



HNB

EUROSUSTAV

GOVERNOR

Pursuant to Article 182, paragraph (9), items (1) and (2), Article 187, paragraph (8), Article 192, paragraph (7) and Article 197, paragraph (8) of the Credit Institutions Act (Official Gazette 22/2026) and Article 43, paragraph (2), item (10) of the Act on the Croatian National Bank (Official Gazette 75/2008, 54/2013 and 47/2020), the Governor of the Croatian National Bank hereby issues the

Decision on governance arrangements

I GENERAL PROVISIONS

Subject matter

Article 1

This Decision governs the requirements related to governance arrangements, as follows:

- 1) the organisational structure;
- 2) the tasks and method of organisation and operation of supervisory board committees;
- 3) the internal controls mechanism and internal control functions;
- 4) general risk management rules;
- 5) credit risk management rules;
- 6) rules for the management of market risks;
- 7) operational risk management rules;
- 8) liquidity risk management rules;
- 9) rules on the management of the risks arising from exposures to shadow banking entities;
- 10) rules on the management of the interest rate risk arising from non-trading book activities;
- 11) rules on the management of environmental, social and governance risks or ESG risks;
- 12) application of the expected credit loss framework (hereinafter referred to as 'ECL');
- 13) requirements relating to the valuation of property collateral; and
- 14) keeping of credit records.

Compliance with the legal acts of the European Union

Article 2

(1) This Decision transposes into Croatian legislation the following acts of the European Union:

- 1) 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 (Text with EEA relevance) (OJ L 176, 27. 6. 2013);

- 2) Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (Text with EEA relevance) (OJ L 150, 7. 6. 2019);
- 3) Directive (EU) 2022/2556 of the European Parliament and of the Council of 14 December 2022 amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU, 2014/65/EU, (EU) 2015/2366 and (EU) 2016/2341 as regards digital operational resilience for the financial sector (Text with EEA relevance) (OJ L 333, 27. 12. 2022);
- 4) Directive (EU) 2024/1619 of the European Parliament and of the Council of 31 May 2024 amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks (Text with EEA relevance) (OJ L, 2024/1619, 19. 6. 2024).

(2) Reference to 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 (Text with EEA relevance) (OJ L 176, 27. 6. 2013); (hereinafter referred to as 'Directive 2013/36/EU') in this Decision shall be taken to mean reference to Directive 2013/36/EU as last amended by Directive (EU) 2024/2994 of the European Parliament and of the Council of 27 November 2024 amending Directives 2009/65/EC, 2013/36/EU and (EU) 2019/2034 as regards the treatment of concentration risk arising from exposures towards central counterparties and of counterparty risk in centrally cleared derivative transactions (Text with EEA relevance) (OJ L, 2024/2994, 4. 12. 2024).

Article 3

The provisions of this Decision comply with the following Guidelines of the European Banking Authority:

- 1) Guidelines on internal governance (EBA/GL/2021/05);
- 2) Guidelines issued on the basis of Article 84, paragraph (6) of Directive 2013/36/EU specifying criteria for the identification, evaluation, management and mitigation of the risks arising from potential changes in interest rates and of the assessment and monitoring of credit spread risk, of institutions' non-trading book activities (EBA/GL/2022/14);
- 3) Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395, (2) of Regulation (EU) No 575/2013 (EBA/GL/2015/20);
- 4) Guidelines on the management of environmental, social and governance (ESG) risks (EBA/GL/2025/01);
- 5) Guidelines on loan origination and monitoring (EBA/GL/2020/06);
- 6) Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses (EBA/GL/2017/06);
- 7) Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06);
- 8) Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 (EBA/GL/2016/07); and
- 9) Guidelines on institutions' stress testing (EBA/GL/2018/04).

Entities subject to the Decision

Article 4

(1) The provisions of this Decision shall apply to credit institutions with head offices in the Republic of Croatia which have been authorised in accordance with the act governing the operation of credit institutions.

(2) The provisions of this Decision shall apply *mutatis mutandis* to third-country branches of credit institutions authorised by the Croatian National Bank to provide services and to financial holding companies or mixed financial holding companies approved in accordance with the act governing the operation of credit institutions or to a designated entity where a financial holding company or a mixed financial holding company has been granted exemption.

(3) Credit institutions shall apply the provisions of this Decision on an individual basis and on a consolidated and sub-consolidated basis in accordance with the act governing the operation of credit institutions.

Definitions

Article 5

(1) For the purposes of this Decision, the following definitions shall apply:

- 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) '*exposure*' means exposure as defined in Article 5, item (1) 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 (Text with EEA relevance) (OJ L 176, 27. 6. 2013), as last amended by Regulation (EU) 2025/1215 of the European Parliament and of the Council of 17 June 2025 amending Regulation (EU) No 575/2013 as regards requirements for securities financing transactions under the net stable funding ratio (Text with EEA relevance) (OJ L 1215, 25. 6. 2025), hereinafter referred to as 'Regulation (EU) No 575/2013';
- 5) '*defaulted exposure*' means exposure as defined in Article 178 of Regulation (EU) No 575/2013;
- 6) '*source of repayment capacity*' means the borrower's total funds, cash flow and payment behaviour considerations, as registered by the credit provider at the moment of the loan origination, covering all sources of cash inflows (such as income, regular private transfers such as alimonies, rental income from real estate property, income from financial investments, income from private businesses or partnerships, income from other sources), funds (such as saving accounts, investment products) and regular expenses;
- 7) '*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;

- 8) '*credit exposure*' means exposure subject to credit risk as defined in Article 5, item (5) of Regulation No 575/2013;
- 9) '*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;
- 10) '*forbearance measure*' means a measure as defined in Article 47b of Regulation (EU) No 575/2013;
- 11) '*non-performing exposure*' means exposure as defined in Article 47a of Regulation (EU) No 575/2013;
- 12) '*expected credit loss*' means a loss as defined in Appendix A to IFRS 9 of the International Financial Reporting Standard 9 (hereinafter referred to as 'IFRS 9');
- 13) '*risk containment*' means the overall strategic determinants, methods, criteria and procedures to accept, avoid, mitigate or transfer the identified risk;
- 14) '*entrepreneur*' means a natural or legal person who independently performs an economic or professional activity for the purpose of making profit, income, revenue, or other economically evaluable benefits except credit institutions, financial institutions, insurance and reinsurance undertakings and public sector entities;
- 15) '*specific plans for monitoring and managing financial risks arising from short-, medium- and long-term ESG factors*' (hereinafter referred to as '*ESG plans*') means specific plans adopted in accordance with the provisions of Article 183, paragraph (1), item (4) and paragraph (2), item (4) of the Credit Institutions Act, which contain an overview and a description of strategic action and tools for managing ESG risks of a credit institution based on an analysis of the forward-looking business environment and a unique, comprehensive process of transition planning so as to ensure a credit institution's operations are robust and ready for a transition towards a climate- and environmentally more resilient and sustainable economy;
- 16) '*risk profile*' means the measurement or assessment of all risks to which a credit institution is or might be exposed in its operation;
- 17) '*forebone exposure*' means exposure as defined in Article 47b of Regulation (EU) No 575/2013;
- 18) '*provisions for impairment*' means 'loss allowance for expected credit losses' defined in Appendix A to IFRS 9;
- 19) '*securitisation*' and the terms related to 'securitisation' means as defined in Regulation (EU) 2017/2401 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 No 2009/65/EC, No 2009/138/EC and No 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28. 12. 2017), as last amended by Regulation (EU) 2021/557 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis (OJ L 116, 6. 4. 2021);
- 20) '*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;
- 21) '*default*' means default as defined in Article 178 of Regulation (EU) No 575/2013;
- 22) '*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;
- 23) '*entities treated as central governments*' include exposures to regional governments or local authorities 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;

- 24) '*risk management system*' means the overall organisational structure, rules, processes, procedures, systems and resources to identify, measure or assess, contain, assume, 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 establishment of the strategy, policy and other internal by laws on risk management;
- 25) '*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;
- 26) '*managerial responsibility*' means as defined in Article 1, paragraph (1) of Commission Delegated Regulation (EU) 2021/923 of 25 March 2021 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards setting out the criteria to define managerial responsibility, control functions, material business units and a significant impact on a material business unit's risk profile, and setting out criteria for identifying staff members or categories of staff whose professional activities have an impact on the institution's risk profile that is comparably as material as that of staff members or categories of staff referred to in Article 92, paragraph (3) of that Directive;
- 27) '*external credit assessment institution*' or '*ECAI*' means as defined in Article 4, paragraph (1), item (98) of Regulation (EU) No 575/2013.

(2) The terms not otherwise defined for the purposes of this Decision shall mean as defined in the Credit Institutions Act (Official Gazette 22/2026; hereinafter referred to as 'Credit Institutions Act') or in Regulation (EU) No 575/2013.

