ensure that the operational risk management system takes into account the fact that operational risk is inherent in all the credit institution's activities, processes, products and systems.

(2) The management board of a credit institution shall ensure that all relevant credit institution's management levels and segments are included in the decision-making process on strategic and other significant determinants related to operational risk management.

Operational risk events and sources Article 65

(1) For the purposes of operational risk management, a credit institution shall define the principles for the establishment and classification of operational risk events and operational risk sources.

(2) A credit institution shall define and prescribe what it considers as significant operational risk and operational risk loss.

Operational risk management Article 66

(1) In its operational risk management, a credit institution shall at a minimum include:

- 1) conduct risk;
- 2) information system risk (ICT);
- 3) model risk;
- 4) business changes, including new products, activities, processes and systems;

- 5) risk occurring in project management;
- 6) risks arising from outsourcing; and
- 7) significant risks inherent in the existing products, activities, processes and systems.

(2) When identifying, measuring or assessing operational risk, a credit institution shall take into account:

- 1) all relevant internal and external factors;
- 2) events which have resulted in losses; and
- 3) the operational risk to which it is exposed, but which has not resulted in losses.

(3) A credit institution shall measure or assess exposures to the identified operational risk, taking into account the probability and frequency of risk occurrence and the potential impact thereof on the credit institution.

Analysis of significant losses
Article 67

(1) A credit institution shall without delay carry out a detailed analysis of significant losses for which it has established that they are related to operational risk.

(2) For the losses referred to in paragraph (1) of this Article, a credit institution shall without delay implement adequate measures to reduce and/or limit the consequences of the events or to contain risk, and it shall report thereon to the management board and other relevant bodies and/or persons.

Monitoring and reporting on operational risk exposures
Article 68

A credit institution shall at a minimum include the following information in the regular monitoring of and reporting on operational risk exposures:

- 1) the type of loss or risk;
- 2) the causes and sources of the events or risks;
- 3) the scope and significance of the events or risks; and
- 4) the measures which are to be or have been implemented to reduce and limit the consequences of the events or to contain risk.

Business continuity management
Article 69

(1) Within business continuity management, a credit institution shall identify and define key/vital business activities, processes, systems (including those that are outsourced) and the level of service which the credit institution shall maintain or timely recover and, in this regard:

- 1) assess the impact of their disruption or discontinuation on the credit institution operation and identify related risks; and
- 2) define the priorities, timeframe and strategy to maintain/recover the identified key business activities, processes, systems and service level.

(2) A credit institution shall ensure that business continuity management is an integral part of operational risk management and overall risk management, which requires the integration of operational risk management methods into the business continuity management process.

Business continuity plan
Article 70

(1) Based on the activities referred to in Article 69, paragraph (1), items (1) and (2) of this Decision, a credit institution shall adopt:

- 1) contingency plans and business continuity plans that ensure its adequate response in case of serious disruption of operation and that it may conduct key business activities in the event of discontinuation of operation; and
- 2) recovery plans for key business activities, processes, systems and services that ensure recovery of operation within an appropriate timeframe.

(2) The recovery plan referred to in paragraph (1), item (2) of this Article may be part of the general recovery plan in accordance with the Decision on recovery plans of credit institutions (Official Gazette 78/2014 and 67/2015, hereinafter referred to as 'Decision on recovery plans').

(3) A credit institution shall document as appropriate the plans referred to in paragraph (1) of this Article and ensure their availability and, where necessary, ensure that they are immediately feasible.

(4) A credit institution shall regularly revise the plans referred to in paragraph (1) of this Article in line with business changes, including changes in the products, activities, processes and systems, changes in the environment, and in line with its business strategy and objectives.

(5) A credit institution shall regularly test the plans referred to in paragraph (1) of this Article, document the results of these tests, and analyse and revise the plans based on test results.

Reporting on business continuity planning
Article 71

(1) A credit institution shall, within the system of reporting on operational risk exposure, report to the management board and to the relevant levels of credit institution's management on all relevant facts related to the plans referred to in Article 70, paragraph (1) of this Decision, and especially on testing the plans, and on all significant changes in business continuity management.

