

**Disclosure of information on supervisory measure of 17 February 2023 imposed on credit institution**

<b>Information on person responsible for breach</b>	
<b>Business name and registered office of legal person</b>	Hranilnica Lon d.d. Žanova ulica 3, 4000 Kranj registration number: 5624908000 (hereinafter: the savings bank)
<b>Information on breach</b>	
<b>Description of circumstances and conduct entailing breach of ZBan-3 or Regulation (EU) No 575/2013</b>	Breaches of the ZBan-3 (cited in detail in the operational part of the order below) were identified on the basis of an inspection, as a result of which Banka Slovenije issued the savings bank with the Order on the rectification of breaches with an additional measure referenced PBH-24.50-003/22-003 of 17 February 2023
<b>Nature of identified breaches</b>	Breaches in the area of credit risk management
<p>1. Hranilnica Lon d.d., of Žanova ulica 3, 4000 Kranj, registration number: 5624908000 (hereinafter: the savings bank) has breached the second paragraph of Article 167 of the Banking Act (hereinafter: the ZBan-3) in connection with paragraphs 79, 80 and 81 of the Guidelines on loan origination and monitoring (EBA/GL/2020/06) by failing to provide for sufficient human resources in the Risk Management Division (hereinafter: RMD) to effectively and comprehensively address and manage credit risk in the processes of credit origination, credit decision-making, credit monitoring, and monitoring and revaluation of real estate collateral, in that:</p> <ul style="list-style-type: none"> <li>– employees at the RMD do not have the requisite level of knowledge and experience in the functioning of the credit assessment system and the methodologies for creating collective impairments, and fail to provide for accurate annual updates of customer credit ratings and the regular assessment of individual impairments;</li> <li>– the savings bank performs asset valuation tasks via persons who lack the requisite knowledge and experience, and who are simultaneously involved in the credit origination process and participate in the collateral revaluation process; and</li> <li>– the savings bank failed to provide in-house training in the wake of the introduction of Guidelines EBA/GL/2020/06 for all employees involved in the credit process.</li> </ul> <p>To rectify the breaches the savings bank must provide for adequate human resources and must strengthen the role of the RMD in the credit process in a way that ensures the adequate management of credit risk in the processes of credit origination, credit decision-making, credit monitoring, and monitoring and revaluation of real estate collateral, and the annual updating of customer credit ratings and assessment of individual impairments. The savings bank must ensure that employees involved in credit origination have an adequate level of knowledge, experience and competence, to which end it must provide frequent and appropriate employee training.</p> <p>2. The savings bank has breached the first paragraph of Article 172 of the ZBan-3 in connection with the fourth paragraph of Article 4 of the Regulation on credit risk management, by failing to use suitable and precisely defined criteria to decide on credit origination, in that:</p> <ul style="list-style-type: none"> <li>– it fails to implement internal policies, strategies and credit origination conditions (as identified in 33 of the total of 42 loans reviewed, which means that 78.6% of the sample deviated from the</li> </ul>	

prescribed conditions);

- it fails to document, substantiate and keep records of all deviations from the lending conditions, as set out by the Credit Risk Management Policy (DUT/332/2021/3.0).

The savings bank must ensure and maintain compliance with the requirements set out in Article 4 of the Regulation on credit risk management, and to rectify the identified breaches must put in place rules and procedures from which it is clear that lending that does not comply with the policy and the prescribed conditions may only be proposed in exceptional cases. It must document and substantiate lending of this type, and must ensure that the circumstances and conditions during its origination are monitored.

3. The savings bank has breached the second paragraph in connection with the first paragraph of Article 172 of the ZBan-3, with the second paragraph of Article 5 of the Regulation on credit risk management, and with paragraphs 122 and 145 of Guidelines EBA/GL/2020/06, by failing to apply consistently defined criteria for deciding on credit origination, the credit risk culture, and the risk appetite, in that:

- it uses revolving loans contrary to their nature and purpose;
- it assesses the creditworthiness of natural persons contrary to the defined criteria;
- it originates credit and allows its drawdown before collateral arrangements are in place;
- it originates credit without the borrower committing their own resources;
- it originates credit in large amounts relative to the size and financial capacity of the borrower;
- it originates credit without all of the conditions for the successful execution of the financed investment being met at the time of origination.

The savings bank must put in place and consistently apply suitable and precisely defined criteria for deciding on credit origination with regard to its own credit risk culture and risk appetite, as proceeds from the second paragraph of Article 5 of the Regulation on credit risk management, and must bring itself into compliance with paragraphs 122 and 145 of Guidelines EBA/GL/2020/06.

4. The savings bank has breached the third paragraph of Article 173 of the ZBan-3 by failing to monitor the transactions of entities and the quality of the collateral for the entire duration of the exposure, in that:

- a. in connection with paragraph 258 of Guidelines EBA/GL/2020/06, the process and frequency of the review of borrowers are not specific and proportionate to the type and risk profile of the borrower and the type, size and complexity of the credit facility, and are not specified in relevant policies and procedures (identified with regard to customer ID 81456 in the reviewed sample of customers);
- b. in connection with Article 16 of the Regulation on credit risk management, in the credit origination and monitoring process it improperly assigns credit ratings in the case of special types of financing, including the financing of newly established SPVs, and fails to take account of all significant and up-to-date information when classifying customers (identified with regard to customer ID 80594 in the reviewed sample of customers);
- c. in connection with the first paragraph of Article 178 of the CRR, as a result of irregular monitoring it fails to identify cases where default has occurred and where the debtor is unlikely

to repay their credit obligations to the institution without recourse by the institution to actions such as realising security (identified with regard to customer ID 79123 in the reviewed sample of customers);