Risk definitions

Article 6

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 arising from non-trading book activities*' ('*IRRBB*') means the current and prospective risk of a negative impact to the institution's economic value of equity, or to the institution's net interest income, taking market value changes into account as appropriate, which arise from adverse movements in interest rates affecting interest rate sensitive instruments, including gap risk, basis risk and option risk;
- 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 exposures to each counterparty, including central counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region, or from the same activity or commodity, the application of credit risk mitigation techniques, and including in particular risks associated with large indirect credit exposures, such as a single collateral issuer. For crypto-assets without an identifiable issuer, the concentration risk shall be considered in terms of exposure to the crypto-assets with similar features;

- 4) '*counterparty credit risk*' means the risk 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 borrower'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*' means the risk 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 as defined in Article 4, paragraph (1), item (52a) of Regulation (EU) No 575/2013;
- 11) '*dilution risk*' means the risk 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 processes, services or activities that it would otherwise execute itself;
- 16) '*information and communication technology risk*' (hereinafter referred to as '*ICT risk*') means the risk defined in Article 3, item (5) of Regulation (EU) 2022/2554;
- 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 as defined in Article 4, paragraph (1), item (52b) of Regulation (EU) No 575/2013;
- 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*' means the risk as defined in Article 4, paragraph (1), item (94) of Regulation (EU) No 575/2013;

- 22) '*credit valuation adjustment risk*' or '*CVA risk*' means 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 acts;
- 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 risk*' means the risk as defined in Article 4, paragraph (1), item (141) of Regulation (EU) No 575/2013;
- 31) '*currency risk*' means the risk as defined in Article 4, paragraph (1), item (142) of Regulation (EU) No 575/2013;
- 32) '*commodities risk*' means the risk as defined in Article 4, paragraph (1), item (143) of Regulation (EU) No 575/2013;
- 33) '*governance risk*' means the risk as defined in Article 4, paragraph (1), item (52i) of Regulation (EU) No 575/2013;
- 34) '*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;
- 35) '*gap risk*' means the risk resulting from the term structure of interest rate sensitive instruments that arises from differences in the timing of their rate changes, covering changes to the term structure of interest rates occurring consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk);
- 36) '*basis risk*' means the risk arising from the impact of relative changes in interest rates on interest rate sensitive instruments that have similar tenors but are priced using different interest rate indices. Basis risk arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest rate sensitive instruments with otherwise similar rate change characteristics;
- 37) '*option risk*' means the risk arising from options (embedded and explicit), where the credit institution or its customer can alter the level and timing of their cash flows, namely the risk arising from interest rate sensitive instruments where the holder will almost certainly exercise the option if it is in their financial interest to do so and the risk arising from flexibility embedded implicitly or within the terms of interest rate sensitive instruments, such that changes in interest rates may affect a change in the behaviour of the client;

- 38) '*credit spread risk from non-trading book activities*' ('CSRBB') means the risk driven by changes in the market perception about the price of credit risk, liquidity premium and potentially other components of credit-risky instruments inducing fluctuations in the price of credit risk, liquidity premium and other potential components, which is not explained by IRRBB or by expected credit/(jump-to-) default risk;
- 39) '*restitution risk*' means the risk of restitution of assets or their value to those who have been unlawfully deprived of it (e.g., by theft, violence, illegitimate decisions) or the payment of compensation for personal harm and damage to the assets. The basic liability of the parties in the case of nullity shall be restitution (lat. *restitutio in integrum*), in such a manner that either party shall be liable to return to the other party all that the party has received on the basis of such a contract;
- 40) '*step-in risk*' means the risk that a credit institution decides to provide financial support to an unconsolidated entity, that is not a fully or proportionately consolidated entity, that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support;
- 41) '*environmental, social and governance risk*' (hereinafter referred to as 'ESG risk', means the risk referred to in Article 4, paragraph (1), item (52d) of Regulation (EU) No 575/2013;
- 42) '*environmental risk*' means the risk as defined in Article 4, paragraph (1), item (52e) of Regulation (EU) No 575/2013;
- 43) '*physical risk*' means the risk as defined in Article 4, paragraph (1), item (52f) of Regulation (EU) No 575/2013;
- 44) '*transition risk*' means the risk as defined in Article 4, paragraph (1), item (52g) of Regulation (EU) No 575/2013;
- 45) '*social risk*' means the risk as defined in Article 4, paragraph (1), item (52h) of Regulation (EU) No 575/2013.

II ORGANISATIONAL STRUCTURE

Duties and responsibilities of supervisory and management boards

Structure and organisation

Article 7

- (1) A credit institution's management and supervisory boards shall, in line with their competences, have the ultimate and overall responsibility for the establishment, implementation and oversight of governance arrangements.
- (2) 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.
- (3) 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.
- (4) The decision-making by the management or supervisory board shall not be entrusted to a single member or a minority of management or supervisory board members.
- (5) The management board and the supervisory board shall cooperate with each other and share relevant information necessary for the performance of their tasks.

Individual statements and mapping of duties

Article 8

(1) Without prejudice to the overall collective responsibility of the management and supervisory board, a credit institution shall draw up, maintain and update individual statements setting out the roles and duties of the chairperson and all members of the management board, senior management and key function holders.

(2) A credit institution shall draw up, maintain and update the mapping of duties including details of the reporting lines, of the lines of responsibility and of the responsibilities for the chairperson and members of the management board, chairperson and members of the supervisory board, senior management, key function holders including heads of internal control functions, the chief financial officer, the head of the internal audit, persons responsible for the function of the prevention of money laundering and terrorist financing, and other persons who are part of the governance arrangements.

(3) A credit institution shall make available individual statements and segregation of duties at all times and submit them to the Croatian National Bank upon request, *inter alia*, for the purpose of obtaining an authorisation.

Duties and responsibilities of the management board

Article 9

(1) In executing its tasks referred to in Article 187, paragraphs (3), (4) and (6) of the Credit Institutions Act, for the purpose of establishing and implementing requirements related to organisational structure, effective risk management and the internal controls mechanism, 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) establish and implement a code of conduct and appropriate policies;
- 5) establish and implement a policy to identify, assess, manage, mitigate or prevent actual and potential conflicts of interest.

(2) When assessing the adequacy of procedures and efficiency of the internal control functions, a credit institution's management board shall, in accordance with the provisions of Article 187, paragraph (6) of the Credit Institutions Act, take into account at least the following:

- 1) the work methodology of an internal control function;
- 2) execution of the work plan of an internal control function;
- 3) the number of employees included in the operation of an internal control function;
- 4) the structure and content of reports of an internal control function;
- 5) findings of an internal control function during the period covered by the assessment of the adequacy of procedures and efficiency of an internal control function;

- 6) the 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 an internal control function.

Supervisory board committees

Composition of supervisory board committees

Article 10

- (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 11

- (1) Supervisory board committees shall document the agendas of committee meetings, the key points of the discussion of the committee's 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 (hereinafter referred to as 'ICT') and internal control functions, as well as information on AML/CTF compliance and aggregated information on suspicious transaction reports, and money laundering and terrorist financing risk factors;
 - 2) receive regular reports, *ad hoc* information, communications and opinions from the heads of the internal 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 regulations that may have occurred, with detailed information on and recommendations for corrective measures taken, to be taken or suggested to address them.

Risk culture and business conduct

Risk culture

Article 12

- (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 act 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) When establishing a risk culture referred to in paragraph (1) of this Article, a credit institution shall also consider ESG risks.

(4) 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 13

(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) The standards referred to in paragraph (1) of this Article shall be subject to the principles of equal opportunities and equal treatment of men and women in matters of employment and occupation as well as no discrimination of employees based on gender, race, colour, ethnic or social origin, genetic features, language, religion or belief, political or any other opinion, membership of a national minority, property, birth, disability, age or sexual orientation.

(3) A credit institution shall establish internal policies prescribing compliance with the standards referred to in paragraph (1) of this Article and ensure supervision of the implementation of those policies.

(4) A credit institution shall adequately:

- 1) ensure equal opportunities for all employees independent of their genders, including with regard to career perspectives;
- 2) aim to improve the representation of the underrepresented gender in positions within the management and supervisory boards as well as in the group of employees that have managerial responsibilities; and
- 3) implement gender neutral remuneration policies, recruitment policies, career development and succession plans, access to training and ability to apply for internal vacancies.

(5) 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, establish a process for dealing with issues of non-compliance and regularly report on the results of that review to the management board of the credit institution.

(6) 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 14

(1) A credit institution shall establish, 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 identifying and managing conflicts of interest that may arise from the conclusion of a legal arrangement as a result of which a credit institution would incur or increase its exposure to persons in a special relationship with the credit institution in accordance with Articles 205 and 206 of the Credit Institutions Act.

Conflict of interest policy for employees

Article 15

(1) A credit institution shall establish, 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) The following situations or relationships where conflicts of interest may arise shall be deemed by the credit institution to be a conflict of interest of employees:

- 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) A credit institution shall 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.

(4) A credit institution shall 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.

(5) A credit institution shall determine the function responsible for receiving reports on actual or potential conflicts of interest of employees and processes for reporting and communication to that function.

(6) 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.

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

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

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

(10) A parent credit institution, a parent financial holding company and a parent mixed financial holding company authorised and approved, respectively, pursuant to the Credit Institutions Act, and the designated entity pursuant to Article 89, paragraph (2), item (3) of the Credit Institutions Act 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.

Documentation of exposures to persons in a special relationship with a credit institution

Article 16

(1) A credit institution shall keep records of exposures to persons in a special relationship with the credit institution referred to in Article 205 of the Credit Institutions Act, including the following information:

- 1) the name of the person and their status;
- 2) the type/nature of the exposure and the amount;
- 3) the terms and conditions applicable to the exposure;
- 4) the date of approval of the exposure;
- 5) the name of the individual or body and its composition taking the decision to approve the exposure;
- 6) the fact (yes/no) as to whether or not the exposure has been granted at market conditions; and
- 7) the fact (yes/no) as to whether or not the exposure has been granted at conditions available to all employees.