(2) A credit institution shall, in the event of circumstances requiring the activation of the plans referred to in Article 70, paragraph (1) of this Decision, without delay notify the Croatian National Bank of all the relevant facts and circumstances pertaining to that matter.

VIII LIQUIDITY RISK MANAGEMENT RULES

Management system
Article 72

(1) A credit institution shall ensure that its liquidity risk management system at a minimum includes the following:

- 1) the assumptions on the behaviour of assets, liabilities and off-balance sheet items of a credit institution and the assumptions on other relevant circumstances so as to ensure their appropriateness in terms of the credit institution's activities and market conditions;
- 2) procedures for the provision of information to the management board and senior management on stress testing results and the response in cases of adverse stress testing results;
- 3) procedures for adequate supervision of encumbered assets providing the management with timely information on the amount and type of encumbered assets and the relevant sources of encumbrance (e.g. repo transactions), the amount and credit quality of unencumbered assets which are subject to encumbrance, listing specifically the volume of assets available for encumbrance and the amount and type of additional encumbrances due to stress (potential encumbrance);
- 4) examination of different possibilities or instruments for liquidity risk mitigation, including systems of limits and liquidity buffers, so as to enable the credit institution to withstand various stress events; and
- 5) ensuring diversification of the structure of funding and access to sources of funding.

(2) A credit institution shall ensure that any impediments to international transfer of surplus liquidity are accounted for in the policy and taken into account in liquidity risk management.

(3) A credit institution operating with foreign currencies shall conduct an analysis of liquidity in foreign currencies and an analysis of mutual convertibility of foreign currencies. For the purposes of this Title, 'convertible currencies' means the currencies of the G-10 countries (Belgium, France, Italy, Japan, Canada, the Netherlands, Germany, the USA, Sweden and Switzerland), the European Economic Area (the EEA consisting of EU Member States and Iceland, Liechtenstein and Norway), Australia and New Zealand.

(4) A credit institution shall identify and monitor professional participants in the money market when managing liquidity risk and prescribe in detail in its internal bylaws the criteria for identification of other legal persons that are professional participants.

For the purposes of this Title, 'professional participant in the money market' means a financial institution, pension fund, investment fund, insurance company and reinsurance company. A professional participant in the money market shall also be some other legal person, except credit institutions, which, for the purpose of managing own resources, participates in the money market in the manner and at a frequency comparable to that of the activities of credit institutions. It implies a legal person which, on a daily basis or frequently, makes legally binding quotations or offers of funds in amounts that are considerable, relative to the total volumes achieved in the money market, or a legal person which influences the determination of the final price of (received/given) funds and thus changes the price of a similar transaction, achieved by a credit institution in dealing with other clients.

(5) A credit institution's management board shall, in addition to the requirements prescribed in Article 9 of this Decision, ensure that the credit institution can meet its daily obligations and that it can withstand periods of stress by maintaining adequate liquidity buffers.

(6) A credit institution's senior management shall, in addition to the requirements prescribed in Article 31 of this Decision, in line with the defined liquidity risk tolerance, define and continuously revise the limits for managing liquidity risk and the limits for authorisation of cash flows above the defined limits.

Policies Article 73

Liquidity risk management policies of a credit institution shall, in addition to the requirements prescribed in Article 42 of this Decision, comprise at a minimum the following:

- 1) structure of assets and liabilities, including off-balance sheet liabilities and assumptions on the liquidity and marketability of assets;
- 2) liquidity risk reporting system, including the reporting of a liquidity position on an aggregate basis in kuna and in foreign currencies;
- 3) measuring and monitoring net cash flows, including intraday liquidity management;
- 4) policies and procedures with foreign currencies;
- 5) cross-border liquidity management, liquidity management across different business lines, branches and subsidiaries, and, where applicable, liquidity management within a group of credit institutions;
- 6) policies for managing encumbered and unencumbered assets;
- 7) diversity and stability of sources of funding and market access; and
- 8) liquidity recovery plans.

Mechanism for the allocation of liquidity costs, benefits and risks Article 74

(1) A credit institution shall ensure that the mechanism for the allocation of liquidity costs, benefits and risks (hereinafter referred to as 'allocation mechanism') is consistent with the liquidity risk management system in place and with the defined liquidity risk tolerance and it shall set up an adequate decision-making process.