- d. in connection with the seventh indent of the fourth paragraph of Article 12 and the first paragraph of Article 16 of the Regulation on credit risk management, and in connection with paragraphs 34 and 58 of Guidelines EBA/GL/2017/06:
- it is irregular in implementing the process of assessing individual impairments (less than once a year), whereby the calculation of individual impairments fails to take account of all up-to-date information, while the information on collateral values is not correctly used in the cashflow projection in cases when single collateral is used for multiple credit exposures,
  - it failed to ensure that factors that impact changes in credit risk and estimates of expected credit losses are comprehensively identified at least once a year (expected credit losses do not include all impacts on changes in risk: collateral, arrears),
  - when assessing the adequacy of allowances it fails to take account of relevant macroeconomic factors (GDP growth, unemployment rate, real estate price index) and expectations at the reporting date that may affect the collectability of remaining cashflows over the life of a group of lending exposures or a single lending exposure.

The savings bank must reclassify customer ID 79123 to Stage 3, reassess the collateral value and create individual impairments.

The savings bank must reclassify customer ID 80594 to Stage 2 and recreate collective impairments in accordance with the credit rating and collateral value.

The savings bank must reclassify customer ID 81456 to Stage 2 and recreate collective impairments in accordance with the credit rating and collateral value.

For all three of the aforementioned customers, the savings bank must submit evidence to Banka Slovenije that the requirements have been met as at 31 March 2023.

To rectify the identified breaches the savings bank must ensure compliance with the seventh indent of the fourth paragraph of Article 12 and the first paragraph of Article 16 of the Regulation of credit risk management, and must put in place an effective credit monitoring system, which must monitor the appropriateness of the allowances and provisions created, whereby it must put in place procedures, mechanisms and criteria for obtaining all relevant, currently available and up-to-date quantitative and qualitative information about the debtor and the exposure that are of relevance to credit processes and credit assessment systems. In the calculation of individual impairments the savings bank must take account of up-to-date information, which must be updated by users in the event of any changes, whereby the users must understand the software support. The savings bank must correctly use information on collateral value in cashflow projections when collateral is used for multiple credit exposures, whereby it will comply with the requirements of paragraphs 34 and 58 of Guidelines EBA/GL/2017/06.

5. The savings bank has breached the first paragraph in connection with the second and fifth paragraphs of Article 170 of the ZBan-3, by concluding legal transactions with persons in a special relationship with the savings bank under terms that are more favourable than those under which the

savings bank typically concludes transactions with other persons during the same period, and in so doing fails to cite objectively justified reasons and fails to inform Banka Slovenije accordingly, which was identified with regard to customers ID 79123 and ID 77346.

For the purpose of concluding legal transactions with persons in a special relationship with the savings bank, the savings bank must update and consistently implement its internal rulebooks in accordance with Articles 169 and 170 of the ZBan-3. The savings bank must consistently and promptly inform Banka Slovenije of the conclusion of transactions referred to in the second paragraph of Article 170 of the ZBan-3, i.e. within five business days of the conclusion of the transaction.

6. As of the day of the service of this order on the rectification of breaches with an additional measure, in accordance with the second indent of point 6 of the second paragraph of Article 280 of the ZBan-3 in connection with the first paragraph of Article 347 of the ZBan-3, the savings bank must cease concluding transactions with persons in a special relationship with the savings bank as defined in the second paragraph of Article 169 of the ZBan-3.
7. The savings bank's management board must submit a detailed action plan to Banka Slovenije by 31 March 2023 stating the measures selected to rectify the breaches referred to in points 1 to 5 of this order and setting deadlines for each. By the same date the savings bank must also report the name of the responsible member of the management board and the names of the responsible persons designated in accordance with the savings bank's internal organisational structure who will be responsible for implementing individual activities to rectify breaches and for preparing and implementing the action plan referred to in this order. The savings bank must rectify the breaches referred to in points 1 to 5 by 31 August 2023, and must deliver a report to Banka Slovenije by 15 September 2023, enclosing documents and other evidence from which it is evident that the breaches have been rectified. The savings bank must enclose in the report documentation from which it is evident that as of the day of service of this order with an additional measure it has not concluded legal transactions referred to in point 6 of this order. The savings bank may not conclude legal transactions referred to in point 6 of this order until it receives a declaratory decision that the breaches referred to in this order with an additional measure have been rectified.
8. In accordance with Article 310 of the ZBan-3, the following information in connection with this supervisory measure is published on the Banka Slovenije website after these proceedings have been completed:
  1. information about the person responsible for the breach (name and registered office of legal person);
  2. information about the breach:
    - a description of the circumstances and conduct entailing a breach of the ZBan-3 or Regulation (EU) No 575/2013,
    - the nature of the identified breaches;
  3. the operational part of the decision by which the relevant proceedings are completed;
  4. information as to whether judicial review proceedings have been initiated against the decision in accordance with the ZBan-3.

**Information as to whether judicial review proceedings have been initiated against order on**

**rectification of breaches in accordance with ZBan-3**

The savings bank has not lodged an objection to this order on the rectification of breaches with an additional measure with Banka Slovenije.