(2) For exposures exceeding EUR 200,200.00, in addition to the information referred to in paragraph (1) of this Article, the records shall include the following additional information:

- 1) the percentage of the exposure and the percentage of the sum of all outstanding amounts of exposures towards the same person compared to:
 - 1) the sum of its tier 1 capital and tier 2 capital; and
 - 2) common equity tier 1 capital of the credit institution;
 - 2) whether the loan is part of a large exposure; and
 - 3) the relative weight of the aggregated sum of all outstanding amounts of exposures towards the same person, calculated as a percentage by dividing the total outstanding amount by the total amount of all outstanding exposures to persons in a special relationship with the credit institution.
- (3) A credit institution shall ensure that the documentation of exposures to persons in a special relationship with the credit institution is complete and updated.
- (4) At the request of the Croatian National Bank, a credit institution shall submit the information referred to in paragraphs (1) and (2) of this Article.

Procedures for internal reporting of breaches of regulations

Article 17

- (1) A credit institution shall, for the purpose of meeting the requirements referred to in Article 352 of the Credit Institutions Act, 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 MECHANISM AND INTERNAL CONTROL FUNCTIONS

Internal controls mechanism

Article 18

(1) A credit institution shall ensure that the internal controls mechanism covers all business lines and organisational units, including internal 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 mechanism.

(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 mechanism, including its business lines, organisational units and internal control functions.

(3) The internal controls mechanism 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.

(4) A credit institution shall ensure the exchange of necessary information in a manner that ensures that the management board, the supervisory board, each business line and organisational unit, including each internal control function, is able to adequately carry out its duties.

(5) Where a credit institution is a member of a group, it shall ensure the necessary exchange of adequate information between:

- 1) the business lines and the compliance function, including the AML/CTF compliance function where it is a separate internal control function, at the group level; and
- 2) the head of the internal control functions at the group level and the management board and the supervisory board of the credit institution.

(6) A credit institution shall implement appropriate procedures that ensure that it complies with its obligations on the prevention of money laundering and terrorist financing.

(7) For the purposes of the procedures referred to in paragraph (6) of this Article, a credit institution shall:

- 1) assess its exposure to the risk that it may be used for the purpose of money laundering and terrorist financing and, where necessary, take mitigating measures to reduce those risks as well as its operational and reputation risks linked to them; and

- 2) take measures to ensure that its employees are aware of money laundering and terrorist financing risks and the impact that money laundering and terrorist financing have on the credit institution and the financial system.

Internal control functions and an internal act on the internal control function

Article 19

(1) A credit institution shall establish internal control functions in accordance with the provisions of Articles 197 and 198 of the Credit Institutions Act.

(2) Internal control functions, in accordance with the authorities and responsibilities of each internal control function, shall ensure the credit institution's compliance with regulations on the prevention of money laundering and terrorist financing.

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

(4) The compliance function shall implement a compliance program by realising the work plan referred to in Article 21 of this Decision in accordance with the methodology and the internal act of the compliance function referred to in this Article.

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

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

- 1) the objectives, scope and mode of operation of the internal control function;
- 2) the organisational structure and the role of the internal control function;
- 3) the position of the internal control function within the credit institution;
- 4) the measures ensuring the independence and objectivity of each internal control function;
- 5) the authorities, responsibilities and relationships with other organisational units;
- 6) mutual relationships with other internal control functions;
- 7) the tasks and responsibilities of the head of each individual internal 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 the internal control functions;
- 9) the authorities and responsibilities of internal control functions associated with the 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.

7) A credit institution shall ensure the internal control functions 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.

Persons carrying out internal control functions

Article 20

(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 internal control function and provide regular professional education and training of the persons responsible for carrying out the internal control function activities.

Internal control function work plan

Article 21

(1) An internal control function shall adopt an annual internal 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 internal control function's work plan.

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

- 1) a list of all the planned activities of the internal control function;
- 2) a list of business areas to be covered by the annual internal 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 head of each internal 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 internal control function's activities.

Internal control function activities

Article 22

(1) The internal 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 mechanism 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 internal control functions, including appropriate addressing and reporting.

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

Activities of the risk management function

Article 23

(1) The risk management 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 management 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 management.

(3) The risk management 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 24

(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 management 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 management 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, an EU parent credit institution with a head office in the RC or a parent financial holding company and a parent mixed financial holding company authorised and approved, respectively in accordance with the Credit Institutions Act and the designated entity in accordance with Article 89, paragraph (2), item (3) of the Credit Institutions Act, 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 the subsidiaries and branches inform thereof the head of the compliance function or the head of the compliance function of an RC parent credit institution, an EU parent credit institution having its head office in the RC, a parent financial holding company or a parent mixed financial holding company or the designated entity.

(4) A credit institution shall take appropriate action against internal or external behaviour that could facilitate or enable fraud, money laundering or terrorist financing or other financial crime and breaches of discipline (e.g., breaches of internal procedures, breaches of limits, etc.).

Activities of the internal audit function

Article 25

(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.

(2) Each entity within the group of credit institutions in the RC shall fall within the scope of internal audit function activities.

(3) A credit institution shall ensure that the internal audit function assesses whether the internal controls mechanism 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 22, 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 management 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 XI, Chapter III 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.
- (4) 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.

Internal control function work reports

Article 26

- (1) Internal control functions shall prepare work reports.
- (2) Depending on the internal control function's activities, internal 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 mechanism 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 management 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 internal control function work report shall be signed by the head of the relevant internal control function.
- (6) A credit institution shall deliver the internal 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 27

- (1) A credit institution shall ensure that decisions on risk assumption are adopted based on appropriate and clearly defined criteria and complete information.
- (2) A credit institution shall determine the key employees and their deputies to be involved in the risk management system.
- (3) 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.
- (4) 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.
- (5) A credit institution shall regularly measure and assess the risks it has identified in its operations and the risk measurement or assessment procedures shall 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.
- (6) The measurement and assessment of risk exposure referred to in paragraph (5) of this Article 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 acts, 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 28

(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 and use not only quantitative information or model results but also 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 29

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 30

(1) A credit institution shall establish 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; and
- 2) determining adequate value adjustments and provisions.

(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 borrowers, 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.

(7) A credit institution shall conduct an *ex ante* assessment of any crypto-asset exposure they intend to take on and of the adequacy of existing processes and procedures to manage counterparty risk and shall report to the Croatian National Bank on those assessments.

Securitisation risks

Article 31

(1) A credit institution shall establish and implement sound policies and procedures for managing the risks arising from securitisation transactions in relation to which the credit institution is investor, originator or sponsor, including reputational risks, such as arise in relation to 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 involving early amortisation provisions shall adopt liquidity plans for resolving the implications of scheduled and early amortisation.

Residual risk

Article 32

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

Concentration risk

Article 33

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

Market risks

Article 34

(1) A credit institution shall establish and implement sound policies and procedures for managing all material 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 fall due before long positions, a credit institution shall take measures against the risk of a shortage of liquidity.

Interest rate risk in the non-trading book

Article 35

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

Operational risk

Article 36

(1) A credit institution shall establish and implement sound policies and procedures for operational risk management, including risks arising from outsourcing arrangements and direct or indirect crypto-assets exposures and exposures to crypto-asset service providers and to cover 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 establish policies and contingency plans and policies and business continuity plans in order to allow the credit institution to keep operating in the event of severe business disruption and limit losses incurred as a consequence of such disruption.

(4) A credit institution shall, within the meaning of paragraph (3) of this Article, also establish ICT policies and business continuity plans and ICT response and recovery plans for the

technology it uses for the communication of information and ensure that those plans are established, tested and managed in accordance with Article 11 of Regulation (EU) 2022/2554 of the European Parliament and of the Council of 14 December 2022 on digital operational resilience for the financial sector and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014, (EU) No 909/2014 and (EU) 2016/1011 (Text with EEA relevance) (OJ L 333, 27. 12. 2022).

Liquidity risk

Article 37

(1) A credit institution shall establish 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 time horizons including intra-day;
- 3) ensure the management of liquidity risk in the domestic currency 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 38

(1) A credit institution shall establish and implement sound policies and procedures for managing the risk of excessive leverage.

(2) 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 obligations.

(3) 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 and 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 39

A credit institution shall establish and implement sound policies and procedures for managing strategic risk, reputation risk, country risk, environmental, social and governance risks, compliance with AML/CTF and other financial crime risks and other risks to which it is or might be exposed in its operation.

Risk-taking and management policies

Article 40

(1) A credit institution shall:

- 1) determine the risk appetite as regards specific risks;
- 2) determine clearly-defined powers and responsibilities to manage risks within a credit institution;
- 3) prescribe 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) set internal limits and controls and other risk containment and monitoring procedures;
- 5) establish and implement procedures and measures in the event of non-compliance with the established policies and procedures, including breaches of internal limits;
- 6) adopt and implement procedures and measures for crisis situations; and
- 7) where applicable, prescribe risk management within the group.

(2) The policies for risk assumption and management 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 (2) 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 41

(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 material 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) Material 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 acts 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 internal 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.
- (6) A credit institution shall identify and assess the money laundering and terrorist financing risks associated with the new product or business practice, and set out the measures that may be taken to mitigate those risks.

Stress testing

Article 42

- (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 establish and implement policies and procedures governing stress testing.
- (3) The risk management 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) 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 and stress testing exercises should include various impact intensities and at least one scenario must include a significant economic recession.