(2) A credit institution shall use the allocation mechanism for internal pricing. The credit institution shall include in the allocation mechanism at a minimum:

- 1) the impact of current market conditions, i.e. direct costs of funding (e.g. market cost of securing funds, base yield curve), and other direct costs of funding (e.g. the bid/ask spread, transaction price, the cost of physical transfer of cash, etc.);
- 2) the conditions in which the credit institution operates (e.g. credit quality, funding sources availability);
- 3) different behaviour characteristics of individual products from liquidity point of view (e.g. the cost of early withdrawal, products available through e-banking or products with irregular cash flows); and
- 4) indirect costs of sources of funding (e.g. the cost of liquidity mismatch, the cost of liquidity buffer, the cost of additional collateral, etc.).

(3) A credit institution shall regularly update the allocation mechanism, taking into account the impact of the factors referred to in paragraph (2) of this Article.

(4) A credit institution shall ensure controlling and monitoring of the allocation mechanism by an independent organisational unit or function (e.g. a risk control function).

(5) A credit institution shall ensure that all relevant levels of management and all relevant organisational units are fully informed about the allocation mechanism and that they apply it actively and appropriately.

Net cash flow measuring and monitoring
Article 75

(1) A credit institution shall set up a system for assessing all current and future inflows and outflows, including the assessment of the funds needed for off-balance sheet items. A credit institution shall take into account the accepted clearing and settlement standards and the timeframe used in determining cash flows on individual dates.

(2) A credit institution shall regularly examine the close interaction between funding liquidity risk and market liquidity risk. A credit institution shall also consider the close interaction between liquidity risk and other risks to which it is exposed, such as interest rate, credit, operational, legal and reputation risks.

(3) A credit institution shall manage liquidity risk during relevant periods, including intraday, to ensure that adequate levels of liquidity buffers are maintained. Liquidity buffers especially include maintenance of sufficient liquid assets in the form of reserve, high-quality, unpledged liquid assets which are available to the credit institution at all times and serve as insurance in various stress events (of different intensity and duration), including loss or decrease in unsecured and otherwise available funding sources. There should be no legal or operative impediments to using those funds.

(4) A credit institution shall ensure liquidity risk management in different timeframes. In doing so, it shall consider changes in intraday, short-term and medium-term liquidity needs of a credit institution and how these needs are met, as well as its longer-term (structural) liquidity needs and how these needs are met and potential vulnerabilities to events, activities and strategies of a credit institution. A credit institution shall regularly check the accuracy of input data used in liquidity position calculation.

(5) A credit institution shall actively manage collateral, separate encumbered from unencumbered assets and monitor the amount of available collateral instruments by natural and legal persons holding them and by countries in which those instruments are legally registered in a register or in an account. A credit institution shall monitor the eligibility of those instruments for their timely use, and especially for use in contingent situations.

(6) A credit institution shall also take into account the existing legal, regulatory and operative impediments to transfer of liquid and unpledged assets between entities within and outside the European Economic Area.

Sources of funding and market access

Article 76

(1) A credit institution shall draw up a methodology for determining, measuring, monitoring and managing funding positions which shall comprise current and future materially significant cash flows arising from assets, liabilities and off-balance sheet items, including contingent liabilities and the possible impact of reputation risk.

(2) In the context of managing liquid assets and sources of funding, a credit institution shall ensure access to different sources of funding on the financial market and manage the available market sources of liquidity by ensuring that its liquidity policy comprises at a minimum the following:

- 1) profile of a source of funding and its projection, taking into account the maturity mismatch in the long term with respect to the business model, strategy and risk tolerance;
- 2) procedures which ensure continuous active management of market sources of liquidity;
- 3) procedures for the establishment and maintenance of cooperation with providers of sources of funding, including monitoring the frequency of use of available sources of funding;
- 4) assessment of the access to financial markets and of available funding under normal and stressed conditions;
- 5) assessment of the stability of sources of funding and the risks affecting their stability;
- 6) monitoring the concentration of sources of funding in terms of the assessment of liquidity of individual instruments, geographic locations and providers of sources of funding; and
- 7) identification of and procedures for the use of alternative sources of funding.