(6) By way of derogation from paragraph (5) of this Article, a credit institution which is not significant need not use scenario analysis, except for liquidity risk exposure.

(7) 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.

(8) 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.

(9) 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.

(10) A credit institution shall adequately document the stress testing procedure and regularly update that documentation.

(11) The internal audit shall include the audit of the stress testing procedure in its work plan.

(12) A credit institution shall ensure that it tests its resilience to long-term negative impacts of ESG factors, both under baseline and adverse scenarios within a given timeframe, starting with climate-related factors.

(13) A credit institution shall include in the stress testing referred to in paragraph (1) a number of ESG scenarios reflecting potential impacts of environmental and social changes and associated public policies on the long-term business environment.

(14) A credit institution shall ensure that in the resilience testing process referred to in paragraph (12) of this Article it uses credible scenarios, based on the scenarios elaborated by international organisations.

V CREDIT RISK MANAGEMENT RULES

Organisational requirements

Article 43

(1) A credit institution shall ensure that the front office function is clearly separated, operationally and organisationally, from the risk management function and the business support function, up to the level of the management board, which does not lead to a conflict of interest and ensures effective management of credit risk.

(2) A credit institution shall establish a documented framework for the credit exposure decision-making process which shall contain a consistent organisational structure for the decision-making process on the granting of credit exposures that ensures:

- 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 borrowers and collateral providers and at the level of the group of clients connected with the borrowers 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 management function.

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

(6) A credit institution shall include ESG risks in credit risk policies and procedures and embed them in the framework for credit risk monitoring by ensuring that their lending policies in respect of individual sectors, which reflect ESG risks, are cascaded down into clear lending criteria available to business lines employees and credit decision-makers.

(7) As regards environmental risks, a credit institution shall include a combination of qualitative and quantitative aspects in its policies and procedures, and based on a significance assessment and a defined risk appetite, it shall determine quantitative indicators of credit risk comprising the most significant client groups, types of collateral and risk mitigation instruments.

Credit process

Article 44

The credit process shall at a minimum include the following:

- 1) a credit exposure granting process;
- 2) a creditworthiness assessment;
- 3) a credit risk exposure analysis;
- 4) an early warning system;
- 5) a treatment of non-performing and forborne exposures;
- 6) a risk assessment process;
- 7) a risk exposure monitoring process;
- 8) the use of ECL requirements;
- 9) a valuation of property collateral; and
- 10) the content of and keeping records on credit exposures.

Credit exposure granting process

Article 45

(1) A credit institution shall, prior to granting a credit exposure, based on the loan application of the borrower, analyse that the application is in line with its risk appetite, policies, credit-granting criteria, limits and relevant indicators, as well as with any applicable macroprudential measures.

(2) 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 borrower by means of suitable methods and approaches adequate for the level of risk, the size, type and complexity of the credit product and borrower's type and the timeliness in meeting the obligations to the credit institution and other creditors.

(3) Before granting a credit exposure, a credit institution shall assess the quality, marketability, availability, value and legal certainty 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.

(4) A credit institution shall assess the creditworthiness of the borrower, taking into account its own criteria prescribed in an internal act and the minimum requirements referred to in this Decision and the Decision on the classification of exposures into risk categories and the method of determining credit losses and, where the borrower is a consumer, additional criteria to be taken into account in accordance with consumer protection regulations.

(5) If the borrower is likely to face financial difficulties in meeting the contractual loan obligations, a credit institution shall request from the borrower and/or third parties reliable documentation demonstrating realistic projections of the borrower's ability to maintain solvency.

(6) When analysing the riskiness of an exposure, a credit institution shall primarily take into account the creditworthiness of the borrower and treat, in general, the collateral received for the exposure as the secondary source of repayment.

(7) A credit institution shall establish a policy on eligible collateral and the methodology for collateral valuation, 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.

Creditworthiness assessment

Article 46

- (1) To assess the credit worthiness and risk profile of the borrower, a credit institution shall have sufficient, accurate and up-to-date information.
- (2) A credit institution shall adjust creditworthiness assessment to the specific characteristics of the credit exposure and in particular to the nature, maturity and the interest rate.
- (3) For assessing the borrower's ability to meet its obligations under a contract on credit exposures, a credit institution shall adopt methods and approaches, which may also include models, and the selection of the method should depend at least on risk level, the size and type of credit exposure.
- (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.
- (5) 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 to assess the relevant factors that might affect the borrower's present and future repayment capacity and should avoid inducing undue hardship and over-indebtedness.
- (6) The factors referred to in paragraph (5) of this Article should include at a minimum other servicing obligation, their remaining duration, their interest rates and the outstanding amounts, and repayment behaviour, e.g., evidence of any missed payments and their circumstances.
- (7) If a contract on credit exposure involves any form of guarantees from third parties, a credit institution shall have a sufficient level of information and data necessary to assess the guarantee and, when relevant, the financial position of the guarantor.
- (8) As part of the creditworthiness assessment of consumers and entrepreneurs, a credit institution shall carry out sensitivity analyses reflecting potential negative events in the future that are relevant to the type and purpose of the credit exposure, including at a minimum a reduction in income, an increase in interest rates in cases of variable rate loan agreements; negative amortisation of the loan; and balloon payments or deferred payments of the principal or interest, deterioration in the marketability of the immovable property, and the implication of currency-induced credit risk.
- (9) A credit institution shall adequately document the information and data that lead to credit exposure approval, including the creditworthiness assessment that served as a basis for approving or declining the credit facility and shall maintain this documentation in an accessible form.

Credit risk exposure analysis

Article 47

- (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.

(2) A credit institution shall take into account the analyses referred to in paragraph (1) of this Article when defining the strategies and policies for credit risk assumption and management.

(3) 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 48

(1) A credit institution shall:

- 1) establish, review and where necessary update, 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 quantitative and qualitative early warning 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.

(3) A credit institution shall establish policies and procedures prescribing the activities and processes in the case of activation of early warning indicators.

Treatment of non-performing exposures

Article 49

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

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

- 1) the method of determining, measuring, monitoring, overseeing, reducing and managing non-performing exposures as well as measures to avoid the origination of non-performing exposures in the credit institution's assets;
- 2) established objectives in terms of time and value regarding an efficient management of non-performing exposures and exposures subject to forced collection aimed at reducing the amount of non-performing exposures in a clear, credible and feasible manner for each relevant portfolio;
- 3) an assessment of the operating environment and external conditions;
- 4) strategic objectives of the credit institution for non-performing exposures in short-term, mid-term and long-term periods;
- 5) an implementation of the operational plan for the treatment of non-performing exposures; and
- 6) complete integration of the strategy for the treatment of non-performing exposures in credit institution's management processes, including the regular review, monitoring and independent oversight of such treatment.

(3) In the framework for the treatment referred to in paragraph (1) of this Article, a credit institution shall take account of the provisions aimed at consumer protection and ensure fair treatment of consumers.

(4) A credit institution shall analyse the impact of non-performing exposures on its own funds, risk exposure amount, profitability, liquidity and other business indicators.

(5) A credit institution shall plan its capital adequately to ensure that the level of the available capital is sufficient for a sustainable reduction in non-performing exposures.

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

- 1) hold/forbearance strategy;
- 2) active portfolio strategy for the reduction of non-performing exposures;
- 3) change of type of exposure or collateral, including foreclosure, debt to equity swapping, debt to asset swapping or collateral substitution; and
- 4) different legal options such as pre-bankruptcy and bankruptcy proceedings or out-of-court settlement.

(7) A credit institution shall ensure that the objectives pertaining to non-performing exposures are clearly defined, at a minimum in regard to the time frame, main portfolios and implementation options, as well as realistic, supportable, aligned and that they lead to an actual reduction in non-performing exposures.

(8) A credit institution with increased levels of non-performing exposures shall establish a permanent and efficient function responsible for the monitoring and treatment of non-performing exposures, independent from the activities performed by the front office function.

(9) Within its policies for the treatment of non-performing 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 for non-performing exposures.

(10) Within the treatment of non-performing exposures, a credit institution shall prescribe in its internal act the criteria, procedure and decision-making levels for taking appropriate legal actions necessary for the activation and liquidation of the collateral.

Treatment of forborne credit exposures

Article 50

(1) A credit institution shall establish and implement policies for the treatment of forborne credit exposures which shall at a minimum include the following:

- 1) the process and procedures for granting forbearance measures, the method of making decisions on forbearance 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 forbearance measures depending on the reasons why credit exposures have been identified as non-performing exposures;
- 3) a description of available forbearance measures; and
- 4) information requirements for assessing the viability of forbearance measures;
- 5) documentation on forbearance measures granted;

6) the procedures and indicators for monitoring efficiency and effectiveness of the forbearance measures.

(2) A credit institution shall monitor the efficiency of the forbearance measures granted and based on the performance results of implemented forbearance measures, regularly review and update policies for the treatment of forbore credit exposures.

(3) Prior to granting a forbearance decision, a credit institution shall assess the economic justification of granting forbearance of credit exposures to an individual borrower or a group of borrowers with similar economic characteristics. If such forbearance of credit exposures is economically justified, the credit institution shall establish an adequate forbearance plan and monitor its implementation and effects.

(4) When determining whether the granting of forbearance of credit exposures to an individual borrower or a group of borrowers is economically justified, a credit institution shall obtain:

- 1) a detailed analysis of the reasons that led to difficulties in the operation of the borrower or, where applicable, a group of borrowers;
- 2) a plan for the operational, financial and ownership restructuring of the borrower; and
- 3) a cash flow projection for the period defined in the forbearance 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 forbearance of the borrower, where applicable;
- 2) an analysis of possible methods of credit exposure forbearance 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 forbearance plan.

(6) Prior to approval of any forbearance measure, a credit institution shall assess the creditworthiness of a borrower or, where applicable, a group of borrowers.

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

(8) A credit institution shall distinguish between renegotiations or rollovers granted to borrowers not in financial difficulties and will not likely be in financial difficulties, and forbearance measures, such as concessions under Article 47b of Regulation (EU) No 575/2013 granted to a borrower who is, or will likely be in financial difficulties.

Credit risk assessment procedure

Article 51

(1) A credit institution shall establish sound procedures and systems to adequately identify, measure, assess, monitor and report on credit risk and reduce its level and to that end it shall establish, document and implement policies that include methodologies, procedures and controls for assessing and measuring credit risk of all exposures subject to credit risk measurement.

(2) A credit institution shall ensure that the determination of loss allowances for expected credit losses is based on the policies and methodologies referred to in paragraph (1) and that it leads to an accurate and timely recognition of ECLs in accordance with IFRS 9.

(3) A credit institution shall ensure that the total amount of provisions is adequate and complies with the IFRS 9 targets and that it adequately captures the ECL within that framework, taking account of the relevant factors and expectations on the reporting day that might affect the recoverability of the remaining cash flows over the life of an individual exposure or a group of exposures, examine data beyond historic and existing data and take into account reasonable and supportable forward-looking information, including macroeconomic factors relevant for the exposures in question in accordance with IFRS 9.

Credit risk monitoring process

Article 52

(1) A credit institution shall establish a robust and effective credit exposure monitoring framework ensuring relevant and up-to-date information on credit risk exposure, borrower, group of persons connected with the borrower and the quality, marketability, availability, value and legal certainty of the collateral as well as the fulfilment of the contract on credit exposures during the legal relationship giving rise to credit exposure.

(2) A credit institution shall monitor borrower's compliance with contractual covenants and, when the credits have been granted for designated purposes, monitor whether the funds placed have been used exclusively for these purposes.

(3) 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 borrower or collateral provider deteriorates.

(4) 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.

(5) A credit institution shall perform regular credit reviews of borrowers' risk exposures and review and update all the relevant credit information in accordance with borrower's type and profile and the type, size and complexity of the credit facility.

(6) 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.

Implementation of ECL requirements

Article 53

(1) For the purposes of this Article, exposure means loans, loan commitments and financial guarantee contracts to which an ECL framework applies.

(2) A credit institution shall regularly, and at least on a quarterly basis, examine if there has been a significant increase in credit risk exposure since the initial recognition.

(3) If, at the reporting date, the credit risk on an exposure, which is subject to credit risk measuring, has not increased significantly since initial recognition, the credit institution shall measure provisions for the impairment for these exposures in accordance with paragraph 5.5.5 of IFRS 9, where the amount of these provisions always has to reflect the possibility that a

credit loss will occur in accordance with paragraphs 5.5.17 and 5.5.18 of IFRS 9 and a nil allowance may occur only in exceptional cases.

(4) A credit institution shall adopt an active approach to the assessing and measuring of a 12-month ECL, that enables a timely identification of changes in credit risk and a timely recognition of these changes in the ECL, while the assessment of the amount and time of a 12-month ECL should be an unbiased probability-weighted estimate of ECL that is determined by evaluating a range of possible outcomes.

(5) A credit institution shall, in accordance with paragraph 5.5.9 of IFRS 9, consider the change in the risk of default occurring over the expected life of the exposure to assess if the exposure should move to a lifetime ECL measure.

(6) When assessing a significant increase in credit risk since initial recognition in accordance with paragraph B5.5.17 of IFRS 9, a credit institution shall consider a wide range of information, including information on macroeconomic conditions, the economic sector and geographical region and analyse all reasonable and supportable forward-looking information for key drivers of credit risk in their exposures and portfolios, which are available and relevant in accordance with the need to achieve a high-quality, robust and consistent implementation of the accounting requirements while taking into account historic data and information on the current conditions so as to be able to quantify credit risks in each of its exposures or portfolios based on these data and projections.

(7) A credit institution shall, in accordance with paragraph B5.5.2. of IFRS 9, consider recognising lifetime expected credit losses before an exposure, which is subject to credit risk measuring, becomes past due, i.e., before any objective evidence of delinquency appears in exposures affected.

(8) A credit institution shall establish an internal act prescribing the criteria for a significant increase in credit risk for various types of exposures, which are subject to credit risk measuring in accordance with paragraph 5.5.9 of IFRS 9.

(9) When selecting the criteria for a significant increase in credit risk, a credit institution shall consider each of the 16 classes of indicators listed in paragraph B5.5.17., items (a) to (p) of IFRS 9 to the extent they are relevant for exposure that is being assessed and consider if there is any other information that should be taken into account.

(10) A credit institution may use the more-than-30-days-past-due rebuttable presumption only as a backstop measure, but not as a primary indicator of transfer to lifetime ECL.

(11) Where a credit institution considers that the more-than-30-days-past-due presumption referred to in paragraph (10) of this Article is rebutted in a specific case on the basis that there has not been a significant increase in credit risk despite the more-than-30-days-past-due status, the credit institution shall substantiate this by a thorough analysis that should take into account current, reasonable and supportable forward-looking information.

Valuation of collateral

Article 54

(1) A credit institution shall establish and regularly update a policy and procedures for the valuation of collateral in the form of immovable and movable property and ensure compliance with its framework for risk appetite.

(2) A credit institution shall develop and implement the policy and procedures referred to in paragraph (1) of this Article by ensuring:

- 1) compliance with the applicable international, European and national standards;
- 2) the independence of the quality assurance procedure carried out by the function responsible for the monitoring and reassessment of collateral from the function conducting the initial valuation, the processing of the borrower's application and the monitoring of credit exposure and the approval process;
- 3) the independence of the external appraiser selection process;
- 4) the review of internal and external valuations with market indicators;
- 5) regular back-testing of internal and external valuations;
- 6) the quality assurance process on an appropriate sample size.

(3) A credit institution shall ensure that the valuation of collateral is carried out at the point of origination and that the value of all collateral in the form of immovable property is assessed by an internal or external valuer using full visit to the property, with internal and external assessment of the property.

Content of and keeping records on credit exposures

Article 55

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

- 1) basic data on borrowers (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 borrower with other persons in case a borrower 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 borrowers and creditors of every borrower to whom credit institution's exposure is individually significant;
- 4) where applicable, financial reports of a borrower for the last three years;
- 5) an analysis and assessment of a financial and economic position of a borrower, including internal rating of a borrower;
- 6) for individually significant exposures, evidence, if any, of impairment of borrower's financial assets, analysis and assessment of borrower'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 borrower 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 50 of this Decision; and
- 13) other documentation that may complement the information on the borrower'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.

Processing of personal data

Article 56

(1) When assessing the borrower'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 borrower's creditworthiness and timeliness in meeting obligations.

(2) When assessing the borrower'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 borrower should be proportionate to the risk arising for the credit institution from that credit exposure.

(4) The scope of data referred to in paragraph (3) of this Article 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 55 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 57

(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 borrower's creditworthiness. The criteria shall at a minimum include an assessment of a significant increase in the debt repayment amount in case of major 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 borrower'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 borrowers 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 borrower'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 58

- (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, activity or the application of credit risk mitigation techniques; and
 - 3) concentration of exposures or collateral by individual counterparties, interdependent counterparties or in specific industries, economic sectors or geographical regions that may have a higher degree of sensitivity to ESG risks; and
 - 4) 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 59

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 60

- (1) A credit institution shall ensure that the front office function is clearly separated, operationally and organisationally, from the risk management 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 61

- (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 act 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) Where transactions are contracted by telephone, a credit institution shall ensure that all telephone conversations of the employees authorised to contract transaction are recorded.
- (5) 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.
- (6) The certificate for the contractual transaction and the accompanying documentation are to be forwarded to the treasury back office function in the shortest possible time.
- (7) The transactions concluded after the working hours of the treasury back office function must be specifically marked and included in the daily trading position.
- (8) A credit institution shall ensure that the employees authorised to contract transactions enter transaction data into the information system using their own identification marks.
- (9) The time of data entry and employee identification mark referred to in paragraph (8) of this Article shall be automatically generated.
- (10) A credit institution shall:
- 1) conduct an *ex ante* assessment of any crypto-asset exposure it intends to take;
 - 2) conduct an assessment of the adequacy of the existing processes and procedures for market risk management and notify the Croatian National Bank of those assessments.

Transaction recording and control

Article 62

- (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.
- (3) 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.
- (4) A credit institution shall establish the regular control of the transaction contracting process, including the control of:
 - 1) the integrity of the contractual transaction documentation and the timely transmission of the documentation 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 63

(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) the 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) the complexity of financial instruments (e.g. OTC derivatives or instruments valued using mark- to-model techniques);
- 8) embedded options;
- 9) profit and capital simulations under various scenarios, including the maximum loss quantification under extreme market conditions; and
- 10) the impact of ESG risks on the value of financial instruments in its portfolio, an estimate of the potential risk of losses for the portfolio and the increased volatility of the portfolio's value.