Stress testing Article 77

(1) In addition to the requirements referred to in Article 44 of this Decision, in its liquidity risk management policies, a credit institution shall define stress testing (scenario and sensitivity analyses) in the following way:

- 1) prescribe and adopt procedures for the implementation and analysis of different stress testing exercises and their frequency (at least annually), taking into account credit institution-specific (internal), market-wide (outside) scenarios and factors and combined alternative scenarios;
- 2) prescribe that testing be conducted under shorter and protracted stressed conditions;
- 3) determine a schedule of stress testing when making plans for the following year; and
- 4) provide for alternative scenarios for liquidity positions and instruments for liquidity risk mitigation and at least once a year review assumptions on which the decisions on sources of funding are based. Those alternative scenarios relate in particular to off-balance sheet items and other contingent liabilities, including securitisation special purpose entities or other special purpose entities, as determined in Regulation (EU) No 575/2013, in relation to which a credit institution acts as a sponsor or ensures material liquid support.

(2) When conducting stress testing, a credit institution shall take into account the sources with an agreed early withdrawal option.

(3) When conducting stress testing, a credit institution shall calculate the impact of margin calls on the liquidity of all positions with possible margin calls.

(4) When conducting stress testing, a credit institution shall take into account mutual convertibility and liquidity of different convertible currencies and their availability on foreign exchange markets.

(5) The results of stress testing shall be used as a basis for taking corrective measures or activities for mitigating the exposure of a credit institution, ensuring liquidity buffers and adjustment of the liquidity profile of a credit institution to its risk tolerance.

(6) A credit institution shall use stress testing results, and in particular the results of the alternative scenarios referred to in paragraph (1), item (4) of this Article in adjusting liquidity risk management strategy, adopting policies, determining limits, assuming positions and drawing up efficient contingency plans and liquidity recovery plans.

Contingency and liquidity recovery planning of a credit institution
Article 78

(1) A credit institution shall prepare a contingency and liquidity recovery plan which shall constitute an integral part of the liquidity risk management policy.

(2) The contingency plan may be an integral part of a liquidity recovery plan and it shall at a minimum include the following:

- 1) early warning indicators which serve to identify the emergence of a crisis and the designation of the persons responsible for monitoring and reporting on these indicators (e.g. breaches of internal limits, a fall in deposits, a fall in stock prices, higher funding costs compared to other credit institutions, credit institution's credit rating change, difficulties in accessing funds in the money market, asset quality or profitability deterioration);
- 2) duties and responsibilities of individual employees in case of liquidity shortfall in a credit institution (such as those in charge of client and public relations, relations with key market participants, shareholders and central banks);
- 3) procedures which ensure timely and relevant provision of information to senior management and the management board of a credit institution for the purposes of decision-making in crisis situations;
- 4) procedures and processes ensuring liquidity to cover current liquidity deficits and the timeframes within which individual actions have to be taken (e.g. sale of assets, establishment of new funding lines) under normal and stressed conditions;
- 5) a strategy for potential asset encumbrance arising from different stress situations (a decline in a credit institution's credit quality, a decline in the value of pledged assets or increased margin calls);
- 6) identification, size and reliability of all sources of funding, indicating the order of use under different stress situations; and
- 7) circumstances warranting the execution of contingency plans and contact data (address, telephone, e-mail address and similar data) and the location of persons responsible for the execution of the plan.

(3) A liquidity recovery plan may be an integral part of the general recovery plan and, in addition to the requirements listed in the Decision on recovery plans, it shall comprise adequate strategies and appropriate implementation measures for settling potential liquidity deficits, including liquidity deficits in relation to branches established in another Member State.

(4) A credit institution shall at least once a year test contingency and liquidity recovery plans and update them on the basis of stress testing results as defined in Article 77 of this Decision, and it shall notify senior management thereof. Senior management shall adopt a revised recovery plan and appropriately adjust internal policies and processes.

(5) A credit institution shall take in advance the necessary actions to enable immediate implementation of liquidity recovery plans, if necessary. Those actions include holding collateral which is readily available for financing with the central bank and, if necessary, holding collateral in the currency of another Member State or in the currency of a third country that the credit institution is exposed to and, when necessary for operative reasons, within the host Member State or within a third country to whose currency it is exposed.