(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 the carrying values of the credit institution's foreign exchange positions arising from changes in the exchange rate of a foreign currency.

(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 64

(1) The monitoring of the 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.

(3) The structure of the limits referred to in paragraph (1) of this Article shall be based on an assessment of the level of risk and the maximum permitted losses.

(4) A credit institution shall ensure that the limits are adjusted on a regular basis in accordance with stress testing results.

(5) The limits referred to in paragraph (1) of this Article shall apply to each contractual transaction.

(6) 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.

(7) 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 recognised and included in a daily report on limits without delay.

(8) 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.

(9) 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.

(10) A credit institution shall monitor the excesses of the limits on a daily basis, during and at the end of the working hours.

(11) 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 RULES ON THE MANAGEMENT OF INTEREST RATE RISK ARISING FROM NON-TRADING BOOK ACTIVITIES

IRRBB management system

Article 65

The IRRBB management system shall include at least the following:

- 1) an overall strategy for the management of IRRBB;
- 2) written policies and procedures for the management of IRRBB;
- 3) systems used by the credit institution to identify, assess and manage IRRBB; and
- 4) systems of limits that ensure that IRRBB exposures are consistent with the credit institution's risk appetite and the overall approach to IRRBB measurement and management.

Terms specific for IRRBB

Article 66

For the purposes of IRRBB measurement and management, the following terms shall have the following meaning:

- 1) '*interest rate sensitive instruments*' means assets, liabilities and off-balance-sheet items in the non-trading book, excluding assets deducted from common equity tier 1 (CET1) capital;
- 2) '*net interest income measures*' means the measures of changes in expected future profitability within a given time horizon resulting from interest rate movements, in case of IRRBB; or from credit spread changes, in case of CRSBB; '*net interest income measures*' encompass interest income and interest expenses;
- 3) '*economic value (EV) measures*' means measures of changes in the net present value of the interest rate sensitive instruments over their remaining life resulting from interest rate movements. EV measures reflect changes in value over the remaining life of the interest rate sensitive instruments, i.e., until all positions have run off;
- 4) '*economic value of equity (EVE) measures*' means a specific form of EV measure where equity is excluded from the cash flows;
- 5) '*conditional cash flow modelling*' means cash flow modelling under the assumption that the timing and amount of cash flows is dependent on the specific interest rate scenario, i.e., it is assumed that the timing of cash flows of options, of instruments with embedded, explicit options and of instruments of which the maturity depends on clients' behaviour, is modelled conditional on the interest rate scenario;
- 6) '*unconditional cash flow modelling*' means cash flow modelling under the assumption that the timing and amount of cash flows is independent of the specific interest rate scenario;
- 7) '*run-off balance sheet*' means a balance sheet where existing non-trading book positions amortise and are not replaced by any new business;
- 8) '*dynamic balance sheet*' means a balance sheet incorporating future business expectations, adjusted for the relevant scenario in a consistent manner;
- 9) '*constant balance sheet*' means a balance sheet including off-balance-sheet items in which the total size and composition are maintained by replacing maturing or repricing cash flows with new cash flows that have identical features with regard to the amount, repricing period and spread components;

- 10) '*credit spread sensitive instruments*' encompass assets, liabilities and off-balance-sheet items in the non-trading book, which are sensitive to credit spread changes (excluding assets deducted from common equity tier1 capital (CET1), e.g., real estate or intangible assets or equity exposures in the non-trading book).

Overall strategy for the management of IRRBB

Article 67

(1) A credit institution shall identify its existing and prospective exposure to IRRBB and CSRBB in a proportionate manner, depending on the level, complexity and riskiness of the non-trading book positions it faces, or an increasing risk profile taking into account its business model, its strategies and the business environment it operates in or intends to operate in.

(2) A credit institution shall monitor and assess its CSRBB-affected exposures, by reference to the asset side of the non-trading book, where CSRBB is relevant for the risk profile of the credit institution. For the purposes of this paragraph, 'asset side' includes only fair value assets, unless the credit institution proves that the risk is also present in other asset items in the non-trading book.

(3) An RC parent credit institution and an EU parent credit institution having its head office in the RC, a parent financial holding company, a parent mixed financial holding company or the designated entity shall ensure that internal governance arrangements and processes for the management of IRRBB are consistent and well-integrated on a consolidated and a sub-consolidated basis.

Responsibilities of the management board

Article 68

(1) Regarding the IRRBB management process, a credit institution's management board shall:

- 1) establish a system to take appropriate actions to identify, measure, monitor and control IRRBB, consistent with the approved strategies and policies by setting:
 - 1) appropriate limits on IRRBB, including ensuring compliance with those limits, and procedures for approvals of necessary exceptions;
 - 2) systems and standards for measuring IRRBB, valuing positions and assessing performance, including procedures for updating interest rate shock and stress scenarios and key underlying assumptions driving the IRRBB analysis;
 - 3) a comprehensive IRRBB reporting and review process; and
 - 4) effective internal controls and management information systems (MISs);
- 2) approve major hedging or risk-taking initiatives in advance of implementation; positions related to internal risk transfers between the non-trading book and the trading book should be properly documented;
- 3) establish a system of regular reporting to the management board, at least quarterly, on the level and changes in the credit institution's IRRBB exposure; and
- 4) ensure that the validation of IRRBB measurement methods and assessment of corresponding model risk are included in the policies reviewed and approved by the management board.

(2) A credit institution's management board may designate an organisational unit, committee or employees responsible for IRRBB control and management and it shall ensure that senior management, expert individuals or an asset and liability management committee (ALCO)

designated for the actions referred to in paragraph (1) of this Article are appointed in a documented, clear and transparent manner and it shall set them clear objectives and responsibilities.

(3) A credit institution's management board shall ensure that the IRRBB identification, measurement, monitoring and control functions have clearly defined responsibilities, and that they are independent from risk-taking functions on IRRBB and report IRRBB exposures directly to the management board or the persons referred to in paragraph (2) of this Article.

Risk appetite

Article 69

(1) A credit institution's management board shall adopt clearly defined IRRBB appetite statements as the acceptable impact of interest rate fluctuations on both IRRB measures and implement them through a comprehensive risk appetite framework, i.e., policies and procedures for limiting and controlling IRRBB, and the risk appetite in terms of IRRBB should be reflected in limits.

(2) In its risk appetite frameworks, a credit institution shall delineate and approve delegated powers, lines of responsibility for IRRBB management decisions and it shall list the instruments, hedging strategies and risk-taking opportunities authorised for IRRBB.

(3) In defining its risk appetite, a credit institution shall take account of net interest income risks that may arise as a consequence of the accounting treatment of transactions in the non-trading book. The risk should not be limited to interest income and expenses but should also include the effects of changes in interest rates on the market value of instruments.

System of limits

Article 70

(1) A credit institution shall establish limits that target maintaining IRRBB exposures consistent with its risk appetite and with its overall approach for measuring IRRBB, in particular the following:

- 1) policy limits appropriate to the nature, size, complexity and capital adequacy of the credit institution, as well as its ability to measure and manage its risks;
- 2) aggregate limits that clearly articulate the acceptable amount of IRRBB should be applied on a consolidated basis and, as appropriate, at the level of individual affiliates;
- 3) systems to ensure that positions that exceed, or are likely to exceed established limits receive prompt management attention and are escalated without delay; there should be a clear policy on who will be informed, how the communication will take place and the actions which will be taken in response; and
- 4) depending on the nature of the institution's activities and business model, sub-limits may also be identified for individual business units, portfolios, types of instruments, specific instruments or material sub-classes of IRRBB risks, such as gap risk, basis risk and option risk.

(2) The reporting of risk measures to the management board should have at least a quarterly frequency and should compare current exposure with policy limits.

(3) A credit institution shall establish and monitor the framework of hedging strategies that use instruments such as derivatives and to control mark-to-market risks in instruments that are accounted for at fair value.

Policies and processes for the management of IRRBB

Article 71

(1) A credit institution's management board shall, based on its overall IRRBB strategy, establish robust IRRBB policies, processes and systems which should ensure that:

- 1) procedures for updating scenarios for the measurement and assessment of IRRBB are set up;
- 2) the measurement approach and the corresponding assumptions for measuring and assessing IRRBB, including the allocation of internal capital to IRRBB risks, are appropriate and proportional;
- 3) the assumptions of the models used are regularly reviewed and, if necessary, amended;
- 4) standards for the evaluation of positions and the measuring of performance are defined;
- 5) appropriate documentation and control over permissible hedging strategies and hedging instruments exist; and
- 6) the lines of authority and responsibility for managing IRRBB exposures are defined.

(2) The policies should be well reasoned, robust and documented and should address all IRRBB components that are important to the institution's individual circumstances and should include the following:

- 1) the application of the boundary between 'non-trading book' and 'trading book'; internal risk transfers between the non-trading book and the trading book should be properly documented and monitored within the broader monitoring of the IRRBB originated by interest rate derivatives instruments;
- 2) the more detailed definition of economic value and its consistency with the method used to value assets and liabilities (e.g., based on the discounted value of future cash flows, and on the discounted value of future net interest income) adopted for internal use;
- 3) the more detailed definition of net interest income measures plus market value changes and its consistency with the credit institution's approach to developing financial plans and financial forecasts adopted for internal use;
- 4) the size and the form of the different interest rate shocks to be used for internal IRRBB calculations;
- 5) the use of conditional or unconditional cash flow modelling approaches;
- 6) the treatment of 'pipeline transactions' (including any related hedging);
- 7) the aggregation of multicurrency interest rate exposures;
- 8) the measurement and management of basis risk resulting from different interest rate indexes;
- 9) the treatment of non-interest-bearing assets and liabilities of the non-trading book (including capital and reserves) in calculations measuring IRRBB for the internal capital adequacy assessment process (ICAAP);
- 10) the behavioural treatment of current and savings accounts;

- 11) the measurement of IRRBB arising from behavioural and automatic options in assets or liabilities, including convexity effects and non-linear payoff profiles;
- 12) the degree of granularity employed in measurement calculations (e.g., use of time buckets); and
- 13) the internal definition of commercial margins and adequate methodology for internal treatment of commercial margins.