IX MANAGING RISKS ARISING FROM EXPOSURES TO SHADOW BANKING ENTITIES

Definitions
Article 79

The terms used in this Title shall have the following meaning:

1. 'credit intermediation activities' means bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities. These activities include at least core financial services referred to in Article 8, paragraph (1), items (1) to (6) and items (11) and (12) of the Credit Institutions Act, as well as the activities listed in items (1) to (3), (6) to (8) and (10) of Annex I to Directive No 2013/36/EU, as transposed into regulations of other Member States governing credit institutions;

2. 'exposures to shadow banking entities' means the sum of all credit institution's exposures to individual shadow banking entities pursuant to Part Four of Regulation (EU) No 575/2013 with an exposure value equal to or in excess of 0.25% of the credit institution's eligible capital as defined in Article 4, paragraph (1), item (71), sub-item (b) of Regulation (EU) No 575/2013, where the value of a credit institution's exposure to an individual shadow banking entity is calculated by taking into account the effects of the credit risk mitigation in accordance with Articles 399 to 403 of Regulation (EU) No 575/2013 and exemptions in accordance with Article 400 of Regulation (EU) No 575/2013;

3. 'shadow banking entity' means an undertaking that carries out one or more credit intermediation activities and that is not an excluded undertaking;

4. 'excluded undertakings' means:

1. undertakings included in consolidated supervision on the basis of the consolidated situation of an institution as defined in Article 4, paragraph (1), item (47) of Regulation (EU) No 575/2013;

2. undertakings which are supervised on a consolidated basis by a third-country competent authority pursuant to the law of a third country which applies prudential and supervisory requirements that are at least equivalent to those applied in the European Union; it shall be deemed that third-country credit institutions listed in the Commission implementing decision adopted pursuant to Article 107, paragraph (4) of Regulation (EU) No 575/2013 of the European Parliament and of the Council are subject to prudential and supervisory requirements that are at least equivalent to those applied in the European Union; and

3. undertakings which are not within the scope of items (1) and (2) but which are:

a) credit institutions:

- with head offices in the Republic of Croatia (hereinafter referred to as 'RC'); and
- with head offices in other Member States which operate in accordance with the regulations of the Member State to which Directive 2013/36/EU has been transposed;

b) investment firms with head offices in the RC and other Member States;

c) third-country credit institutions if the third country applies prudential and supervisory requirements to that institution that are at least equivalent to those applied in the European Union; it shall be deemed that third-country credit institutions listed in the Commission implementing decision adopted pursuant to Article 107, paragraph (4) of Regulation (EU) No 575/2013 are subject to prudential and supervisory requirements that are at least equivalent to those applied in the European Union;

d) recognised third-country investment firms;

e) entities which are financial institutions authorised and supervised by the competent authorities in the RC or other Member States or third-country competent authorities and subject to prudential requirements comparable to those applied to institutions in terms of robustness where the credit institution's exposure to the entity concerned is treated as an exposure to an institution pursuant to Article 119, paragraph (5) of Regulation (EU) No 575/2013;

f) the Croatian Bank for Reconstruction and Development, credit unions with head offices in the RC and entities referred to in items (2) to (23) of Article 2, paragraph (5) of Directive 2013/36/EU;

g) central government in the Republic of Croatia and other Member States, regional or local authorities of the Republic of Croatia or of other Member States, or public international bodies of which one or more Member States are members;

h) in the RC, insurance holding companies, insurance undertakings and reinsurance undertakings in accordance with the Insurance Act (Official Gazette 30/2015), and in other Member States, in accordance with the regulations of those Member States governing the operation of such entities, and third-country insurance undertakings and third-country reinsurance undertakings where the supervisory regime of the third country concerned is deemed equivalent;

i) in the RC, the undertakings covered by Article 6 of the Insurance Act, and in other Member States, the undertakings excluded from the scope of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II, OJ L 335, 17.12.2009) in accordance with Article 4 of that Directive, as transposed into regulations of those Member States;