(3) A credit institution shall review all IRRBB policies, at least annually, and revise them as needed.

IRRBB measurement

Article 72

(1) A credit institution shall establish robust internal measurement systems (hereinafter referred to as 'IMSs') that capture all components and sources of IRRBB which are relevant for its business model.

(2) A credit institution shall measure its exposure to IRRBB in terms of potential changes to both the economic value and net interest income measures plus market value changes. A credit institution shall use complementary features of both approaches to capture the complex nature of IRRBB over the short-term and long-term time horizons. In particular, a credit institution shall measure and monitor:

- 1) the overall impact of key modelling assumptions on the measurement of IRRBB across different IRRBB measures; and
- 2) the IRRBB of their non-trading book interest rate derivatives where relevant for the business model.

(3) If a credit institution excludes commercial margins and other spread components from economic value measures, it shall use:

- 1) a transparent methodology for identifying the risk-free rate at inception of each instrument; and
- 2) a methodology that is applied consistently across all interest rate sensitive instruments and all business units.

(4) A credit institution shall include commercial margins when calculating net interest income measures.

(5) A credit institution shall include non-performing exposures (net of impairment and provisions) in interest rate sensitive instruments reflecting expected cash flows and their timing.

(6) When measuring its exposure to IRRBB, a credit institution shall develop and use its own assumptions and calculation methods and may not purely rely on the calculation and outcomes of the supervisory outlier tests.

(7) A credit institution shall perform the measurement at least quarterly and more frequently in times of increased interest rate volatility or increased IRRBB levels.

(8) When measuring IRRBB, a credit institution shall fully understand and document key behavioural and modelling assumptions. These assumptions should be aligned with business strategies and be tested at least annually.

(9) A credit institution shall review at least annually key measuring assumptions, such as characteristics of non-maturity deposits (hereinafter referred to as 'NMDs'), prepayments on

fixed rate loans, early withdrawals of fixed term deposits, drawing of commitments, currency aggregation and treatment of commercial margins, and more frequently under rapidly changing market conditions.

Internal reporting

Article 73

(1) A credit institution shall ensure that internal risk-reporting systems provide timely, accurate and comprehensive information about its exposures to IRRBB. Internal reports shall be delivered to the management board and senior management at least quarterly. A credit institution shall regularly review the accuracy of these reports.

(2) The reports referred to in paragraph (1) of this Article should contain information at relevant levels of aggregation (by consolidation level and currency) and a level of information adapted to the particular management level and to the specific situation of the credit institution and the economic environment. The reports should include at least the following:

- 1) summaries of the aggregate IRRBB exposures, including information on exposures to gap, basis and option risk; the reports should contain explanations of all major assets, liabilities, cash flows, and strategies that are driving the level and direction of IRRBB;
- 2) compliance with policies and limits;
- 3) key model assumptions;
- 4) details of the impact of key model assumptions on the measurement of IRRBB, including changes in assumptions under various interest rate scenarios;
- 5) details of the impact of interest rate derivatives on the measurement of IRRBB;
- 6) details of the impact of fair value instruments, including Level 3 assets and liabilities as defined by the International Financial Reporting Standard 13 Fair Value Measurement (IFRS 13), on the measurement of IRRBB;
- 7) results of stress tests; and
- 8) summaries of the reviews of IRRBB policies, procedures and adequacy of the measurement systems, including any findings of internal and external auditors or other equivalent external parties.

(3) The reports referred to in paragraph (1) of this Article should, on a regular basis, include the results of the model reviews and audits as well as comparisons of past forecasts or risk estimates with actual results to inform potential modelling shortcomings.

VIII OPERATIONAL RISK MANAGEMENT RULES

Governance arrangements

Article 74

(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 75

(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 76

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

- 1) conduct risk;
- 2) information system risk;
- 3) model risk;
- 4) business changes, including new products, activities, processes and systems;
- 5) risk occurring in project management;
- 6) risks arising from outsourcing;
- 7) significant risks inherent in the existing products, activities, processes and systems; and
- 8) legal risk.

(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.

(4) A credit institution shall include significant ESG risks in its operational risk management framework and consider how ESG risks could affect different types of regulatory operational risk events referred to in Article 324 of Regulation (EU) No. 575/2013 and the ability of the credit institution to continue to provide key operations.

Analysis of significant losses

Article 77

(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 78

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 79

(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.

(3) For the purpose of carrying out the activities referred to in paragraph (1) of this Article, a credit institution shall:

- 1) analyse risk factors for and its exposure to severe business disruptions or discontinuation and assess their potential impact using internal and/or external data and scenario analysis; and
- 2) cover in analysis all business lines and organisational units, including the risk management, and take into account their interdependency.

Business continuity plan

Article 80

(1) Based on the activities referred to in Article 79, 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 a general recovery plan in accordance with the decision on recovery plans of credit institutions.

(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 81

(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 80, 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 80, paragraph (1) of this Decision, without delay notify the Croatian National Bank of all the relevant facts and circumstances pertaining to that matter.

IX LIQUIDITY RISK MANAGEMENT RULES

Governance arrangements

Article 82

(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;
- 5) ensuring diversification of the structure of funding and access to sources of funding;
- 6) the impact of ESG risks on net cash outflows (e.g., increased drawdowns of credit lines) or on the value of assets constituting their liquidity buffers and, if necessary, include these effects in the calibration of their liquidity buffers or liquidity risk management framework;
- 7) in relation to environmental risks, their impact on the availability and/or stability of funding sources.

(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, the European Economic Area (EEA), 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 acts the criteria for identification of other legal persons that are professional participants.

(5) For the purposes of this Title, 'professional participant in the money market' means a financial institution, pension fund, investment fund, insurance or reinsurance undertaking or other legal person, except credit institutions, who, for the purpose of managing own funds, participates in the money market in a manner and at a frequency comparable to the activities of credit institutions, and this shall imply those legal persons who, on a daily basis or frequently, offer binding quotations or offers of funds in amounts that are significant in relation to total realised volumes 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 the credit institution in dealing with other clients.

(6) 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.

(7) A credit institution's senior management shall, in addition to the requirements prescribed in Article 29 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 83

(1) Liquidity risk management policies of a credit institution shall, in addition to the requirements prescribed in Article 40 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 the domestic currency 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 84

(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 management 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 85

(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.

(2) A credit institution shall take into account the accepted clearing and settlement standards and the timeframe used in determining cash flows on individual dates.

(3) A credit institution shall regularly examine the close interaction between funding liquidity risk and market liquidity risk and it shall 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.

(4) A credit institution shall manage liquidity risk during relevant periods, including intraday, to ensure that adequate levels of liquidity buffers are maintained.

(5) 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, and there must be no legal or operational impediments to the use of these funds.

(6) A credit institution shall ensure liquidity risk management in different timeframes and 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.

(7) A credit institution shall regularly check the accuracy of input data used in liquidity position calculation.

(8) 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.

(9) A credit institution shall monitor the eligibility of the collateral instruments referred to in paragraph (8) for their timely use, and especially for use in contingent situations.

(10) 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 86

(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 87

(1) In addition to the requirements referred to in Article 42 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.

(2) The alternative scenarios referred to in item (4), paragraph (1) of this Article shall 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.

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

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

(5) 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.

(6) 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.

(7) 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, establishing 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 88

(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 87 of this Decision, and it shall notify senior management thereof, which shall establish 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, and these 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.

X ESG RISK MANAGEMENT RULES

Governance arrangements and materiality assessment

Article 89

(1) A credit institution shall, in accordance with Articles 181 and 182 of the Credit Institutions Act, as part of its governance arrangements, including its risk management framework, establish robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of ESG risks in the short, medium and long term.

(2) As regards ESG risks, a credit institution shall adjust the governance and risk management procedures referred to in paragraph (1) of this Article with the objectives set out in the ESG plans adopted in accordance with the provisions of Article 183, paragraph (1), item (4) and paragraph (2), item (4) of the same Article of the Credit Institutions Act.

(3) For the purpose of applying paragraph (1) of this Article, a credit institution and a small and non-complex credit institution shall carry out at least every year or every two years, respectively, an assessment of the materiality of ESG risks. However, a credit institution, including a small and non-complex credit institution, shall update its assessment more frequently if there is a significant change in its business environment related to ESG factors, such as important new public policies or changes in the credit institution's business model, portfolio or business.

(4) The strategies, policies, processes and systems referred to in paragraph (1) of this Article, as well as the risk materiality assessment itself, shall be proportionate to the scale, nature and complexity of the ESG risks of the business model and the scope of the credit institution's activities, exposures to ESG risks and consider the short and medium term and a long-term time horizon of at least 10 years.

(5) A credit institution shall consider the impact of ESG risks on all traditional categories of financial risks to which it is exposed, including credit, market, liquidity, operational (including litigation), reputation risk, business model and concentration risk.

(6) A credit institution shall include ESG risks, which are part of its risk inventory, in its risk appetite, which should be aligned with the credit institution's strategic objectives and obligations and ESG plans in accordance with the provisions of Article 183, paragraph (1), item (4) and paragraph (2), item (4) of the same Article of the Credit Institutions Act.

(7) A credit institution shall ensure that all relevant risk-bearing group entities and business lines and units properly understand and apply the defined risk appetite in terms of ESG risks.

(8) A credit institution shall ensure continuous training of employees and promotion of knowledge with a view to understanding the consequences of ESG factors, i.e., ESG risks, and raising awareness of the credit institution's strategic objectives and obligations in terms of ESG risks and the adoption and implementation of ESG plans, i.e., the development and implementation of the transition planning process.

(9) A credit institution shall monitor ESG risks on an ongoing basis through internal reporting systems, for example by including ESG risks in regular risk reports or by means of indicators that support effective monitoring, with a view to transmitting appropriate information and aggregated data on ESG risks to senior management and the management body.

ESG plans

Article 90

(1) A credit institution shall ensure that its ESG plans are forward-looking and include general objectives, measures and specific objectives in terms of the credit institution's business model and strategy and that, where applicable, they are compliant with other applicable requirements, for example where a credit institution is required to disclose information on ESG matters in accordance with Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29. 6. 2013), ESG plans in accordance with Article 183, paragraph (1), item (4) and paragraph (2), item (4) of the same Article of the Credit Institutions Act shall be consistent with the plans referred to in Article 19a or 29a of Directive 2013/36 and shall

include activities relating to the credit institution's business model and strategy that are consistent with both plans.

(2) The quantifiable targets and processes to address the ESG risks included in the ESG plans shall consider the latest reports and measures prescribed by the European Scientific Advisory Board on Climate Change, in particular in relation to the achievement of the climate targets of the Union.

(3) A credit institution shall clearly define and assign responsibilities for developing, validating, implementing and monitoring ESG plans, taking into account the interlinkages and impact that the transition planning process could have on other processes, such as the broader business strategy and risk appetite.

Content of the ESG plan

Article 91

(1) A credit institution shall document its ESG plan, including the methodologies, assumptions, criteria, targets and measures planned to achieve the objectives, as well as audits performed and planned, and define the scope of risks covered by each part of that plan.

(2) The ESG plan shall include at least:

1) the strategic objectives and the implementation stages of the plan, including:

- 1) an overarching strategic objective to manage the short, medium and long-term ESG risks, in line with the overall business strategy and risk appetite;
- 2) a comprehensive set of long-term objectives with defined objectives at each intermediate stage to ensure the resilience of the business model to ESG risks, including the alignment of the business structure and revenues with such defined intermediate objectives;
- 3) key assumptions, inputs and supporting information relevant to the understanding of the credit institution's general and specific objectives, including the choice of one or more central or reference scenarios and the credit institution's conclusions stemming from the results of materiality assessments of ESG risks, portfolio alignment assessments and other scenario analyses;

2) specific objectives and indicators, including:

- 1) quantitative objectives for the management of ESG risks, including those resulting from the process of adjustment to legal and regulatory sustainability objectives in the countries where the credit institution operates and broader transition trends towards a sustainable economy, as well as indicators used to monitor ESG risks and progress towards achieving the objectives;
- 2) portfolios, sectors, asset classes, business lines and, where applicable, economic activities (i.e., individual technologies) covered by targets and monitoring metrics, ensuring that the scope of objectives and indicators sufficiently reflects the nature, size and complexity of the credit institution's operations and its materiality assessment of ESG risks;
- 3) time horizons during which objectives and indicators are applied;

3) governance arrangements, including:

- 1) governance structure of the ESG plan (roles and responsibilities for drawing up, validating, implementing, monitoring and updating the ESG plan, including escalation steps in case of deviations from targets);
 - 2) capacity and resource-related activities to ensure adequate knowledge, skills and expertise for the effective implementation of the ESG plan, including training and internal culture on ESG risks;
 - 3) remuneration policies and practices to promote sound management of ESG risks in line with the institution's objectives and risk appetite;
 - 4) data and systems used for the transition planning process;
 - 4) implementation strategy, including:
 - 1) an overview of the short, medium- and long-term actions taken or envisaged as part of core banking activities and processes to achieve the objectives of the ESG plan, including how the credit institution integrates the objectives of the ESG plan into its decision-making process and its regular risk management framework, complemented by information on the observed effectiveness or estimated contribution of each action to the relevant objectives;
 - 2) adapting policies and procedures relating to financial risk categories and to lending and investment policies and conditions relating to key economic activities, sectors and locations;
 - 3) changes introduced in the combination and pricing of services and products to support the implementation of the plan;
 - 4) investments and strategic portfolio allocation supporting the credit institution's business strategy and risk appetite in relation to ESG risks, including information on sustainability-related and transition-related products and services and how any changes in strategic financing choices are accompanied by proportionate risk management processes;
 - 5) an engagement strategy, including:
 - 1) policies for the engagement with counterparties, including information on the frequency, scope and objectives of cooperation, types of possible activities and escalation procedures or criteria;
 - 2) the processes, methodologies and indicators used to collect and assess information related to counterparties' exposures to ESG risks and to compliance with the credit institution's objectives and risk appetite;
 - 3) results of cooperation practices, including an overview of counterparties' adaptability and resilience in the transition to a more sustainable economy.
- (3) By way of derogation from paragraph (2) of this Article, a small and non-complex credit institution and a credit institution that is not a large credit institution shall include in each ESG plan item at least the aspects covered by paragraph (2), item (1), sub-items (1) and (2), item (2), sub-items (1) and (2), item (3), sub-item (1), item (4), sub-items (1) and (2) and item (5), sub-items (1) and (2).

XI MANAGING RISKS ARISING FROM EXPOSURES TO SHADOW BANKING ENTITIES

Definitions

Article 92

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

- 1) '*banking services and activities*' means as defined in Article 2 of the Commission Delegated Regulation (EU) 2023/2779 of 6 September 2023 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria for the identification of shadow banking entities referred to in Article 394(2) of Regulation (EU) No 575/2013 (OJ L, 12. 12. 2023), hereinafter referred to as 'Commission Delegated Regulation (EU) 2023/2779';
- 2) '*exposure 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 equal to or in excess of 0.25% of the credit institution's tier 1 capital as defined in Article 25 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 and Article 493 of Regulation (EU) No 575/2013;
- 3) '*shadow banking entities*' means undertakings as defined in Article 1 of Commission Delegated Regulation (EU) 2023/2779.

Identification of exposures to shadow banking entities

Article 93

(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 establish and implement policies, procedures and other internal acts 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 acts 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
- 9) 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 regulatory technical standard adopted by the European Commission pursuant to Article 4, paragraph (4) of Regulation (EU) No 575/2013 and in particular 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 prescribed by the mentioned regulatory technical standard, 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 acts 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.

(6) A credit institution shall adequately incorporate the policies referred to in paragraph (2) of this Article to the policies referred to in Article 190 of the Credit Institutions Act.

(7) 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.

(8) 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 94

(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 95 and 96 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 95 and 96 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 95

- (1) A credit institution shall set and apply an individual internal limit on exposure to each shadow banking entity relative to its tier 1 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 banking services and activities relative to other business activities of the shadow banking entity;
 - 7) interconnectedness as outlined in Article 93, paragraph (3), item (6) of this Decision; and
 - 8) any other relevant factors identified by the credit institution in accordance with Article 93, 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 96 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 paragraph (2) of this Article.

Aggregate internal limit

Article 96

- (1) A credit institution shall set and apply an aggregate internal limit on total exposure to all shadow banking entities relative to its tier 1 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 93, paragraph (3), item (2) of this Decision and the risk appetite as outlined in Article 93, 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 93, 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 97

- (1) If a credit institution is not able to meet the requirements referred to in Article 93 of this Decision or the requirements referred to in Article 94 of this Decision, it shall set an aggregate internal limit on exposures to shadow banking entities in the amount not exceeding 25% of its tier 1 capital.
- (2) If a credit institution can meet the requirements referred to in Article 93 of this Decision and the requirements referred to in Article 94 of this Decision, but cannot gather sufficient information to enable it to set internal limits referred to in Articles 95 and 96 of this Decision, it shall set the aggregate internal limit on exposures to such entities in the amount not exceeding 25% of its tier 1 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 95 and 96 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 96 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.

XII TRANSITIONAL AND FINAL PROVISIONS

Article 99

- (1) On the date of entry into force of this Decision, the Decision on governance arrangements (Official Gazette 96/2018, 67/2019, 145/2020, 145/2021, 51/2023, 28/2024, and 150/2024) shall cease to have effect.
- (2) This Decision shall be published in the Official Gazette and shall enter into force on the eighth day after the day of its publication.

(3) A credit institution shall adjust its policies and procedures to the provisions of this Decision by 30 June 2026 at the latest.

(4) A small and non-complex credit institution shall adjust its operation to the provisions of Article 89, paragraph (3) and paragraphs (5) to (9) of the same Article, Article 90, paragraph (3) and Article 91 by 11 January 2027 at the latest.

No.: 103-091/03-26/BV
Zagreb, 13 March 2026

Boris Vujčić

Governor