j) in the RC, pension companies as defined in Article 3, item (1) of the Act on Voluntary Pension Funds (Official Gazette 19/2014 and 29/2018) and Article 2, item (1) of the Act on Mandatory Pension Funds (Official Gazette 19/2014, 93/2015 and 64/2018), pension insurance companies as defined in Article 3, item (1) of the Act on Pension Insurance Companies (Official Gazette 22/2014 and 29/2018), and in other Member States, institutions for occupational retirement provision within the meaning of item (a) of Article 6 of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (OJ L 235, 23.9.2003 – hereinafter referred to as 'Directive 2003/41/EC'), as transposed into regulations of those Member States, and institutions for occupational retirement provision subject to prudential and supervisory requirements comparable to those applied to institutions within the meaning of item (a) of Article 6 of Directive 2003/41/EC in terms of robustness;

k) undertakings for collective investment referred to in items (i) to (vi) of this sub-item except undertakings that invest in financial assets with a residual maturity not exceeding two years (short-term assets) and have as distinct or cumulative objectives offering returns in line with money market rates or preserving the value of the investment (money market funds):

(i) in the RC, UCITS funds as defined in Article 4, paragraph (1), item (2) of the Act on Open-End Investment Funds with a Public Offering (Official Gazette 44/2016), and in other Member States, undertakings for collective investment within the meaning of Article 1 of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (hereinafter referred to as 'Directive 2009/65/EC'), as transposed into regulations of those Member States;

(ii) undertakings for collective investment established in third countries where they are authorised under laws which provide that they are subject to supervision considered to be equivalent to that laid down in Directive 2009/65/EC;

(iii) in the RC, alternative investment funds as defined in Article 4, item (3) of the Act on Alternative Investment Funds (Official Gazette 21/2018), and in other Member States, undertakings for collective investment within the meaning of Article 4, paragraph (1), item (a) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010/EC), as transposed into regulations of those Member States with the exception of:

– undertakings employing leverage on a substantial basis according to Article 111, paragraph (1) of Commission Delegated Regulation (EU) 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to



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exemptions, general operating conditions, depositaries, leverage, transparency and supervision; and

– undertakings which are allowed to originate loans or purchase third-party lending exposures onto their balance-sheet pursuant to the relevant fund rules or instruments of incorporation;

(iv) which are authorised as 'European long-term investment funds' in accordance with Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds;

(v) within the meaning of Article 3, paragraph (1), item (b) of Regulation (EU) 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds ('qualifying social entrepreneurship funds'); and

(vi) within the meaning of Article 3, paragraph (b) of Regulation (EU) 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds ('qualifying venture capital funds');

l) central counterparties (CCPs) as defined in item (1) of Article 2 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, established in the European Union and third-country CCPs recognised by the European Securities and Markets Authority (ESMA) pursuant to Article 25 of that Regulation;

m) in the RC, electronic money issuers as defined in Article 5 of the Electronic Money Act (Official Gazette 64/2018), and in other Member States, electronic money issuers referred to in item (3) of Article 2 of Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, as transposed into regulations of those Member States;

n) in the RC, payment institutions as defined in the Payment System Act (Official Gazette 66/2018), and in other Member States, payment institutions referred to in item (4) of Article 4 of Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, as transposed into regulations of those Member States;

o) entities the principal activity of which is to carry out credit intermediation activities for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings;

p) in the RC, resolution authorities in accordance with Article 8 of the Act on the Resolution of Credit Institutions and Investment Firms (Official Gazette 19/2015), and in other Member States, resolution authorities in accordance with Article 2, paragraph (1), item (18) of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council (OJ L 173, 12.6.2014, hereinafter referred to as 'Directive 2014/59/EU');

r) in the RC, asset management vehicles and bridge institutions as defined in the Act on the Resolution of Credit Institutions and Investment Firms (Official Gazette 19/2015), and in other Member States, asset management vehicles and bridge institutions as defined in items (56) and (59) of Article 2, paragraph (1) of Directive 2014/59/EU, as transposed into regulations of those Member States; and

s) in other Member States, entities wholly or partially owned by one or more public authorities established prior to 1 January 2016 for the purpose of receiving and holding some or all of the assets, rights and liabilities of one or more institutions in order to preserve or restore the viability, liquidity or solvency of an institution or to stabilise the financial market.

Identification of exposures to shadow banking entities
Article 80

(1) A credit institution shall identify all exposures to individual shadow banking entities, all risks arising from those exposures, and it shall assess the impact of those risks.

(2) A credit institution shall adopt and implement policies, procedures and other internal bylaws to prescribe the method for the identification, recording, monitoring and reporting on exposures to shadow banking entities, all risks arising from those exposures and the potential impact of those risks.

(3) In the policies, procedures and other internal bylaws referred to in paragraph (2) of this Article, a credit institution shall at a minimum include:

- 1) procedures to identify all exposures to shadow banking entities, all potential risks to which the credit institution is exposed on the basis of those exposures and the potential impact of those risks;
- 2) procedures to manage, control and mitigate the risks arising from exposures to shadow banking entities, where it is necessary to clearly define analyses to be performed regarding the business of a shadow banking entity to which an exposure arises and credit institution's employees to perform such analyses, the potential risks to the credit institution and the likelihood of contagion stemming from these risks;
- 3) a determination of the risk appetite as regards the risks arising from exposures to shadow banking entities based on the procedures referred to in item (1) of this paragraph;
- 4) internal limits for exposures to shadow banking entities;
- 5) procedures and measures a credit institution will implement in the event of a breach of the internal limits;
- 6) a robust process for determining interconnectedness between shadow banking entities, and between shadow banking entities and the credit institution. This process should in particular address situations where interconnectedness cannot be determined, and set out appropriate mitigation techniques to address potential risks stemming from this uncertainty;
- 7) effective procedures and reporting processes to the management board, the supervisory board and all the relevant levels of credit institution's management regarding exposures to shadow banking entities within the institution's overall risk management system; and
- 8) the stress testing methodology.

(4) When determining the interconnectedness between shadow banking entities referred to in paragraph (3), item (6) of this Article, a credit institution shall determine the relationship of control and the economic and financial interconnectedness in accordance with the Decision on large exposures of credit institutions and review whether there is interconnectedness arising from exposure of a shadow banking entity to a person or a group of connected clients in accordance with Article 4, paragraph (1), item (39) of Regulation (EU) No 575/2013. In addition to capital ties and indicators of economic and financial interconnectedness referred to in the Decision on large exposures, a credit institution shall consider other types of relationships, e.g. the relationship of effective control or the relationship arising from contractual obligations, implicit support or potential reputation risk.

(5) The policies, procedures and other internal bylaws referred to in paragraph (2) of this Article shall be set out in one or more documents which shall be in writing, clearly defined and documented, and accessible to all the employees of a credit institution involved in the assumption and management of the risks arising from exposures to shadow banking entities. A credit institution shall adequately incorporate the policies referred to in paragraph (2) of this Article to the policies referred to in Article 48, item (4) of the Credit Institutions Act.

(6) The credit risk committee or another credit institution's body with equivalent tasks shall supervise the performance of the analyses referred to in paragraph (3), item (2) of this Article, and a credit institution shall ensure that the committee or another designated body is informed of the results of such analyses.

(7) A credit institution shall ensure that the risks referred to in paragraph (1) of this Article are adequately taken into account in the internal capital adequacy assessment and capital planning process in accordance with the Decision on the internal capital adequacy assessment process and internal liquidity adequacy assessment process for credit institutions (Official Gazette 20/2014 and 126/2017).

Duties of the management board

Article 81

(1) A credit institution's management board shall on a regular predetermined basis, and at least annually:

- 1) approve and review the credit institution's risk appetite to exposures to shadow banking entities, including individual internal limits and aggregate internal limits set in line with Articles 82 and 83 of this Decision;
- 2) approve and review the risk management process to manage exposures to shadow banking entities, including analysis of risks arising from those exposures, risk mitigation techniques and potential impact on the credit institution under stressed scenarios;
- 3) review the credit institution's exposures to shadow banking entities (on an aggregate and individual basis) as a percentage of total exposures and expected and incurred losses; and
- 4) ensure the setting of the limits referred to in Articles 82 and 83 of this Decision is documented, including any changes to them.

(2) A credit institution's management board may delegate the requirements related to the reviews referred to in paragraph (1) of this Article to senior management.

Individual internal limit

Article 82

(1) A credit institution shall set and apply an individual internal limit on exposure to each shadow banking entity relative to its eligible capital.

(2) When setting individual internal limits, a credit institution shall take into account the following:

- 1) the regulatory status of the shadow banking entity, in particular whether it is subject to any type of prudential or supervisory requirements;
- 2) the financial situation of the shadow banking entity including at least its capital amount and quality, leverage and liquidity position;
- 3) information available about the portfolio of the shadow banking entity, in particular non-performing loans;
- 4) available evidence about the adequacy of the credit analysis performed by the shadow banking entity on its portfolio, if applicable;
- 5) whether the shadow banking entity will be vulnerable to asset price or credit quality volatility;
- 6) concentration of credit intermediation activities relative to other business activities of the shadow banking entity;
- 7) interconnectedness as outlined in Article 80, paragraph (3), item (6) of this Decision; and
- 8) any other relevant factors identified by the credit institution in accordance with Article 80, paragraph (3), item (1) of this Decision.

(3) The individual internal limit referred to in paragraph (1) of this Article must be tighter than the aggregate internal limit referred to in Article 83 of this Decision.

(4) A credit institution shall document and ensure evidence that in setting an individual internal limit it has taken into account the requirements referred to in all items of paragraph (2) of this Article.

Aggregate internal limit

Article 83

- (1) A credit institution shall set and apply an aggregate internal limit on total exposure to all shadow banking entities relative to its eligible capital.
- (2) When setting an aggregate internal limit, a credit institution shall take into account the following:
- 1) its business model, the risk management framework as outlined in Article 80, paragraph (3), item (2) of this Decision and the risk appetite as outlined in Article 80, paragraph (3), item (3) of this Decision;
 - 2) the size of its current exposures to shadow banking entities relative to its total exposure and relative to its total exposure to financial sector entities subject to prudential and supervisory requirements; and
 - 3) interconnectedness as outlined in Article 80, paragraph (3), item (6) of this Decision.
- (3) A credit institution shall document and ensure evidence that in setting an aggregate internal limit it has taken into account the requirements referred to in all items of paragraph (2) of this Article.

Aggregate internal limit in the event that individual internal limits have not been set

Article 84

- (1) If a credit institution is not able to meet the requirements referred to in Article 80 of this Decision or the requirements referred to in Article 81 of this Decision, it shall set an aggregate internal limit on exposures to shadow banking entities in the amount not exceeding 25% of its eligible capital.
- (2) If a credit institution can meet the requirements referred to in Article 80 of this Decision and the requirements referred to in Article 81 of this Decision, but cannot gather sufficient information to enable it to set internal limits referred to in Articles 82 and 83 of this Decision, it shall set the aggregate internal limit on exposures to such entities in the amount not exceeding 25% of its eligible capital. For exposures to the remaining shadow banking entities, a credit institution shall set individual internal limits and an aggregate internal limit in accordance with Articles 82 and 83 of this Decision.
- (3) In the case referred to in paragraph (2) of this Article, the maximum amount of a credit institution's exposure to all shadow banking entities shall not exceed the lower of the following amounts:
- 1) the aggregate internal limit in accordance with Article 83 of this Decision related to exposures to the remaining shadow banking entities for which individual internal limits have been set; or
 - 2) the sum of the amount of 25 and the amount of individual internal limits set for the remaining shadow banking entities.
- (4) If the total credit institution's exposure to all shadow banking entities exceeds the amount set by the aggregate internal limit referred to in paragraph (1) or (2) of this Article, an excess of the limit shall not include trading book exposures of the credit institution in accordance with Article 395, paragraph (5) of Regulation (EU) No 575/2013.

X TRANSITIONAL AND FINAL PROVISIONS

Cessation of the effect of decisions

Article 85

- (1) On the date of the entry into force of this Decision, the Decision on risk management (Official Gazette 1/2015 and 94/2016), the Decision on liquidity risk management (Official Gazette 105/2016) and the Decision on the internal controls systems (Official Gazette 1/2015) shall cease to have effect.
- (2) Credit institutions shall adjust to the requirements of Article 11, paragraph (2) of this Decision by 30 June 2019 at the latest.

Entry into force Article 86



This Decision shall be published in the Official Gazette and shall enter into force on the eighth day after the day of its publication.

No.: 304-020/10-18/BV
Zagreb, 17 October 2018

Croatian National Bank
Governor
Boris Vujčić